

ROUGH DRAFT

Senate Committee on Food and Agriculture

Senator Dean Florez, Chair

Evaluating the Ongoing Necessity of the Milk Pool Subsidy and its Impact on Consumer Prices

**Wednesday, March 11, 2009
State Capitol, Room 112**

SENATOR DEAN FLOREZ: Okay. Let's go ahead and begin the Senate Committee on Food and Agriculture. I do know we'll have members coming into the hearing as it progresses, but I do want to thank everyone for being here today. Obviously today the goal is to take a critical look at a system that's had a very long, long history in California agriculture, and that is, the milk pool.

As most of you know, under the federal program, price regulation related back to milk dates back to the 1930s, and that current regulatory system was in place essentially until the late 1960s. And the question today is, 30 years later, is there value still, given the economics and nature of our economy? Has there been a significant evolution in this particular milk pool that would allow us to change it? And I'm really interested in just hearing views today. The great thing about today's hearing is, we're not voting on a bill. So what we're doing is trying to ferret out good and bad, positive, negatives, and, more importantly, the issue to us is with the new evolving and growing organic-milk category, how this all fits together.

Obviously there's been a resurgence in popularity in terms of organic milk and particularly raw milk. Issues that pertain to those particular categories are of extreme interest to the committee. Obviously we know that the economy and the dairy industry's evolved. The way we regulate the price of milk has substantially remained unchanged, and the issue to the basic question today is whether or not the milk pricing structure is prepared or does it make a difference in the new economy.

I can tell you that the issue for us tonight is—or today—is really, the one critical element is the consumer, and the consumer obviously, from its value-chain perspective in many cases, is left out of the discussion. As you know, we've reformulated the Ag Committee to include consumers, consumption, and distribution. These are as important as production, so we want to make sure that on our three-legged stool that we continue in the committee to continue to talk about these issues. And milk pool's a great place to start to have that conversation. As you know, it's the new paradigm of the committee. We need to understand how we regulate milk and its impact on the consumer and consumer prices, and specifically we want to know what is the bottom-line effect on what people pay for the gallon of milk that they buy and what kinds of effects and what kind of brand marketing and what types of sub-categories there are now in milk, and how we can decipher that when we have a milk pool that in essence covers five categories of product.

I can tell you that we are absolutely very thankful for all of you who have come to our office before the hearing. It's been an educational experience, to say the least, and I want you to know that the vertical curve on understanding this complex market mechanism is straight up for us. But we did enjoy in many cases the opportunity to get a better handle on this. We have a lot of questions today. And so if there are prepared statements, we'd ask you to hold those statements and maybe briefly summarize the statement if you have one. But I'd like to get to some of the questions. The goal is to build a transcript so we can reread it, have an opportunity to look at it, before we start moving any legislation, if at all,

through the process. And so if there are items that you want on the record, please make sure that the sergeants grab them. We will make sure they're part of the record as well. And I do want you to know we also have public comment at the end of this hearing, so there is a sign-in sheet for public comment. We look forward to hearing anyone else who was not on the agenda. And let's go ahead and begin, if we could, with Panel 1, which is entitled What is the Milk Pool and How Does it Work?

And I do want to thank our Department of Food and Agriculture. As you know, the committee has renamed ourselves to reflect the Department of Food and Ag. We're now the Senate Committee on Food and Ag, and we very appreciate Rayne Pegg being, as she normally is, and thank you very much. And if you can introduce your counterparts. I do have some questions. And if we might start with questions and then maybe a statement. It's really up to you.

MS. RAYNE PEGG: Yes. My name is Rayne Pegg, deputy secretary of legislation and policy with the department. And with me, I have Don Shippelhouse and Candace Gates who are with our dairy programs and can address many of the pooling and producer pricing questions.

SENATOR FLOREZ: Thank you.

MS. PEGG: Now do you want to start with questions?

SENATOR FLOREZ: Yes, if we could.

MS. PEGG: Okay.

SENATOR FLOREZ: Let's go through as many questions as we can. And anything I didn't ask, maybe you can then bring to the forefront in terms of whatever statement you may have had. But I'd like to—the big question obviously is, to start the threshold point of view, is really, What's the purpose of the milk pool and the state marketing order?

MS. PEGG: Right.

SENATOR FLOREZ: Any of you can answer these.

MS. PEGG: Yes. Well, I think what's interesting is, actually when the law was created, it recognized, that prior to the milk-pooling system, that the system was inadequate. What you saw is, you saw fluctuations in

consumer prices, you saw instability in supply, and many of the small producers were not able to compete with the big producers; so hence why pooling went into effect in 1967 with the Gonsalves Act, so that's the initial intent of it. The law even clearly states this, that it was created to provide consumers with the adequate and continuous supply of fresh milk products and at a fair and reasonable price.

SENATOR FLOREZ: Okay. So the state marketing order—and I'll name some of the things you've mentioned—the orderly—allows for orderly marketing, the adequate supply of milk, and increasing farmer's income—some of the stated goals of this. But I guess the question really is whether the goals that we've set then in 1967, have they been achieved, and I'd really be interested, from your perspective, whether or not we've reached that.

MS. PEGG: Well, and I think a lot of the producer groups can also comment on this. But, you know, looking at—I think history is really what shows us why the pool was put into place. Looking at the history, what was occurring is for the fluid milk price, people primarily, they wanted to sell to those processors that were processing fluid milk products because they got the best price. And so the smaller producer could not always compete with the larger producer. That was say to the processor, hey, I'll give you a deal on it; I'll give you a vacation; I'll give you a Rolex watch, whatever. And the smaller producer wasn't able to do that. He had to sell his milk at a lower price and wasn't able to compete. So pooling is basically to take all the revenue and distribute it out amongst all the producers.

SENATOR FLOREZ: Okay. So everybody out there with a Rolex watch was given quotas. Is that what you're saying, or is there some other way to look at it? Why ultimately did the system not work, from your vantage point, CDFA's perspective? Did it allow gaming of this system? Were there illegalities occurring; were there buyoffs occurring? There must have been some major reason to create this pool beyond some of the things that are stated—adequate supply of milk and orderly marketing and these types of things. Is that the primary reason why this system has changed?

MS. PEGG: It was to help smaller producers as well as provides stability in the marketplace for consumers.

SENATOR FLOREZ: Okay. Why does California have a separate marketing order and the federals have a marketing order as well? Why do we have two separate systems?

MS. PEGG: I know Don can go into more detail. I think what, with the California marketing order, basically the federals also mirrored our marketing order; and producers can decide if they want to go to a federal marketing order at any point. Our marketing order is similar. There are some differences. Our prices are very similar.

SENATOR FLOREZ: Okay. Similar in some cases, not in others, right?

MS. PEGG: Right.

SENATOR FLOREZ: Cheese, for example.

MS. PEGG: Right.

SENATOR FLOREZ: And these types of things.

Does the marketing order provide more flexibility, for example? Is there statewide...

MR. DONALD SHIPPELHOUTE: By flexibility, what do you mean?

SENATOR FLOREZ: Well, I mean, in terms of the benefits of someone picking one system or another. Is there a reason, I think as has been mentioned, folks can choose what system they can be under? Is it really a choice or is it something that federal or state...

MR. SHIPPELHOUTE: I'm sorry. It would not be a choice. Producers can make a choice to participate in a federal system or a state system. If a California producer wanted to participate in a federal order today, they would have to ship their milk into an area that had a federal order, and there is milk produced in California shipped into federal orders and participating in those federal orders.

If somebody wanted to adopt a federal order in California and have California become a federal order, they would have to go to USDA, petition USDA, to have an order written for California, and then it would be voted on

by the producers to determine whether or not they wanted that order to come into existence. There was an attempt in the '30s to have the federal order in California. However, the courts said that the conditions weren't proper for there to be a federal order in California, and so the producers came to the legislature and asked for California to regulate prices, and that's when the state stepped in and started regulating prices in the '30s.

SENATOR FLOREZ: And in terms of those regulations, prices, so it's the wish of the producers that the state step in, in order to deal with the fluctuation in prices; or was it a supply issue at that time?

MR. SHIPPELHOUTE: Well, it was a fluctuation of price that was impacting supply. In an unregulated environment, retailers and processors, in order to try and get consumers into their stores or to win market share, we're reducing their prices, passing those price reductions onto the dairy farmer to the point that the dairy farmers could not continue to stay in business. And so in order to ensure that continuous supply of milk, the regulations were put into place, the laws and regulations were put into place, to establish those prices that the farmers would receive.

SENATOR FLOREZ: Okay. And do you have any thought in terms of, if California were to eliminate the state marketing order, would this system automatically revert to the federal marketing order?

MR. SHIPPELHOUTE: It would not be automatic.

SENATOR FLOREZ: It would not be automatic. Then what would be in place then, if the state were to, in essence, end its marketing order?

MR. SHIPPELHOUTE: It depends on what—in looking at SB 362, if you were to eliminate the pool, you would still have minimum prices for farmers. You would still have the five class prices.

SENATOR FLOREZ: And you would still have them because of the federal order?

MR. SHIPPELHOUTE: No.

SENATOR FLOREZ: Okay. Tell me why. Explain that.

MS. PEGG: You haven't eliminated the minimum, the minimum prices. You've just eliminated the pool.

SENATOR FLOREZ: Okay.

MS. PEGG: And so the prices would still...

SENATOR FLOREZ: Gotcha.

MS. PEGG: ...be in effect.

SENATOR FLOREZ: And you're referring to the bill. But I'm asking a larger question in terms of the actual marketing order in terms of categories altogether. If were to deregulate the entire market, would it revert to a federal system, I guess, is my...

MS. PEGG: Well, I believe they would have to petition USDA to do a federal order and that could take a year, year and a half. They may expedite it.

SENATOR FLOREZ: Okay. So in terms of the actual dairy industry itself, it couldn't remove itself from the state marketing order at all? What if the majority of folks wanted to get out of this process?

MS. PEGG: The legislature can do that. They can also petition the secretary.

SENATOR FLOREZ: Who's *they* can petition?

MS. PEGG: Producers.

SENATOR FLOREZ: The producers themselves, okay, okay. Can they modify the provisions of the state marketing order?

MR. SHIPPELHOUTE: Can I...

SENATOR FLOREZ: Yes. Jump in.

MR. SHIPPELHOUTE: I'm sorry. Anybody can petition for a public hearing. Any producers, processors, consumers—any interested party can petition to change the stabilization of marketing plans and regulations. Those changes that we would make have to stay within the restrictions of the law, but one of the changes that could be made would be—the program could be voted out after a public hearing and a system put up to a vote.

SENATOR FLOREZ: Okay. So the state couldn't simply decide to deregulate? It's not a possibility in this system?

MR. SHIPPELHOUTE: When you say the *state*, are you talking about...

SENATOR FLOREZ: Legislature.

MR. SHIPPELHOUTE: The legislature could eliminate the California system.

SENATOR FLOREZ: It could?

MS. PEGG: Yes.

SENATOR FLOREZ: Okay. And, again, if we decided to do that, what would be the fallback?

MS. PEGG: There would be no system in place until a federal system...

SENATOR FLOREZ: You have to pull the mike up.

MS. PEGG: There would be no system in place until a federal marketing order went into effect.

SENATOR FLOREZ: Okay. And is that what would happen, is the federal marketing order would—we'd have to wait for that to come into effect? Or what's the—take me through the process.

MS. CANDACE GATES: We would have to—is that on?

MS. PEGG: Yes, it's on.

MS. GATES: The industry would have to petition.

SENATOR FLOREZ: Okay. You're going to have to pull your mikes really close and a lot louder...

MS. GATES: Okay.

SENATOR FLOREZ: ...because I can't hear you from here so I know somebody in the back of the room can't hear you.

MS. GATES: Okay. The industry would have to petition USDA to be part of the federal order.

SENATOR FLOREZ: Okay.

MS. GATES: It would not just automatically revert to that.

SENATOR FLOREZ: Okay. And do we know the timeframe for that if indeed that was the current...

MS. PEGG: That could be a year, year-and-a-half process.

SENATOR FLOREZ: A year, year and a half. Okay. And can you tell us, in terms of—is there any understanding? I mean, Idaho deregulated its

milk market. Any consequences to that, from your vantage point, here in California?

MR. SHIPPELHOUTE: Not from my vantage point, no.

SENATOR FLOREZ: No opinions on that? Okay.

Can you tell us how the calculation for the various classes of milk are determined? How are the prices set, for example?

MS. GATES: I think in your packet, we always tend to start with the 4a, 4b price.

SENATOR FLOREZ: Okay.

MS. GATES: So you're looking at—we're doing end-product pricing which is the commodity, whether it's cheese or butter or powder. We're taking that and moving backwards with it, so we're taking the commodity prices...

SENATOR FLOREZ: Can I interrupt you for one second?

MS. GATES: Sure.

SENATOR FLOREZ: Sergeant, can you turn the microphones up substantially because I'm sorry...

MS. GATES: I'm sorry. It's echoing here so I can hear it.

SENATOR FLOREZ: No. It's not you. Can we turn the system up, please. It would help us quite a bit.

All right. So you were starting at the end product, right?

MS. GATES: Right.

SENATOR FLOREZ: This would be the 4b or...

MS. GATES: Right. We'll start with 4b...

SENATOR FLOREZ: Okay.

MS. GATES: ...and I'll walk you through that. I'll get it with where you're at here.

What you have on your sheet there, the cheddar price, that is going to be the average price that is traded at the Chicago Mercantile Exchange for whatever timeframe that we're looking at. And then you're going to take the difference between what the California producers, processors, receive and—

Okay? I want to make sure you're all right. It's basically the cost of transportation between here and the Midwest.

SENATOR FLOREZ: And who's watching that? You are?

MS. GATES: Yes.

SENATOR FLOREZ: Okay. How often? Daily, weekly, monthly?

MS. GATES: That's done yearly. We do a yearly survey on that.

SENATOR FLOREZ: Yearly. Wow. Okay.

MS. PEGG: We establish minimum price once a month.

SENATOR FLOREZ: Once a month. So the 26th or something like that?

MR. SHIPPELHOUTE: Again, I'd like to clarify your question. When you say we're monitoring, which piece of the formula are you referring to?

SENATOR FLOREZ: I'm asking you, in terms of the various classes of milk, it's my understanding that there's some driver in this process, right?

MR. SHIPPELHOUTE: Yes.

SENATOR FLOREZ: And I think the assumption was, it's going to be fluid milk way back in the day, right? It was going to be 85 percent or something like that. Now it's 15 percent, and it isn't really driving the market. In fact, the lower—the 4b is kind of the driver of this, right?

MS. PEGG: Um-hmm.

SENATOR FLOREZ: And you have control of that, you folks, CDFA. Do you control by looking at the prices, what you set that amount? Or who sets this?

MS. PEGG: That's consumption trends so there's 30—you know, consumers have just changed their habits in eating so we don't...

SENATOR FLOREZ: Did we incentivize consumers to change their habits a long time ago?

MS. PEGG: I mean...

SENATOR FLOREZ: I mean, our cheese is priced lower than federal's right? We're not exactly matching the federal system. We have a different price structure somewhere in this. If our price structure is more

advantageous than the feds in many cases, some producers might want to take advantage of that so that might drive a market, right?

MS. PEGG: Well, I mean, in looking at what's going on, milk is as low as \$1.99 in some stores here in Sacramento. So we didn't do a survey on cheese, so I don't have that available but as of yesterday.

SENATOR FLOREZ: Got it. And I guess I'm focusing on wholesale prices and I'm just trying to figure out what the driver in this is. And you folks are a big part of that, I assume. You're looking at these on a monthly basis. You're making some determination. And if you're picking—let me put it a different way.

Do you believe that you pick winners and losers in your system yourselves at CDFA?

MS. PEGG: I think there's—first, let's—maybe it's getting a little bit confusing here—the minimum prices to producers.

SENATOR FLOREZ: All right.

MS. PEGG: And so it's just an accounting system. So at the end of the day, that's what goes into the pool, fluid milk. And if you see on your chart, we only have February here but we have a new price out for April. But, you know, fluid milk, you account \$11.42 per hundred weight and Class 4b, which is the hard chesses, is \$10.11 per hundred weight.

SENATOR FLOREZ: Let's start at the beginning of that. So who sets that price you've just mentioned?

MS. PEGG: We do.

SENATOR FLOREZ: There we go. Now we're back on track again. So you set, you set the price?

MS. PEGG: Right.

SENATOR FLOREZ: I didn't say it. You did. So I guess the question is, How often are you looking at these markets and therefore setting the price? And therefore, if you're setting prices, I have seen that you are, in many cases, making them on some assumption. And I guess what I'm trying to get from you, the very start question of this, is, How are you making that decision? That's kind of to the core of why we're here.

MS. PEGG: What we're looking at, we're looking at what's going on in the other states, production costs, milk production, number of cows, relationship of California prices to the federal order. So we take all that into account, as well as the Chicago Mercantile, into account when in fact, when determining the price that we're establishing.

SENATOR FLOREZ: Okay.

MS. PEGG: Now if you're asking, you know, what are our other options for price...

SENATOR FLOREZ: No. I'm staying right here for a moment...

MS. PEGG: Okay.

SENATOR FLOREZ: ...so we can stay on this.

Is what you're doing, in terms of that particular choice in this very first instance that you've mentioned, is this a precise process? I mean, is this—or is there some fudge factor in this? Is this an absolutely precise factor; you know exactly what you should be doing? Is there a formula? I mean, is there something beyond you looking at and going, we kind of think...

MR. SHIPPELHOUTE: The formula that we're referring to, the 4b formula, that formula is changed. Every month, there are some variables that go into that formula to determine the price.

SENATOR FLOREZ: Okay.

MR. SHIPPELHOUTE: Those variable inputs would be the Chicago Mercantile Exchange price for 40-pound blocks of cheddar cheese. We look at that Chicago price. Cheese is traded every day. We take a monthly average of that price to plug into the formula, the same with the AA butter price, again, traded at Chicago.

SENATOR FLOREZ: Okay.

MR. SHIPPELHOUTE: We plugged that variable over one month average, plugged that into the formula. And whatever number comes out at the end of that formula is the minimum price that farmers receive. So this formula takes the value of finished product and determines how much of

that value goes back to producers and how much of it stays with the processor.

SENATOR FLOREZ: Okay. Now you're making that determination on a monthly basis, correct?

MR. SHIPPELHOUTE: We're feeding those variables into the formula on a monthly basis; that's correct.

SENATOR FLOREZ: Does any producer out there able to feed their same variables in and get the same, precise calculation that you have given, that it's—I mean, is what you're doing then not a surprise because everybody has already plugged in their own numbers and the formula? The variables haven't changed? Everybody understands what the variables are?

MR. SHIPPELHOUTE: Everybody understands what the variables are; that's correct.

SENATOR FLOREZ: So no one's ever mad at you if you set a certain price?

MR. SHIPPELHOUTE: I wouldn't say that.

SENATOR FLOREZ: Because they've already calculated themselves, right? No reason to be mad at you?

MS. GATES: Senator, those variables...

SENATOR FLOREZ: Because these are things they can plug in, correct?

MS. GATES: Well, Senator, those variables can be changed through a public hearing process.

SENATOR FLOREZ: Gotcha.

MS. GATES: Which they will petition the department that they would like a change in one of those aspects of that formula.

SENATOR FLOREZ: And how often does that happen?

MS. GATES: Sometimes once a year; sometimes six times a year. It depends on the economic and business climate, you know, in the industry.

SENATOR FLOREZ: Got it. And who makes that decision once there's a hearing?

MS. GATES: The department does.

SENATOR FLOREZ: The...

MS. GATES: The department does.

SENATOR FLOREZ: And who in the department? Is that the secretary?

MS. GATES: Yes.

MS. PEGG: The secretary.

SENATOR FLOREZ: Okay. And how does that process work? Is he sitting at the hearing, or does it somehow filter up to him? Is there a board? I mean, how does...

MS. GATES: There's a hearing panel that takes all the evidence, gathers all the evidence, puts together a hearing panel or report or a recommendation to the secretary, and then the secretary makes that decision.

SENATOR FLOREZ: And how often has that happened in the last year or two?

MS. GATES: I think we had two hearings in 2008.

SENATOR FLOREZ: Has there been any changes?

MS. GATES: Yes, there have been.

SENATOR FLOREZ: And when it's a change, what does that tell you at CDFA?

MS. GATES: That there was changes in the market conditions that warranted a change.

SENATOR FLOREZ: Okay. So it's completely—your customers, your consumers, producers, other folks, are driving this; you're not making decisions? If indeed it is absolutely wrong in terms of their perspective, they can go get a hearing; it's easy; everybody sees the day that they make a change and there's no conflict; you're not fighting them? You're agreeing...

MS. GATES: Well, it's a balance between the needs of the consumers, the processors, and the producers to ensure an adequate supply of milk at fair and reasonable prices to consumers.

SENATOR FLOREZ: Okay. Thank you for that. I appreciate the variables.

There are different classes that we've been talking about. We have five classes; is that right?

MS. PEGG: Correct.

MS. GATES: Right.

SENATOR FLOREZ: And the feds have four, right? So why is that? Why do we have five and they have four?

MR. SHIPPELHOUTE: It's just an evolution of the programs over the years. We used to have four and they had three.

SENATOR FLOREZ: Okay.

MR. SHIPPELHOUTE: And we went to five and they went to four. They came closer to meeting us. By that, I mean, they separated cheese out from butter and powder in 2000. So it's just evolved as conditions have changed, what products consumers are purchasing.

SENATOR FLOREZ: And has that evolution—was the change in the classes through legislation or regulation?

MR. SHIPPELHOUTE: Legislation.

SENATOR FLOREZ: Through legislation. Okay. is there any advantage to having less classes of milk?

MR. SHIPPELHOUTE: It would make administration a bit easier, to start with, but I would leave that up to the processors and producers behind me that have more input on that.

SENATOR FLOREZ: It'd make it easier, but would it affect the—I'll ask the next panels, I guess. But if there were just two—one fluid and one manufactured, for example, two classes—is that good or bad from your perspective? Easier to administer or just absolutely not a workable system?

MR. SHIPPELHOUTE: I would leave that up to the producers and processors.

SENATOR FLOREZ: Okay. That's fair.

Let's talk about quota for a minute so I can understand this a little better. We do have a quota system—correct—and that's different than the federal system. Can you tell us the difference, please.

MR. SHIPPELHOUTE: Well, the quota is not a limit on production. If you own quota, the amount of quota that you own, and that you have milk, that same volume of milk, you get a higher price for that milk than you would for milk that you produced that is not covered by quota.

SENATOR FLOREZ: Okay. Anybody can have quota or is this...

MR. SHIPPELHOUTE: Any producer can own quota.

SENATOR FLOREZ: Any producer can own quota.

MR. SHIPPELHOUTE: Any Grade A producer can own...

SENATOR FLOREZ: Any Grade A producer. So where does the producer get, that wants quota, get it? So if I want quota, where do I get it?

MR. SHIPPELHOUTE: You find another producer that's wanting to sell it.

SENATOR FLOREZ: Okay. And that producer can charge me, or how does it work?

MR. SHIPPELHOUTE: Whatever you two agree to, as far as the price, that's an open market.

SENATOR FLOREZ: So it's kind of like the old system we were trying to change in terms of the price quota? I mean, we had quota at some point and then everyone said, not a fair system; I'm trying to get into this system, but yet everybody who has quota or has a producer that they have an arrangement with, isn't fair to folks and so therefore we've created this other system which in essence is supposed to take that out because of a fair milk price. But now if I have quota, I've got to go buy quota at the highest price that someone might be willing to sell to me. Is that the way it works?

MR. SHIPPELHOUTE: Not exactly.

SENATOR FLOREZ: How does it work then?

MR. SHIPPELHOUTE: In the old system, you as a producer got a higher price by entering into an arrangement with a different processor.

SENATOR FLOREZ: Right.

MR. SHIPPELHOUTE: The processor had the upper hand when it came to negotiating terms and contract price, so on and so forth. When we went to the milk pooling system, it took a lot of that advantage away from

the processor and put the producers and processors on a level playing field. So as a producer, if you own quota, yes, you get a higher price but it doesn't matter to you whether you ship your milk to a cheese plant or a butter, powder plant or a fluid plant. You are still going to get that same price, the quota price.

SENATOR FLOREZ: I've gotcha. Okay. The strategic reason for the establishment of quota then, has it worked?

MR. SHIPPELHOUTE: Yes. The reason for quota was to ease the transition from the old system into the pooling system. There were producers, that prior to pooling, had purchased contract with Class 1 bottling plants. And so to ensure that those producers continue to get the Class 1 price, they were issued quota; and in doing so, they basically had the same revenue stream as they would have pre-pooling days.

SENATOR FLOREZ: Got it. Is quota, from your vantage point, and I understand how it makes the system work, but is this an artificial value, quota? I mean, is this in essence, because you have quotas, there's somehow some extra value that, because you own it or you have it, it gives you more value than if you didn't, I mean, in terms of this system?

MR. SHIPPELHOUTE: It's simply an entitlement to a higher price. It's something that you either receive because you were already receiving that pre-pooling days or because you purchased that right from another producer.

SENATOR FLOREZ: Right. Okay. And so it was a preexisting right that in essence was passed on to get a high value; quota gives you a higher value in the market?

MR. SHIPPELHOUTE: The initial quotas that were allocated were based on a producer's historical Class 1 sales.

SENATOR FLOREZ: Okay. Is it still needed 30 years later?

MR. SHIPPELHOUTE: Yes. Producers will comment on that. The pool is just a distribution of revenues, and it's producer revenue that's being redistributed. The quota is a part of that revenue distribution system, and so I would leave it to them.

SENATOR FLOREZ: Okay. That's fair. In terms of trying to stabilize the market, this is your job, though, correct? This is your role. So I guess—let me ask you the question the other way. Is quota helping to stabilize the market then, from your vantage point?

MR. SHIPPELHOUTE: One thing that quota has done is it has helped a lot of small producers stay in business that might not otherwise, especially over in the North Coast area, north bay. A high percentage of quota being produced there helped those producers stay in business. It's also helped producers in Southern California where milk is needed for the fluid market. It has allowed some of those producers down at Chino Basin to stay in business who otherwise may not have.

SENATOR FLOREZ: And how has it helped, from your vantage point, this has helped the smaller producer then, this quota system?

MR. SHIPPELHOUTE: It has helped a lot of smaller producers, yes, especially North Bay is a good example of where, for a variety of reasons, those producers can't expand their herds, but they're able to increase their revenue stream by purchasing more quota.

SENATOR FLOREZ: Okay. And how would you view quota in terms of value to the consumer? Is this quota adding value to the consumer, this system?

MR. SHIPPELHOUTE: It doesn't add or detract from it.

SENATOR FLOREZ: Neither, nor?

MR. SHIPPELHOUTE: Neither.

SENATOR FLOREZ: Okay. All right. Let me just ask a few more questions to the secretary of Agriculture, if I could. If there anything that precludes the secretary from creating a separate, organic classification?

MS. PEGG: We do it on direction of the legislation, so that would be a legislative change.

SENATOR FLOREZ: So a sector can't just say...

MS. PEGG: No.

SENATOR FLOREZ: ...you know, I'd like to have my separate organic milk classification or a separate raw-milk classification or other classifications within this; this is something that we'd have to legislate?

MS. PEGG: Right. That question has been asked before in terms of pooling obligation, and the courts have decided that, when the law was written, they clearly took that into account and included all those parties.

SENATOR FLOREZ: Okay. So the secretary cannot exempt a milk producer from participating in the marketing order?

MS. PEGG: Correct.

SENATOR FLOREZ: Okay. And can you give us some thought process. Does every milk producer then, if you will, participate in the milk pool?

MS. PEGG: Well, there are certain, there are certain, there was a small exemption, that when the law was created, there was an exemption for small producers. They're 500 gallons per day. There's two currently in this state. They're farmer processors.

SENATOR FLOREZ: They're what?

MS. PEGG: They are farmer processors and they're currently in the state, and then some of the, when the law was written, there were also some producer-distributors that were given an exemption for a certain amount of the milk that they produced. And they are still in business today, and I think you'll be hearing from them later.

SENATOR FLOREZ: So out-of-state providers of raw products are exempted or part of the pool or not?

MS. PEGG: Correct.

SENATOR FLOREZ: Which one?

MS. PEGG: They're exempt. They're not part of the pool.

SENATOR FLOREZ: So if you're doing a raw product outside the state, you're exempt from the milk pool?

MS. PEGG: Well, you know, that's Interstate Commerce.

SENATOR FLOREZ: But if you're in the state, you are?

MS. PEGG: Well, yes, you have to. You're regulated by the pool.

SENATOR FLOREZ: But if you're outside, you don't, outside the state?

MS. PEGG: Correct.

SENATOR FLOREZ: Okay. Let me just ask a few more, one more question, actually.

We were going over the class prices, 1, and we were led down to 4b. In terms of where California's Class 1 price compares to the federal marketing order, it's on par, higher or lower or it's basically the same?

MS. PEGG: I think it's basically the same.

MS. GATES: Yes. It's pretty close to the same.

SENATOR FLOREZ: Close to the same.

MS. GATES: Very close.

SENATOR FLOREZ: And is this the case for Class 4 cheese, same as the fed's?

MS. GATES: I think it's fairly close.

SENATOR FLOREZ: Okay. So here's no differential between the feds and our state when it comes to that last category?

MS. PEGG: There may be some differential but I don't think it's significant at all.

SENATOR FLOREZ: Okay. All right. Is there anything else you guys would like to add in terms of other comments?

MS. GATES: Did you want to add something?

MR. SHIPPELHOUTE: I would just point out that differential between the state price and the federal order price, that relationship has changed over the years, so it's not always been where it is today. There's been times where California 4b price was considerably lower than the now Class 3 price in the federal order which is...

SENATOR FLOREZ: Has it ever been higher than the federal price, '97?

MR. SHIPPELHOUTE: There may be some short windows perhaps where it was. I don't know the answer to that for sure.

SENATOR FLOREZ: That was a long pause. (Laughter) Not much came out of that one. What was the reason for the pause? Was there some thought processes that you might want to share with us?

MR. SHIPPELHOUTE: I think you were asking me about the relationship between what a cheese processor has to pay in a federal order versus what a cheese processor would have to pay in the California system.

SENATOR FLOREZ: Yes, and you said that there was a very small distinction, correct?

MR. SHIPPELHOUTE: What I said was, that has fluctuated over time. It's not always been what it is today. The reason for my pause was, her question was on a different issue.

SENATOR FLOREZ: Okay. All right. Did we not mention a right issue we should have asked or...

MS. PEGG: No.

SENATOR FLOREZ: Rayne?

MS. PEGG: You've got it all covered.

SENATOR FLOREZ: Okay. All right. Well, thank you for the testimony.

MS. PEGG: Thank you.

SENATOR FLOREZ: I appreciate it.

Okay. Let's go, if we could, to Evaluating the Need for Change in California's Milk Pool. We have Richard Shehadey, Scott Shehadey, John Knutson, and Rachel Kaldor. Nice seeing you.

Thank you for joining us. I have some questions. I know you probably have some statements; but if I could, maybe some questions for Richard and Scott first. Is that possible to start there?

MR. SCOTT SHEHADEY: Yes.

SENATOR FLOREZ: Great. Now you are conventional dairies, meaning, you're a producer-processor; is that correct?

MR. S. SHEHADEY: That's correct.

SENATOR FLOREZ: It is? Okay. Can you give the committee a second to give us some background of your dairy operations so we can get a better understanding about how it works in this producer-processor mode?

MR. S. SHEHADEY: Sure. We have our own farms where we produce a percentage of the milk that we process. We also buy milk from cooperative and independent farmers as well, and we process, package, and distribute the dairy products throughout Northern California.

SENATOR FLOREZ: And what does a producer-processor mean? Some of didn't get that. Vertically integrated? Is that...

MR. S. SHEHADEY: Vertically integrated, yes, on a portion of what we sell.

SENATOR FLOREZ: Okay. And who do you sell your milk to? Is that retailers, another distributor?

MR. S. SHEHADEY: Retailers, distributors, restaurants, food service, hospitals, schools, a broad array.

SENATOR FLOREZ: Okay. And how would you describe the impact of the milk pool in your business?

MR. S. SHEHADEY: Currently one of the challenges that we're facing is out-of-state competition, and we are in a place where we're not competitive due to the regulations that we have to pay minimum prices, and pooling is a component of that as well as pricing is a component of that. Our concern is being able to compete and being able to provide a product to the consumer that's competitive and fair with everyone else. So that's one of the concerns that we have with respect to the current regulations as they stand.

SENATOR FLOREZ: And would you say that the milk pools helped your business? Big softballs I'm throwing to you right now.

MR. S. SHEHADEY: Yes.

SENATOR FLOREZ: I mean, how would you term it? It's helped business; is it tougher, no value, good, bad?

MR. S. SHEHADEY: Over the years, it's been fairly—I would say, one way or the other, it hasn't impacted us, other than this being competitive with other states at this point.

SENATOR FLOREZ: And how much money are you paying per month into the milk pool?

MR. S. SHEHADEY: Offhand, I can't say exactly but it's in the hundreds of thousands to millions of dollars per month.

SENATOR FLOREZ: Per month? Okay.

And is it your thought that, given that amount of money, you're disadvantaged because you are vertically integrated in terms of the milk pool?

MR. S. SHEHADEY: We are disadvantaged on the amount of milk that we buy from our own farms where we are obligated to pay into the pool. We cannot pay ourselves directly. At that point, we're disadvantaged in the pool as something that hurts us. There's a portion of milk that we can pay ourselves the full price, as was mentioned by the department, but there's a large portion that we cannot pay ourselves.

SENATOR FLOREZ: So even though you're vertically integrated—and it's all one operation—you're still paying into the milk pool even though you're set up to be, if you will, vertically integrated and you're not—you can't take advantage of these economies or to get the value chain or vertical integration—is that basically...

MR. S. SHEHADEY: That's correct.

SENATOR FLOREZ: ...that you have to pay into this, even though you're all one operation and you're there?

MR. S. SHEHADEY: That's correct.

MR. RICHARD SHEHADEY: That's correct.

SENATOR FLOREZ: Okay. Is there a thought process that, Then why be business efficient? I mean, if indeed you're paying into the milk pool but you're vertically integrated—I mean, this is something—you're still trying to be business efficient because you're bringing your cost down? I

mean, how does business efficiencies work in this industry then if producers, processors are penalized, if you will, under the milk pool system?

MR. S. SHEHADEY: Well, it certainly hurts the potential efficiencies that could be there because of the pooling obligation.

SENATOR FLOREZ: And these are monies you could in essence put back into various efficiencies going forward? What would you do with the extra money that you didn't have to put in the milk pool?

MR. S. SHEHADEY: Well, it's a combination of being more efficient as an operator, providing a better price to the consumer, and we're currently engaged in certain environmental improvements and things that we're doing with methane digesters, et cetera, that I think are positive for California.

SENATOR FLOREZ: And from a price perspective, how would, how does it impact a consumer from your vantage point and the folks you have to compete with; you're vertically integrated and yet paying in, not being able to take advantage of some of that?

MR. S. SHEHADEY: Well, the difference varies from month to month, but it can be anywhere from 15 cents a gallon to 40+ cents a gallon.

SENATOR FLOREZ: To the consumer?

MR. S. SHEHADEY: Difference. Now how that would play out to the consumer would be relative to exactly what the blend was, you know, of our milk versus other milk, et cetera.

SENATOR FLOREZ: And how do you view the import of milk into the state and how does that affect you, given this system?

MR. S. SHEHADEY: Given the system, it affects us in that our retailers are looking for the most competitive price that they possibly can buy at. And if we are able to meet the price, we have the business. If not, we lose the business. And as it stands right now, we're losing some of our own business due to this out-of-state issue. So from a competitive standpoint, we're not competitive.

SENATOR FLOREZ: Maybe the last question for either of you, but obviously the big question is, the milk pool for producer-processors like

yourself, is it working; do you want changes; do you see recommendations to make the system better?

MR. S. SHEHADEY: The system as it stands is not working for us, and we don't see ourselves in a competitive situation and we're not able to run our business competitively with these interstate issues so we don't see the system working as it is. With respect to recommendations, I think there needs to be a lot of discussion about exactly what the correct solution is. But from our standpoint, there needs to be change.

SENATOR FLOREZ: And does milk produced in California ever get transported out of state, get bottled, and brought back into California to avoid the milk pool?

MR. R. SHEHADEY: Yes.

SENATOR FLOREZ: It does. So give me an explanation of how that works.

MR. R. SHEHADEY: Sure. Last year, one of the examples that my brother Scott had mentioned was a plant in Yerington, Nevada. It's 90 miles outside of the border. The sole purpose was to take advantage of California state milk regulations, the sole purpose. Its key customer is large warehouse stores, okay? And the sole purpose was to take milk from, or over-supplied milk, surplus milk, out of California or other regions, bottle it, and then ship it back into California.

SENATOR FLOREZ: And avoid the milk pool altogether?

MR. R. SHEHADEY: Avoid the milk pool and to be able to be at an advantage of 20 to 30 cents a gallon.

SENATOR FLOREZ: And that's the cost differential in terms of being competitive in today's market?

MR. R. SHEHADEY: Right, correct.

SENATOR FLOREZ: Okay.

UNIDENTIFIED SPEAKER: _____?

MR. S. SHEHADEY: We have not.

MR. R. SHEHADEY: No, we have not done that.

SENATOR FLOREZ: And is the plant still in operation?

MR. R. SHEHADEY: Yes.

SENATOR FLOREZ: Has it cost you any business?

MR. R. SHEHADEY: Yes.

SENATOR FLOREZ: Okay.

MR. S. SHEHADEY: Significant.

MR. R. SHEHADEY: And it's not only this business. But when they took some of our business, they also lowered the retail price in California at the sum of 20 to 30 cents a gallon. So then it wasn't just this customer that we were losing, but it's every one of our other customers that was calling us because now they couldn't compete from just these stores. But all of the other retail outlets couldn't so it was forcing us to have pressure on our margins, trying to compete, and we can't. Our hands are tied.

UNIDENTIFIED SPEAKER: _____?

MR. S. SHEHADEY: Yes.

SENATOR FLOREZ: Okay. Gentlemen, thank you.

If I could, let's go to Mr. Knutson. Appreciate you being here. You're in organic dairy; is that correct?

MR. JOHN KNUTSON: Yes, we are.

SENATOR FLOREZ: Okay. And you're also a producer-processor, correct?

MR. KNUTSON: No. Independent dairy.

SENATOR FLOREZ: You're not? Okay. You're just a producer?

MR. KNUTSON: Yes.

SENATOR FLOREZ: And the difference, for Senator Maldonado and I, between a conventional dairy and an organic dairy is what principally?

MR. KNUTSON: The way the animals are raised, fed, treated, all the different feeds they eat, there's no antibiotics, growth hormones, no fertilizers in the pastures, commercial fertilizers, everything is just as it was 100 years ago.

SENATOR FLOREZ: Okay. Senator Maldonado.

SENATOR ABEL MALDONADO: Does surplus organic milk make it back into conventional milk?

MR. KNUTSON: Yes.

SENATOR MALDONADO: If I'm drinking conventional milk, I might be drinking organic milk?

MR. KNUTSON: Not likely.

SENATOR MALDONADO: You just said it does.

MR. KNUTSON: It does but it may be a load a week or a load a month or something that might be sold.

SENATOR MALDONADO: Maybe three loads a month?

MR. KNUTSON: Yes.

SENATOR MALDONADO: Maybe half a load this month and six next month?

MR. KNUTSON: Yes, right.

SENATOR MALDONADO: Okay.

SENATOR FLOREZ: And in terms of the different markets, are the different markets for your product and conventional products, organic dairies and conventional dairies, two different markets, from your perspective?

MR. KNUTSON: Yes, they are.

SENATOR FLOREZ: Okay. And how does the California milk pool account for this difference in markets?

MR. KNUTSON: Could you repeat that, please?

SENATOR FLOREZ: How does the milk pool account for the difference in markets?

MR. KNUTSON: Our milk, we're above minimum price so our price is set by whoever we sell our milk to. Our milk goes through the pool, but our price is not the same as a conventional.

SENATOR FLOREZ: So you go through the pool and you pay into the pool?

MR. KNUTSON: Yes.

SENATOR FLOREZ: Right. But the milk pool doesn't necessarily account for the difference in your market segmentation, does it?

MR. KNUTSON: I don't believe so. I'm just a dairyman. They write me the check.

SENATOR FLOREZ: No, I get that. I get that. But should the pool recognize a difference between organic and non-organic milk?

MR. KNUTSON: I believe it should because we're looking at different procedures of the cattle, we're looking at a specialty product, and we're looking at a different consumer.

SENATOR FLOREZ: Okay. And do you believe that the amount of money you pay per month in the pool is reflective of the value that you're producing? I mean, how would you—or what you're getting from the pool?

MR. KNUTSON: We have the same situation as these guys here. From what I understand, 14 percent of the milk on the store shelves, packaged milk, is imported milk. Of that, 14 percent, 40 percent of that is organic that's been imported and brought into the state. And there's a lot of truckloads of organic milk coming in from the north, the northeast, daily into the state. I know last fall there's at least five loads a day that doesn't go into the pool.

SENATOR FLOREZ: Okay. And do you think that the organic dairy industry should be excluded from the pool?

MR. KNUTSON: Yes, I do.

SENATOR FLOREZ: Exempted from the pool? And what harm would that cause the pool if you were indeed excluded? What would be your picture of this?

MR. KNUTSON: I don't think we'd harm the pool.

SENATOR FLOREZ: And why not?

MR. KNUTSON: Because we're a small amount. We're a small amount.

SENATOR FLOREZ: And you're small but at the same time a growing industry, right?

MR. KNUTSON: Yes, yes. We are but we'll never be. If we ever reached 10 percent, that would be a surprise.

SENATOR FLOREZ: Okay. And maybe just a last question for you. How would you change the milk pool to allow for more positive impacts for your particular market and segmentation?

MR. KNUTSON: Well, I'd like not to be in it at all, but I think that the pool has been good for California for a lot of years, and I think it needs to be tweaked, not necessarily done away with.

SENATOR FLOREZ: Okay. Mr. Knutson, another thing I'd like to know about is that we spend a lot of money on the McKinsey Report, and I don't know what's going on with that, if anybody is looking into this and seeing what they wrote and if we're going to do anything about it because they had some suggestions.

SENATOR FLOREZ: We do. We have that. In fact, we are going to talk about that a little later. But, yes, and that was part of a process of trying to figure out what we should be looking at and not looking at—what should be in the pool, what should be out of the pool. Thank you so much for your testimony.

Okay. Rachel, thanks for being here. Just in terms of the, if we could, the milk processors, the threshold question obviously, milk pool working, not working, and just get your overall impressions of it.

MS. RACHEL KALDOR: Well, our overall impression is that it's a producer-driven program. It came into existence in 1967 in order to equalize, as was talked about by the department, producer's access to the market. It is a program that is very similar to the United States, I should say, USDA, programs that are administered throughout the rest of the country.

From our perspective, we in 1967, processors, that is, surrendered the ability to obtain milk on the open market in exchange for equal raw-product cost when we're dealing with head-to-head competitors. So that's the exchange that was made at that time. For our membership, the most important factor in the pool is maintaining equal raw-product costs so that, when we're dealing, as the earlier witnesses noted, we are dealing with situations at times of out-of-state milk coming in. The Nevada plant that

was mentioned is a huge challenge for the entire bottling industry. It exists somewhat mysteriously, given its location and the challenges it faces in terms of supply and distribution. But that said, as was also noted earlier, it does serve those big-box stores so it's meant to serve a certain segment of the market. Its prices as an unregulated plant operating outside the state create major challenges for other conventional bottlers, and those are our members. So while the producer-distributors have enjoyed a portion of their production being exempted from the pool that happened in 1967, the cap of exempt quota that producers-distributors have was increased in 1978 and then again in 1995. When that happened, that created some inequities in terms of equal raw product costs again. So that's a key factor for our membership.

So again, in terms of the pool and how it works, we do obviously acknowledge that producers decided to join together and share revenue, and our position is and our function in that is paying in based on the classified pricing that you heard from the earlier panelists.

SENATOR FLOREZ: Do you think the milk pool should be revised, tweaked, or do we need to deal with the Nevada distributing plant and everything goes away and everything's fine...

MS. KALDOR: No. Frankly, the institute, has been very clear with our producer partners that we do feel that there is now a time to modernize the industry, modernize the regulation that provides the governance of the industry, to reflect our marketing challenges, our production challenges, and so forth. So we have engaged in in-depth discussion. Western United Dairymen, who you'll be hearing from on a later panel, has been hosting some forums for producers and processors to discuss change. And you noted earlier the McKinsey Study which outlines the challenges and potential changes that could occur in the industry to ensure its future success.

SENATOR FLOREZ: Does the milk pool limit processor's ability to forward contract?

MS. KALDOR: Milk pooling does not. However, the law does state that we can never pay below the regulated minimum price. So proprietary processors, those of my membership, cannot forward contract. I would add that forward contracting has never been really an issue at Class 1, the bottled-milk segment, but for lower classes would provide some income assuery—this is my picture—income assuery to farmers and input security for processors so they could forward price in the market. But forward contracting, as much as we have tried, does not exist for proprietary processors. Here in California, it is allowed at the federal level, I might note.

SENATOR FLOREZ: I was going to ask you, Is that a disadvantage then outside, compared to other states then?

MS. KALDOR: I would say that we would appreciate having that same advantage as other states do.

SENATOR FLOREZ: Okay. Is there anything else you'd like to add in terms of the milk pool?

MS. KALDOR: No. Other than the fact that you've noted the complexity of the regulatory framework that we're dealing with, we do believe that we can work with our producer partners to achieve positive change in the industry and we're looking forward to moving forward on that. Thank you.

SENATOR FLOREZ: Yes, Senator Maldonado.

SENATOR MALDONADO: Rachel, thanks for being here. Who owns that plant in Nevada?

MS. KALDOR: It's one dairy farmer.

SENATOR MALDONADO: Is he in California?

MS. KALDOR: And several other investors. Pardon me?

SENATOR MALDONADO: Is the dairy farmer from California?

MS. KALDOR: No. He is from Nevada. He does have a long-term contract with a processor in California so he does ship milk. We've had a longstanding relationship with the state of Nevada in terms of it being a very lucrative market for California milk, namely, into Southern Nevada. That's obviously Clark County, a large, until now, growing population.

SENATOR FLOREZ: And the state of Nevada then obviously couldn't join the state of California in a marketing order that would...

MS. KALDOR: That would be what we would be determining, a Compact, and that would have to be approved by Congress. So, yes, they do have, they have a Nevada Dairy Commission. They set price; their raw-product price is the same as Northern California.

SENATOR FLOREZ: All right. So there's some semblance that that could occur but probably wouldn't or would if indeed _____?

MS. KALDOR: You know, if the state, if the state's dairy farmers wanted to join with California farmers, if there were an advantage to them to do that, they could in fact—again, this would form a Compact. It could operate in ways that would allow for interstate commerce, burdens to be lifted and so forth.

SENATOR FLOREZ: All right. For anybody on the panel, any other questions or any comments you would like to leave before we go onto the next panel?

Yes, Senator Maldonado.

SENATOR MALDONADO: I just want to ask one more question of you, John, organic farmer, and I'm not going to harp on this too much today, but I'm going to ask you a question and hope you can answer it for me.

You told me earlier today that surplus organic milk goes into the conventional milk.

MR. KNUTSON: Yes.

SENATOR MALDONADO: Why don't you just lower the price of the organic milk and put it all on organic so you can sell it in the market?

MR. KNUTSON: Well, the cost of organic milk, the cost to produce organic milk, is really high because of the feed costs that we have to pay. Our feed costs will generally run double what the conventional farmers will run, and our feed stuffs are hay, generally comes from high desert because—and then we have to haul it in from there but we get it from there because it's colder in the winter; they don't have the weed problems; they

don't have the bug infestation, okay? So we've got to pay that extra feed cost coming in. All our grains coming in from the Midwest is \$80 a ton on the freight. And then we have to compete against that Midwest organic producer that is getting all his feeds cheaper than us.

SENATOR MALDONADO: So in essence, rather than...

MR. KNUTSON: We can't afford it.

SENATOR MALDONADO: So you can't afford it?

MR. KNUTSON: Yeah. But generally it doesn't happen very often. In the spring flush when the cows...

SENATOR MALDONADO: So you don't use it as a marketing tool?

MR. KNUTSON: No.

SENATOR MALDONADO: You're saying, you just use it as a fact that you have extra milk?

MR. KNUTSON: Yes.

SENATOR MALDONADO: You can't sell it?

MR. KNUTSON: Yes.

SENATOR MALDONADO: You have a couple of loads left over; and instead of throwing it away or lowering the price, you put it into the conventional site?

MR. KNUTSON: Yes. And I don't know that that happens at all in California.

SENATOR MALDONADO: Okay.

MR. KNUTSON: I know it doesn't happen with the people that we sell our milk to.

SENATOR MALDONADO: Okay. Thank you.

SENATOR FLOREZ: Thank you all. Appreciate it.

UNIDENTIFIED SPEAKER: Thank you.

SENATOR FLOREZ: Let's go onto the third panel, evaluating the ongoing necessity of the milk pool subsidy and its impact on consumer prices. And in this section, the perspective on the efficiency of the milk pool as it presently operates, we do have Tiffany LaMen—pronounce that for me.

MS. TIFFANY LaMENDOLA: LaMendola.

SENATOR FLOREZ: The director of Economic Analysis for Western United Dairymen, and Bill Van Dam, CEO—good to see you again—Alliance of Western Milk Producers.

And let's go ahead. And if we could begin, just general questions for either of you, in terms of the milk pool. The question, of course, is, Is this the right system for California? Why is milk sold in this manner and why is it, of all the commodities sold, why is it so special in this case to have this particular milk pool to it? Big broad question and then we'll probably narrow it down. Either of you.

MR. VILL VAN DAM: Who would like to start?

SENATOR FLOREZ: Go ahead.

MS. LaMENDOLA: I'll start. Yes, I think the pooling program has a long history in the state. Milk is a highly perishable product and producers need to find a home for that product. The system, I think, has done a really good job in bringing stability to the industry and ensures that all producers of all sizes, no matter where they're located or where they ship their milk, receive a price at equitable and equal to the their neighbors who are shipping milk of the same composition. I think for consumers, its ensured a local supply, continuous supply, of milk throughout the state and I think for processors, as you heard, it provides for equal raw product costs. So, you know, lots of changes have been made to this system in the last 40 years. I think changes will continue to be made, but overall it's been an effective program for the industry as a whole.

SENATOR FLOREZ: Okay. So does it work?

MR. VAN DAM: Oh, yes, it works.

SENATOR FLOREZ: Okay. And to whose benefit does it work?

MR. VAN DAM: It works for the benefit of everybody in the system. I believe every party in the system benefits from the system that's been set up with the pricing as it stands. And then with the pooling, the pooling in particular probably works most for the producers but it avoids a lot of problems that would occur if we didn't have a system of equitably distributing those funds that we collect out to the producers. If we don't do

it that way, they'll only end up competing directly with each other for those markets, and that's where the problem started way back in 1930s when we were driven down to those low prices. They put in the pricing to stop them from driving the price so low. Then you had the problem of the producers then competing for those various markets and that's why pooling came in. You were earlier alluding to the old shipping right from way back. That was a problem.

SENATOR FLOREZ: Yes.

MR. VAN DAM: People had to invest a lot of money in getting into the market.

SENATOR FLOREZ: Okay. And in terms of the consumers benefiting from the milk pool, you didn't mention them.

MR. VAN DAM: Yes. The consumers, the pool is almost totally transparent to them. All the pool does is, it takes the money that's generated by the pricing system and distributes it to producers. There's some real esoteric arguments we can make about...

SENATOR FLOREZ: Unless you're buying it from the Nevada plant, right? Then you're getting a cheaper price.

MR. VAN DAM: Well, that cheaper price...

SENATOR FLOREZ: The consumer probably sees a big difference there.

MR. VAN DAM: Yes. That's a very interesting question and we can spend a long time on it. It is an interstate commerce clause issue that we have been unable to deal with. We would like to but we can't. At first, when they started up this plant, we had a temporary, really big timing difference between what milk prices were available to them compared to what our Class 1 prices—that's narrowed considerably since then. And there are competitive issues are going to play there. They're a long ways away, but they have put together a very special package that a particular company wanted. That is the advantage they have in the market. I think they got a lock on that for a while.

SENATOR FLOREZ: And let me give you some—it's been said—and you can tell me if it's right or not—that the milk pool was really only a system created for growth. In other words, if there was growth and demand, that somehow the milk pool was going to be a very good thing. Is that the case in terms of growth, or what if there's an oversupply of milk? How is this milk pool elastic enough to deal with all of these variables, changes?

MR. VAN DAM: The interesting part of the pool back in 1967, '65, and stuff like that, and I'm one of those people that was—I started working in California in the dairy industry in 1969, so I've been around while those arguments are very fresh. It was not intended to generate a lot of growth in the state of California. It was intended to have that Class 1 utilization be spread equitably to producers. What it did, however, by transferring the ownership of that market right to the producers that freed them up—and we had exactly the opposite of the intended effect, which is what we see now—is a very, very large dairy state making a lot of manufacturing products, and that has been a big part of the success story in this state. The pooling provided the security in the business for the producers to grow like that and they did and it was successful. This is a very successful dairy industry.

MS. LaMENDOLA: I might just add to that too, that as the industry grew, there's only so much fluid milk you can produce to supply to the consumers in the state and that's not an easy product to ship. So when there's growth, it needs to come in manufactured products that can be stored and shipped out of state and we ship a great deal of product outside of California, so that was part of the dynamics as well.

SENATOR FLOREZ: And that is the case when we have an oversupply of milk, or what happens when we have an oversupply of milk in this milk pool system?

MS. LaMENDOLA: Exactly what's—I mean, what's happening right now is mostly a demand issue. I mean, we're facing a global recession; demand has dropped off. Prices to producers right now are frankly terrible. It's about half of their cost of production. So prices to them are market driven based on supply and demand. There has been periods where supply

exceeds demand and the same thing happens—prices fall. And we'll see a supply response quickly after that and we're seeing that now. California's had about eight consecutive months of year over year declines in milk production.

SENATOR FLOREZ: Go ahead.

MR. VAN DAM: If I could add to that, because there's two aspects to that oversupply problem.

One is that we just went through a period and we're in it a little bit now but we'll be out of it shortly where we actually had more milk in this state than we had plants. That is a bad problem. That causes a lot of grief. It happens rarely. But when it happens, it is not a fun time to be in, and so you have to build more plants in order to have the milk processed. Those plants are being built. They're being built by the cooperatives, the ones that I represent, and that milk will be handled.

The second part of it is, is that as you get bigger supplies of milk, that drives the prices down as that product gets out to the market and pushes the prices down, and that becomes an issue as, Are we able to produce milk and process it at a rate that will make money for our producers and then our supplies will grow? And, clearly, that's what happened over the last 30 years. It did grow.

Right now, it's not so clear. The international situation that was going to be our saving grace that was last year—the reason prices went up, because the export markets were fantastic. It looked like we had a new paradigm going. So much for new paradigms. They are not going to happen very often. We still don't know how that's going play out, but it is of great interest to us.

SENATOR FLOREZ: Okay. Any validity to the criticism that the milk pool creates waste and unnecessary high consumer prices? You would say absolutely not in each of those criticisms?

MR. VAN DAM: Yes. I'll steal your words, *absolutely not*.

SENATOR FLOREZ: Okay.

MR. VAN DAM: I cannot see how that's even remotely possible.

SENATOR FLOREZ: Okay. And explain that for us in why it isn't so we can just get it on the record.

MR. VAN DAM: Well, I'm not sure what it is you're getting at. It does not cause higher prices.

SENATOR FLOREZ: Why isn't it creating waste, one; and why isn't it creating higher consumer costs for fluid milk and cheese?

MS. LaMENDOLA: As far as consumer prices, the pooling program does not set consumer prices. That's completely determined by the retail level. So what the pooling and pricing system does, it establish...

SENATOR FLOREZ: Does it affect it at all or...

MS. LaMENDOLA: Minimum prices. So it establishes minimum prices that the processors pay. Whatever is charged or extracted from the marketplace beyond that is out of the control of the state or producers, quite frankly.

SENATOR FLOREZ: And in terms of the efficiency argument we're talking about, vertically integrated producer processors, what would you say to them?

MR. VAN DAM: Well, on the vertically integrated producer...

SENATOR FLOREZ: Should we do something for them that's different than for the rest of folks, given they're vertically integrated and they've vested in efficiencies and they're trying to, you know, and yet they have this milk pool that forces them, even though they're on the same...

MR. VAN DAM: They made a deal 40 years ago. There were a lot of them in existence back in 1965, producer-handlers, producer-distributors, whichever you want to call them, PDs, and there were a lot of them around then because the only way, one of the only ways that a producer going into business could get himself a Class 1 price was to bottle his own milk and sell it directly to the consumers, and the Class 1 prices were worth a lot then. And as a differential price, it was huge. The differentials are about the same. But against the lower prices then, it was very big, and they were a force to be reckoned with when we went into pooling. And the deal that was struck is that they would agree to take an exempt quota, a special kind

of quota, for their production that they had in Class 1 at that moment and that would be exempted from the pool end.

But here's the key thing—and this is the point that I need to make—all their growth would be participating in the pool; and on all their growth, they would compete on equal footing with all the other handlers in the state. That was a key element in pooling and an agreement made. They have grown; the ones that still exist have grown. They have expanded their Class 1 sales. Their Class 1 sales are more than they used to be, and they settled with the pool with the rest of it. It's a deal they made. It's a deal I feel they should honor.

SENATOR FLOREZ: Okay. So you saw the gentlemen that were up here testifying as producer-processors who I'm sure themselves aren't 40 years old. So when you say 40 years ago a deal was made, I mean, are we in the same market that we were 40 years ago, same amount of producers, same amount of consumers in terms of their choices, what they want, see? I mean, is this still the same market it was 40 years ago?

MR. VAN DAM: Everything is bigger; everything is going faster and there's fewer of them. But the point is still the same. They have a given amount that they're exempt from the pool. It's a fixed amount that they've agreed to. It works within our system. If it keeps getting bigger, then it's going to screw up the system. We like to keep the system like it is. They made an agreement. We live with it.

We have, I believe, and I've always argued this, and I spent some of my career out in the federal market areas, we had in California what I considered to be the best solution to the producer-distributor problem. The federal order is now working just the opposite, and they have a set of hearings in process now that will come to a culmination probably in a year that is going to eliminate the concept of producer-distributors in the federal orders, so they would not even exist in the federal order.

SENATOR FLOREZ: Is that a good thing for producer-processors?

MR. VAN DAM: It's a horrible thing for the producer-processors, but it is a good thing in terms of getting your regulatory systems set up. If you're going to regulate milk, regulate it all.

SENATOR FLOREZ: Okay.

MR. VAN DAM: Because, if you start leaving these exceptions, and there'll be people in there—the Yerington Plant's classic—classic—because the boundary is in there and it causes the problem so that plant gets built in a place that makes no sense to build the fluid milk plant. But in order to get around the regulations, you do it and you'd have those activities that cause these laws to be put in place 70 and 40 years ago. You'd have the same problems again.

SENATOR FLOREZ: So no exception, no exceptions? Organic milk should be part of this?

MR. VAN DAM: Milk is milk. If you're going to have a regulatory system, you need to regulate it all.

SENATOR FLOREZ: Is raw milk, milk?

MR. VAN DAM: Yes, it is. All our milk is raw milk until it gets processed at a plant.

SENATOR FLOREZ: And processed meaning it's...

MR. VAN DAM: Homogenized and pasteurized.

SENATOR FLOREZ: Pasteurized.

MR. VAN DAM: Or turned into cheese.

SENATOR FLOREZ: And raw milk is...

MR. VAN DAM: Raw milk is a product that is just bottled as raw milk.

SENATOR FLOREZ: Right, non-pasteurized.

MR. VAN DAM: Say again.

SENATOR FLOREZ: Pasteurized or non-pasteurized?

MR. VAN DAM: Not pasteurized. That's the point of it.

SENATOR FLOREZ: Right. So then you would include that also in the milk pool?

MR. VAN DAM: Well, certainly.

SENATOR FLOREZ: And what value would raw milk get out of this pool, given they're paying into it? What's the value of it?

MR. VAN DAM: The value for them, that isn't the issue. The value is that we have a system that works right to set a standard for all of milk. The value they would get—we have, what, two raw-milk producers? If they became exempt from pooling and had all those things, then people again would be out pushing and we'd see a lot more raw-milk people going into business.

SENATOR FLOREZ: Okay. So the stability of the market depends on everyone being part of this system...

MR. VAN DAM: Yes.

SENATOR FLOREZ: ..and not one link being out of it?

MR. VAN DAM: In times, stability to market is involved. But as a policy on why you regulate something, if the policy is going to make sense, you have to regulate it all. You don't have to do anything. I suggest that you would need to. (Laughter)

SENATOR FLOREZ: No, no, and we probably won't. So we're just trying to figure out what should stay in and what should be in or what should be out and I'm just wondering—yes.

MS. LaMENDOLA: I might just add too—and I kind of said this earlier—but pooling and pricing, all it does is establish again just that minimum price, that equal raw-product cost for all milk going into fluid purposes. What each of the different segments is able to extract from the marketplace is totally up to them. Those revenues are maintained by them. This is just setting an equal raw product.

SENATOR FLOREZ: Yes, but they're paying money out of their pocket into something that—I guess at the beginning of the hearing, and we asked CDFA this, and I think you mentioned as well, that the whole purpose of the milk pool is to create stability, right?

MR. VAN DAM: Yes.

SENATOR FLOREZ: Right. So stability in all of the milk products, is raw milk an unstable—is it part of this? I mean, was there a problem in raw

milk in terms of stability? No one had enough and people were arguing and taking barbers? We had all of these, you know, ups and downs that the rest of the market did?

MR. VAN DAM: The point would be, though, not that the small amount that we have now would cause instability in our market.

SENATOR FLOREZ: Okay.

MR. VAN DAM: It is the fact that some of it is exempted—that is a Class 1 product—it's a fluid milk product. Some of it is exempted and would cause things that have to happen which would cause the instability, that we got rid of many years ago.

SENATOR FLOREZ: And that assumption is that, because it's part of the pool, it's going to be used in some fashion, even though we know it's not going to be used for the final product but its part of the setup ?? pool.

MR. VAN DAM: It is milk. It needs to be part of the whole thing.

SENATOR FLOREZ: Okay. And it's milk up to the point of what? I mean, in terms of till it's distributed?

MR. VAN DAM: Well, it's milk until the consumer drinks it. I don't mean to be flippant but...

SENATOR FLOREZ: Right.

MR. VAN DAM: ...you're getting at something different.

SENATOR FLOREZ: Right, right.

MR. VAN DAM: Yes, well, until the raw milk is processed, then it's still milk, though. We've got it in the system.

SENATOR FLOREZ: Right. But the milk pool limits in terms—we have a raw-milk panel right after you, so maybe you can answer some of these questions about it. But in terms of raw milk being out of the process or exempted from the process, the pool limits for the raw-milk market, from your vantage point, you say it's very small number, two producers?

MR. VAN DAM: So far, the volume's quite small. Yes, I do see it as a small amount.

SENATOR FLOREZ: And we have an exemption for—I think CDFA mentioned already for some folks, correct?

MR. VAN DAM: For producer-distributors who have had the historical right for 40 years. The new ones are not allowed to start up. Forty years ago, we shut the door on any new producer-distributors.

MS. LaMENDOLA: And any of their growth is pooled beyond a set exemption. That was set 40 years ago.

SENATOR FLOREZ: Okay. And 40 years still works today for you, in other words?

MR. VAN DAM: Yes.

SENATOR FLOREZ: In other words?

MR. VAN DAM: Yes.

SENATOR FLOREZ: What's the consequence of simply allowing the market to determine minimum prices? When that starts happening and you turn the whole thing loose, what starts—you're anxious to answer that?

MS. LaMENDOLA: Well, I guess I would argue that the market does set minimum prices currently. I mean, we have pricing formulas, but the market drives the commodity prices that are pushed through those formulas. So we have, you know, classified pricing formulas but the marketplace drives those commodity prices that drives—that's exactly why producer prices are so low right now.

SENATOR FLOREZ: So are the most efficient producers in California rewarded under this system?

MS. LaMENDOLA: Most efficient? What do you mean?

SENATOR FLOREZ: Are able to bid for the lowest price? I mean, this system, in my view, is inefficient, maybe not from a price perspective or from a pay perspective. But how do we get—how is a producer incentivized in this system to be more efficient if everybody is getting the same price—if Senator Maldonado and I are getting the same price—he runs a great farm; I run a crappy farm?

MS. LaMENDOLA: Yes. Well, there's minimum prices set.

SENATOR FLOREZ: He's got a bid; I've got a bid. I mean...

SENATOR MALDONADO: But there's also minimum standards too.

MS. LaMENDOLA: Yes. But each producer can receive a fluctuation on that price based on the quality of their milk, the premiums they may attain, dividends, the components of their fat and solids and nonfat. Every price fluctuates by dairy. There's just this minimum level that sort of sets a standard. And each dairy has the ability to increase that price based on, you know, different factors of their milk composition.

SENATOR FLOREZ: Okay. So there's a floor, is what you saying?

MS. LaMENDOLA: Yes.

SENATOR FLOREZ: Okay. And the floor is set by who again?

MS. LaMENDOLA: The market.

SENATOR FLOREZ: The market. And the retailer?

MS. LaMENDOLA: No.

SENATOR FLOREZ: No? The retailer doesn't get to determine...

MS. LaMENDOLA: The market is what...

SENATOR FLOREZ: The retailer doesn't get to determine what they want to charge?

MS. LaMENDOLA: Oh, retailers can determine what they want to charge; those are consumer prices. But the market is on the Chicago Mercantile Exchange.

SENATOR FLOREZ: I get it.

MS. LaMENDOLA: So that drives the prices for cheese and butter.

SENATOR FLOREZ: But this is an input into the retailer's price as well, correct? So the reason they're able to...

MS. LaMENDOLA: Yes. They're free to charge...

SENATOR FLOREZ: ...sell milk cheaper from Nevada is because the production process of this, because no one's paying into the milk pool for that, is lower so that the retailer can actually charge a lower price than any other item in the store, correct?

MS. LaMENDOLA: A retailer can charge whatever they want.

SENATOR FLOREZ: Right. So then who's in control of the prices then? What's the value of you telling me, well, don't worry about it; there's a

floor, there's a minimum? You're talking about your particular industries. Maybe we're talking—I'm thinking about consumers.

MS. LaMENDOLA: There's very much a disconnect here between consumer prices and what's happening with processor and producer prices. It's like the levels of the marketing chain.

SENATOR FLOREZ: So what's the consequence of allowing wholesalers or retailers to set the price rather than you set a price?

MS. LaMENDOLA: So maybe working...

SENATOR FLOREZ: That's what happens.

MS. LaMENDOLA: ...backwards?

SENATOR FLOREZ: Yes.

MS. LaMENDOLA: So you probably read that in the McKinsey Report as a possible idea.

SENATOR FLOREZ: Yes.

MS. LaMENDOLA: I guess producers might like that. I mean, if we started at retail prices and worked backwards, but there's a lot of difficulties in that. As an industry, we review that.

SENATOR FLOREZ: Tell me what those are because that's what we're here for. I mean, to kill bad ideas early before legislation or to think about some of these things. Why is the McKinsey Report, in terms of controlling milk prices to wholesale or retail level a bad thing versus kind of where we're at in terms of a minimum?

MR. VAN DAM: We were there. We had many years of that where we did have retail pricing and wholesale-level pricing and the minimum price to the producers because the argument then was, hey, if we control all the levels, then there's no non-competitive problems. It turns out that there get to be a lot of squeaky issues that flow through a system, and those squeaky issues gradually causes this thing to come down because when you—frankly, I was here during part of that. You cannot write rules fast enough to keep up with inventive people. And the principle became that you just need to set one price and that's the producer price to the plant and leave the rest of it to compete like it needs to.

SENATOR FLOREZ: That's good for somebody within that chain.

MR. VAN DAM: Yes. They'll compete and they all have the same price and that takes care of that thing. And the offset is, that the producers then have a price that they all get so they don't fight each other for one that's a nickel better and they end up with a price that they can live with. Right now we can't, but that will fix itself; it always does in the market as the bigger market starts moving pieces of it. Sorry. I probably lost you there. I didn't mean to.

SENATOR FLOREZ: No, you didn't. In terms of that bigger market, in your thought process in terms of this, not looking at retailer backwards but right where we're at with producer controlled price—and that's our system, correct? I mean, this is really where the floor is drawn.

MR. VAN DAM: Market's set but same price to all producers because the cheese, the butter, and the powder are the ones that set our market, so everything rides on those three products.

MS. LaMENDOLA: So the pooling system does not ensure high prices to producers. We're all clear on that. It's set by the marketplace. It just sets formulas, collects revenues, and redistributes it equally to producers. It doesn't guarantee them...

SENATOR FLOREZ: When this system was set up 40 years ago, were people thinking that cheese was going to be the driver of this, or was it going to be Class A milk?

MR. VAN DAM: Absolutely not.

SENATOR FLOREZ: Which one?

MR. VAN DAM: There's hardly any cheese produced back then. And back then, the prices...

SENATOR FLOREZ: So things do change for you?

MR. VAN DAM: Oh, they do. Okay, yes. That's a point we should make. They change quite dramatically. Forty years—70 years ago—the pricing rule was put in place—74 years ago. And you got that pricing rule; and through time, you had to adjust as you went—and we did—and we constantly do. And back then the cost of producing milk was the single

most important part of it because 80 percent was going to fluid milk. Cheese didn't move it at all. And so we go to hearings, and they were always about the cost of producing the milk and then we were looking at 13-cent increments, which means nothing to you but it's a penny a gallon, was the idea. In my first hearing back in 19—probably—'70, was about exactly that.

SENATOR FLOREZ: Just to stay on point in terms of the discussion we had with CDFA on prices, the prices then, is it fair to say the prices aren't necessarily then adjusted to supply and demand?

MR. VAN DAM: Oh, they are adjusted to supply constantly.

SENATOR FLOREZ: But the Mercantile driver in this, is it affected by this lower cheese's rush to—the cheese that we didn't have 40 years ago or something?

MR. VAN DAM: Oh, it certainly does. We're constantly watching it. Those of us in this business watch that cheese market all the time because it is the most important single mover and it crashed last year. As the supply of cheese in the world got bigger, it just dropped off the end and we had a horrible crash in December going into January and it was as bad and as precipitous as I've ever seen, and all our prices moved with it, all of them.

SENATOR MALDONADO: There was a correction.

MS. LaMENDOLA: Yes.

MR. VAN DAM: Now it's starting to edge up just a little bit. We're hopeful that it will edge up.

SENATOR FLOREZ: Go ahead, Senator.

SENATOR MALDONADO: I'm trying to—I'm not an expert on the milk pool but I do want to learn more, and I'd love to talk to you, sir.

MR. VAN DAM: I'm here. Just call me.

SENATOR MALDONADO: You've been around the block. This is not your...

MR. VAN DAM: Unfortunately. (Laughter)

SENATOR MALDONADO: This is not your first barbecue (laughter). So what I'm hearing today is that the milk pool covers the bottom-end price for the producer.

MR. VAN DAM: Yes.

SENATOR MALDONADO: So I'm a producer. I produce a gallon of milk; I send it to the processor. And I deliver to the processor for a certain price. Everybody gets the same price.

MR. VAN DAM: Right.

SENATOR MALDONADO: But the processor gets to process the milk and they don't have a set price. They sell it for whatever they like.

MR. VAN DAM: Yes, that's true and we've got to be careful who we're talking about.

SENATOR MALDONADO: Right.

MR. VAN DAM: Because if you're talking about the fluid milk price, the guy that's bottling it and putting it out on the market, that becomes the beginning. As Senator Florez said, that becomes the beginning of his pricing for doing what he does with the rest of the stuff.

SENATOR MALDONADO: But he doesn't have a bottom line. He can charge whatever...

MR. VAN DAM: He can charge whatever he wants after that, not the minimum.

SENATOR MALDONADO: And obviously he sells it to the grocery stores and they can sell it for whatever they want to?

MR. VAN DAM: That's right. That is unregulated. The only regulated step in that is the transfer of our raw milk to them.

SENATOR MALDONADO: I think the question that Senator Florez is trying to get to—I might be wrong—is that you have a bottom for the producer, but is there a bottom for the consumer? I mean, is the consumer getting the right price under this pooling system?

MR. VAN DAM: Well, we believe he does, and there's been dramatic drop in what consumers are paying for milk now as the cheese price went down. I tried to track it. I went over to Costco before and after the thing, went in there, and they dropped their price by 60 cents a gallon so the consumers get a lot better deal.

SENATOR MALDONADO: But the grocery stores are the ones that can set their pricing wherever they want?

MR. VAN DAM: This is true.

SENATOR MALDONADO: They can set it at 3 bucks, 4 bucks, 2 bucks.

MR. VAN DAM: Yes. And, of course, they've got to sell it. And if nobody comes to their store, then they won't. They have competitive constraints on what they can do and get done. They can't just say it's going to be 10 bucks.

SENATOR MALDONADO: But the consumer never knows what the producer got for their milk?

MR. VAN DAM: Unless they know somebody over in CDFA or knows one of us, they probably don't.

SENATOR MALDONADO: Or if we ask the grocery stores to post the price right under their price, won't they pay the producer?

MR. VAN DAM: They probably would not...

SENATOR MALDONADO: Of course not.

MR. VAN DAM: They don't like doing that very much.

SENATOR MALDONADO: Okay.

MR. VAN DAM: We try and put that out occasionally, but it is not our business. We just like the world to know when we're really getting slammed what's going on.

SENATOR MALDONADO: What is the pool price today?

MR. VAN DAM: The...

SENATOR MALDONADO: Pool price...

MS. LaMENDOLA: Over base or blended price to producers is about 83 cents a gallon right now.

SENATOR MALDONADO: Eighty-three cents. So I think what I'm saying, Senator Florez, is that if at Costco or at Raley's, you just put right under the gallon of milk that the producer was paid 83 cents, and then that would probably help them with buying milk.

MR. VAN DAM: It's an interesting thought. We did put out a news release that hit out just in the first of February at which point the price, the value of the milk in the bottle, was 97 cents and it had dropped from a \$1.65 which is a pretty dramatic drop just to try and get the word out there that they could expect a big price drop. And we figured if we, if we had to take the hit on the values, at least we can get some benefit from some overall sales response, and I believe we're getting it.

SENATOR MALDONADO: The reason I say that, Senator, the reason I say that, sir, is because, you might know this but I'm a grower. And the translation from the grower to when it gets to the shelf just isn't there, and the grower is the one that's paying the farm worker and paying the lines of credit and paying everything. And it just seems, that when they see lettuce or broccoli or milk at 4 bucks, they think that producers are the one getting 4 bucks and it just doesn't work that way.

MR. VAN DAM: I agree. It's not very transparent.

MR. ROBERT VANDENHEUVEL: I guess I got my name in too late to make the official agenda, but your staff asked me to be on this panel. Rob Vandenheuvel with Milk Producers Council. I obviously echo the comments here made by my colleagues, but I would concede to Bill to talk mostly about this since he's been around a lot longer than I have and he's given a good historical context.

But the issue we're talking about right now is exactly what I wanted to talk about, is really, if you're looking at consumer prices at the store, the pooling regulations is kind of the wrong target. I mean, what we've got here—and California is not on an island; this is happening nationwide—is you've got a very volatile milk price. Prices in 2006 were very low, near where we are today. Prices in 2007 were record highs, maybe double what they were in 2006 and now we're right back down. And what happens is, when the price is increasing at the farm level, the retailers drive their prices up at that time. Obviously they have higher input costs blaming farmers for that increase. But as our price crashes back down to where we're at now, those retail prices don't come down near as fast as the farm level price does.

Some have called that the stickiness, the stickiness of retail milk prices. It just, you know, they take, like a good business person, they take advantage of that increase of raw-product cost to pass it along to the consumers and they're not so quick to bring that price back down at the stores.

Now Bill has talked a little bit about Costco, and Costcos and Wal-Marts of the world do tend to pass that along. But I've gone into the local grocery store and still seen milk as high as \$4-plus a gallon, you know, last week, so there is still a stickiness to those products. They don't come down. And what you're seeing today with this testimony is that it has nothing to do really with the function of pooling. It has to do with this national milk price volatility.

SENATOR FLOREZ: Let me just make sure for all three of you—let me get this on the record. So you're telling us that pooling doesn't affect retail costs or it doesn't affect retail at all?

MS. LaMENDOLA: Correct.

SENATOR FLOREZ: At all?

MR. VANDENHEUVEL: Correct. And to demonstrate that, I would...

SENATOR FLOREZ: And, what, Costco has milk that's 20 cents lower. That's just on Costco's dime? They're just feeling really good about things, so they decide that they're going to do milk 20 cents lower than anywhere else; is that right?

MR. VAN DAM: They certainly can but that's not...

SENATOR FLOREZ: No. That's what they do; it's not they can. That's what's going on. So I'm just asking, so is that...

MR. VAN DAM: It's not a function of pooling.

SENATOR FLOREZ: It's not a function of pooling?

MR. VAN DAM: No.

SENATOR FLOREZ: Okay. So the Nevada argument we heard earlier is completely invalid?

MR. VAN DAM: Yes, it is. It's a function of pricing. They've got different pricing and they've got a rule there. And I'm probably being too technical.

SENATOR FLOREZ: No, you're not. It's just that it's hard to believe that the base price is not going to affect the retail price at all.

MR. VAN DAM: The base price is set by the pricing system.

SENATOR FLOREZ: I get that. No, I understand. But the pricing system is set—let's just follow the logic here. The pricing system at the end of the day is affected by the Mercantile; the Mercantile is affected by the cheese in many cases, which is it the lowest denominator; we in many cases in California dictate that. So it's a circular thing. So we in many cases, our own California policies in many cases, encourage some of this. Cheese became a much bigger player. As cheese went up, we affected the Mercantile; the Mercantile went up and it goes circular. So at the end of the day, the base price, right? The base price is affected by us as well, correct? Our price, the base price?

MR. VAN DAM: No. We don't have any direct impact on the Mercantile.

SENATOR FLOREZ: We don't?

MR. VAN DAM: What we do have...

SENATOR FLOREZ: Really? We don't have any effect on the—California has no effect on the Mercantile whatsoever in terms of how we—cheese and all?

MR. VAN DAM: Not because of any rules, not because of any rules anybody has.

SENATOR FLOREZ: No.

MR. VAN DAM: We have an impact because we make a lot of cheese.

SENATOR FLOREZ: Exactly.

MR. VAN DAM: And we cannot ignore that.

SENATOR FLOREZ: Thank you. Right.

MR. VAN DAM: That again is in response to the cheese market; and to an extent you're right about the circularity, but that was true of Wisconsin back in the old day too. They made a lot of cheese. That set the market which...

SENATOR FLOREZ: Thank you. I'm just trying to understand. It doesn't make any sense that we don't have any effect on the Mercantile at all to sit and say, no, we don't; we'll kind of settle. So it is circular, in a sense, correct?

MR. VAN DAM: It is to an extent, yes, because those prices that you get for the product set the price you're going to get for the milk that went into it, yes.

SENATOR FLOREZ: Correct. Okay. Thank you.

MR. VAN DAM: And that's the formulas. That's the function of the formulas in there.

SENATOR FLOREZ: Got it. And the formulas are set by the folks that came up earlier every month on the 26th.

MR. VAN DAM: By CDFA through—if you want to attend a boring hearing, go to...

SENATOR FLOREZ: I've heard they're quite exciting sometimes so, you know...

MR. VAN DAM: Well, come. Next time we have one, I'll invite you.

SENATOR FLOREZ: People disagree. I heard they're actually pretty good.

SENATOR MALDONADO: If you're there, Senator Florez, it will be exciting. (Laughter)

MS. LaMENDOLA: Senator Florez...

SENATOR FLOREZ: I'm just trying to—I mean, Senator Maldonado has made the clearest argument for me today but go ahead.

MS. LaMENDOLA: You just mentioned that CDFA sets the formulas on the 26th. It's not the formulas that they adjust. On the 26th, we look at the average of the commodity prices in the market.

SENATOR FLOREZ: And the plugging in and do the formula. Now it pops out the price.

MS. LaMENDOLA: The formulas are adjusted through the hearing process, and that can be changed one to six times a year...

SENATOR FLOREZ: I understand. But is it fair to say—just let me get this straight. So 40 years ago, we never probably assumed that our policies, our five tiers versus the fed’s four tiers, would be encouraging—not encouraging—it’s probably too strong a word—would be moving towards cheese as opposed to fluid milk? Is that fair to say?

MR. VAN DAM: If I follow your statement, it is fair to say that we did not anticipate that happening. It was not anticipated that we would become a major cheese-producing state. That came later. The 1980s is when it started. I should have brought my picture along. In 1977 I attended—’72—I attended the groundbreaking of the first big cheese plant in California. It was in Tracy.

SENATOR FLOREZ: Interesting.

MR. VAN DAM: And that was the beginning of that thing. So it’s my fault. (Laughter)

SENATOR FLOREZ: Do you see that changing in the next 20 years, 30 years?

MR. VAN DAM: We’re certainly worried about it, cheese, because we are so far from where the consumer is. We produced more cheese than this state needs. We’re a long ways away from the consumer in this country, and they’re over on the Eastern Seaboard; that’s where the people are. And a lot of cheese plants are being built between us and them by our brothers and cousins and people like that. So we’re worried about that and we could see a change. The change that seemed to be building up was we’re moving over toward producing powdered milk which is an item in international trade and we’re participating in feeding the world, and we’re pretty excited about it until that market crashed.

SENATOR FLOREZ: And that was China?

MR. VAN DAM: Partly China; partly it started raining in New Zealand and Australia; partly that Argentina is responding to it; partly that European economic community responded to the higher prices that were caused by this world market, and now they’re back in the subsidy business.

SENATOR FLOREZ: Gotcha. Let's just go to a few more questions so I can understand from your perspective. I think you heard me mention a contract forward type, forwarding, contract forwarding.

What would be your perspective on that in terms of forward contracting? What's wrong with that? Does it work with the milk pools? Does it create efficiencies, create, allow for innovation? What would be your big picture on that?

MS. LaMENDOLA: Yes. So the program that was proposed a few years back worked within the pooling system and the way that that worked, according to a report CFA published to the legislature, was that it shifted 100 percent of the risk to the producers. So it was only the processor that was guaranteed a fixed price so that was our biggest concern with that. I guess if you move outside of that, I need to know kind of the specifics of forward contracting to say definitely. I mean, there are mechanism for risk management that both producers and processors all over the state take place in today, through the futures and options and different setups. So that was our biggest concern but there was no way to make it work, at least the way it was proposed, that didn't shift the risk to the producer. It didn't really work as a forward contracting program for them.

SENATOR FLOREZ: And in terms—well, let me ask: Is there a form of forward contracting that would work in this system? Not in the one that you looked but any sort of variation of that?

MR. VAN DAM: What Tiffany was alluding to is the fact that there is a futures market that allows any producer to participate in lock-in prices for the future. That is a Class 3 contract which is the federal cheese price but you can do it and the game will play, even if you're a California producer, because you don't have to necessarily be supplying a Class 3 plant. So that is there. That is available to people, and it's had rather modest degrees of success. But anybody that bought a futures position last year would be delighted right now because a year ago you could have gotten \$17, and now we're at 9 something or 10 something. So it can work; it is there; that is working.

I should add to this whole debate on the futures contracts, is, much of the reticence of producers to talk about it, it goes back to the days—they still remember; some of the guys are still around; there are a few guys older than me in the business that are still around—that remember the days when they had no leverage against their buyer, and their worry is that they will be made to accept these contracts. It may be somewhat irrational. But, you know, where there's smoke there's sometimes fire. In fact, there's often fire. And that is the basis of our reticence. We'll stay there for a while as we work on this and try and understand it and get to the point where we really get a clear vision of it. In the meantime, those who really want to do it, they can through the futures market.

SENATOR FLOREZ: Okay. Just a couple more questions in terms of the thought processes for Australia in terms of their experiment in deregulation. What would you say about that, that it worked, didn't work, better, wouldn't work here?

MR. VAN DAM: It wouldn't work here. It's worked for them. It's quite a shock to their system. But as they were ready to go into international trade, they had to have a mechanism in place to have their prices meet what international trade is willing to pay. So they went through big shock on getting out of that thing and they did, but they didn't have a lot of options for their milk. They just had a handful of milk and they wanted to grow and do it.

You also mentioned Idaho and you might be getting there. I happened to spend a good deal of time in Idaho. Idaho—95 percent of their milk goes to cheese. Therefore it's only the cheese plants competing with each other for milk and it's working out very nicely, but a key element in that is that...

SENATOR FLOREZ: Is that where California's going? I mean, how much is our fluid milk, 15 percent or something?

MR. VAN DAM: Well, it's 38 percent now.

SENATOR FLOREZ: Thirty-eight percent now?

MR. VAN DAM: Well, 38 percent that's in there. It's shifted downward quite dramatically. It's 42 percent if you do it on a solid basis, 42 percent of our milk. It used to be 50, but our powder is growing and our cheese is—what's that?

MS. LaMENDOLA: Class 1.

MR. VAN DAM: Did I say Class 1?

MS. LaMENDOLA: He asked.

SENATOR FLOREZ: I'm asking about Class 1.

MR. VAN DAM: Did you ask about Class 1 and I gave you...

SENATOR FLOREZ: Fluid. I mean, I didn't give you...

MR. VAN DAM: It's a technique I've been taught. Give the answer I want to give. (Laughter) Sorry. You asked about Class 1?

SENATOR FLOREZ: Yes. I'm just asking—I mean, you mentioned Idaho and it being predominantly..

MR. VAN DAM: It's 3 percent. I managed a plant in Idaho for a while and I told my people, for marketing purposes, assume Idaho has no people. You've got to market it somewhere else, but 95 percent of the milk goes into cheese. And they have around them regulated areas. All the areas around them are regulated. There is a ship into our regulated—that sets the price for them without being there. It's working well. They're getting by. They're starting to have the erosion around the edges which is Salt Lake City. Salt Lake City is where the Class 1 markets are, and the people not in Salt Lake City are starting to reach over to it. Josh is giving me the eyeballs like I better shut up so I will.

SENATOR FLOREZ: No, not at all. The milk, treating all fluid milk the same, which is our system—correct?—whether it's raw milk or organic milk or any sort of milk you mentioned earlier, does that allow us to produce environmentally efficient dairies, given that we're treating it all the same, all the same concept?

MR. VAN DAM: That question sounds similar to the one you asked about efficient, Are we going to end up with efficient producers? And you said the two of us next door and I didn't answer that then, same sort of

thing. We're seeing substantial growth in our dairy industry in terms of size of dairies, and part of it is because they are the ones who can afford the environmental adjustments that we have to make and we'll see more of that happening because of those roles.

But the other thing is, if you have two dairies side by side and they're getting the same price for their milk but they're not the same efficiency, the one who's more efficient and a better producer will be the one who wins the game in the long run, and we will gradually move in that direction and it has worked that way for years now.

SENATOR MALDONADO: How could that person be more efficient if they're getting the same price? Is the administrator better?

MS. LaMENDOLA: I'd like to add to that, though. Again, and I kind of mentioned this earlier, it's a minimum price. Those producers who have chosen to do organic or so forth are receiving premiums for that milk. The over-base price coming out of the pool for that that producer is the same but that is not what those producers are being paid. They are receiving a premium for that product, and they need to receive a premium to produce that product. It costs them more and so forth—so just to clarify that.

SENATOR FLOREZ: So you're saying that these folks are rewarded with a premium; they're rewarded to be more environmentally efficient, dairy is being rewarded?

SENATOR MALDONADO: Can you explain the reward?

MS. LaMENDOLA: Sure. Up and down the state—I mean, it doesn't matter if you talk to a co-op or a processor, they all have different premium structures. Some of them give premiums for quality; they give bonuses.

SENATOR FLOREZ: What about talking to an organic...

MS. LaMENDOLA: So the organic producers receive a higher price for their milk than their conventional neighbor.

SENATOR MALDONADO: So they're in the pool but they just get higher...

MS. LaMENDOLA: Yes. So the processor pays the Class 1 into the pool. Out of the pool, they receive the over base. They are required to give

that to the producer. But on top of that, they can add whatever they want to get an adequate supply of that milk.

SENATOR MALDONADO: Can they do that to any grower?

MS. LaMENDOLA: Yes.

SENATOR MALDONADO: So let's say, I just happen to have a nicer dairy. Can I have a bonus price for my milk if my dairy is nicer than my neighbor's?

MS. LaMENDOLA: Yes. Many of the co-ops have quality bonuses. I mean, it's up to their discretion; it's up to their discretion if they add to that minimum price. Some of them do; some of them don't. Some years they do; some years they don't. It's up to their—it's their discretion.

SENATOR MALDONADO: So it's a minimum pool, plus?

MS. LaMENDOLA: For some people.

SENATOR MALDONADO: For some people?

MS. LaMENDOLA: Yes.

SENATOR FLOREZ: Okay. Who are the people that don't get the plus for some? I mean, those are people that just aren't doing anything?

MS. LaMENDOLA: Yes. I guess it would be hard to say, depends on who they ship to, if they ship to an independent processor, that may be a premium, a cheese-yield premium, based on components of that milk, some co-ops paid quality premium; some don't. I guess it just depends on where they...

SENATOR FLOREZ: So why would an organic dairy come up and testify earlier that they want out of the milk pool then? I mean, given that they're getting, you know, a reward?

MR. VAN DAM: Well, they're getting...

SENATOR FLOREZ: So why would they argue to be...

MR. VAN DAM: John was pretty clear that he was paid above the minimum prices.

SENATOR FLOREZ: So why would they argue it?

MR. VAN DAM: Because he's—it's quite simple. He wants to get that little bit that gets paid into the pool, the difference between the over-base price and the Class 1. He would like to have that too.

SENATOR FLOREZ: And that's, in your mind, that's a no-no?

MR. VAN DAM: Yes. And it's not those few dollars that we're talking about. It's the principle of having a pool where all the milk is regulated so you've got a good handle and you keep your arms wrapped around it.

SENATOR FLOREZ: And if you don't, because if you don't keep your arms around it...

MR. VAN DAM: Then every one of those little holes...

SENATOR FLOREZ: These will proliferate?

MR. VAN DAM: Every little hole you left will start expanding.

SENATOR FLOREZ: Right. Let me ask a question on it. Do you really think, do you really believe that would happen with raw-milk dairies, that they would just pop up all over California if indeed we—we have two of them. I mean, do you really think, given your premise that raw-milk dairies would just proliferate in California?

MR. VAN DAM: I've been around the block, like Senator Maldonado said. In almost every crease you leave in the system, it gets exploited by somebody.

SENATOR MALDONADO: See, Senator Florez, the way I look at this...

SENATOR FLOREZ: Yes, go ahead. I'm sorry.

SENATOR MALDONADO: The way I look at this, Senator Florez, is that, to the raw people, it doesn't matter to them because they're getting the minimum plus a bonus. So why would the raw people be afraid to be in the pool? Or why would the organic people be afraid to be in the pool if at the end of the day they're going to get a bonus? So I don't understand why they would say that they're...

MR. VAN DAM: And it is those, the difference in those dollars that they would like to have instead of sharing with the pool because it is shared

with the pool; then it goes to all producers and adds to the pool level. But it is a principle of regulation and you guys are the regulators.

SENATOR FLOREZ: No, no. And we're not master planners either. I mean, I think what you're saying to me is that—it's an interesting argument, when we began the hearing, about the purpose of the milk pools provide stability, I mean, absolute stability. And you seem to be arguing, that if we took folks out of this, you know, organic, raw, that it would create—I assume you're saying it would create an unstable environment because folks would rush into these and exploit this, you know, raw milk.

MR. VAN DAM: They might rush in. They might...

SENATOR FLOREZ: Raw-milk dairies would just, you know...

MR. VAN DAM: Yes. They might rush in; they might creep in but they'll come in.

SENATOR FLOREZ: Really?

MR. VAN DAM: These exceptions will be found and they will be used...

SENATOR MALDONADO: Can I ask you, Why would they do that? Why would they creep in? What would be the benefit of...

MR. VAN DAM: Well, the benefit would be taking the Class 1 price—that's what they would get for all their milk if they could be exempt from it, assuming they could get it all sold and you touched on that with John a while ago—assuming that they get it all sold, they get the Class 1 price instead of the over-base price or the quota price if they happen to have quota.

SENATOR FLOREZ: All right. Now I get it. Let me turn it around, upside down, for a minute so I can understand this. So I get, I completely get your argument. Let's talk about the consumer for a moment, because we haven't mentioned them, for a little bit, other than Senator Maldonado's dual price, which I kind of like.

What if the consumers in California, for whatever reason, wanted more organic milk and wanted more raw milk in droves? Let's assume this market just exploded? Could we not argue that the milk pool itself limits

raw milk from expanding in California? Because if we took them out and allowed them to—you say they would pop up all over. I mean, I would assume they would pop up all over only if there was consumer demand for either organic or raw milk. And what would be bad about that? What would be wrong if more consumers wanted to see more raw-milk dairies, but yet the very pool that we're talking about limits their growth or wants them out altogether? I mean, what if consumers wanted to see this? How would consumers get more raw milk in California if they were at capacity, for example, and they couldn't because the raw-milk system that they work under right now, the milk pool, wouldn't allow them to expand? Because I think the opposite of what you're saying is that the raw milk—excuse me—the system we have now provides stability by not allowing some of these folks to go off in these little niches and grow. But if there's consumer demand for these and they need to grow and they can't grow because they're under this milk pool, aren't we denying consumers something that they might want to see?

MS. LaMENDOLA: I just can't understand how the milk pool would limit growth of any certain segment of the industry. Again, it just sets this minimum price. The amounts those folks are extracting from the market are there. There is a premium there and you may want to ask them that. I don't see the pool being...

SENATOR FLOREZ: The limiting factor?

MS. LaMENDOLA: The limiting factor in their growth.

MR. VAN DAM: Not at all.

SENATOR FLOREZ: But you were just arguing that the pool should be the limiting factors so everybody didn't go off and do what they needed to do outside the pool?

MS. LaMENDOLA: And that's what I kind of wanted to add Bill. I don't think the argument there is that raw milk producers would pop up everywhere. I think the argument is that you start. And, again, milk being milk, if you start segmenting and pulling out little segments here, little segments there—you know, some producers will come forward and say, well,

I have a higher fat test to my milk; I think I should be exempt or I have a higher quality premium; or more cheese can be made from my milk—it just starts splintering the system. It's not that we're concerned about more raw milk or more organic milk. It's just concern about splintering the system.

SENATOR FLOREZ: No, I get it. So I guess you would be arguing that none of these folks should be able to argue some value in their product because that's what they would be doing—you just mentioned. They would go out and say, I have this because my milk does this, or I do this because my milk does that. They would be able to segment and the raw milk—excuse me—the milk pool doesn't allow any sort of market segmentation at a certain level. It just kind of, all of it's milk, right? Is that what consumers want right now? I thought they wanted a little differentiation in terms of their product on the shelf.

MR. VAN DAM: They can have all the differentiation they want. It still works.

MS. LaMENDOLA: Yes, and I think they're paying for that.

MR. VAN DAM: It's just a matter of making sure that the regulatory system contains all the milk. I'm sorry. I said it enough times. Maybe I made my point.

SENATOR MALDONADO: Raw milk is where everyone starts?

MR. VAN DAM: Yes.

SENATOR MALDONADO: Everybody starts with raw milk?

MR. VAN DAM: Right.

SENATOR MALDONADO: And then from the raw milk, that's where you have a choice of where you're going to go with it. So what's the difference between Dairy A and Dairy B on raw milk? There's no difference in the milk?

MR. VAN DAM: Well, there's always some difference in the milk. It's the different dairies.

SENATOR MALDONADO: Raw milk's raw milk. What's the difference?

MR. VAN DAM: They're raw milk but they'll have different coliform standards, a hot topic here.

SENATOR MALDONADO: Different colored cow raw milk?

MR. VAN DAM: But much, much of the milk produced in California, a lot of it produced, maybe as much as 35 percent, meets the raw-milk standards and could be sold as raw milk under today's standards.

SENATOR MALDONADO: Okay.

MR. VAN DAM: But it isn't because—well, we won't go there.

SENATOR MALDONADO: Senator Florez, I think, if you want to drop the price in organic milk or raw milk, you have truth in labeling because I believe that there's a lot of producers that produce more organic milk than they can market. So what they do is that they punted off into the conventional milk to stabilize their price because, if there is a glut of organic milk at the stores, the price will go down.

SENATOR FLOREZ: Okay. Any other comments from—thank you, Senator Maldonado.

Any other comments from the panel?

SENATOR MALDONADO: Just one more comment.

SENATOR FLOREZ: Yes, of course.

SENATOR MALDONADO: I want to know, I'm going to take a little different tack than Senator Florez on this. Can a farmer—if I wanted to be a dairy farmer, what's the minimum head that justifies being a small dairy?

MR. VAN DAM: You qualified that pretty interestingly. I suppose you mean a small dairy with ten head, but you to know if it's economically feasible.

SENATOR MALDONADO: Well, what's economically feasible?

MR. VAN DAM: It's difficult to say, but I would throw a number out there and say, if you're less than 500 and you're just starting up, you're going to have a difficult time making...

SENATOR MALDONADO: Okay. Let's say 500.

MR. VAN DAM: Yes. And the average size of a herd in California is almost 1,000 now.

SENATOR MALDONADO: Let's say I want to start my dairy with 500 head of cattle. Does the pool prevent me from—let's say I can't afford 500. I want to do a 250-head dairy. The milk pool prevents me from getting into the business, doesn't it?

MR. VAN DAM: No, it doesn't.

SENATOR MALDONADO: It doesn't?

MR. VAN DAM: No, not at all. What prevents you right now is you won't find a home for your milk so likely. But once that's solved and we've got enough homes for milk, that nothing in the pool would prevent you. If you can find a place to ship the milk, you can be in the pool.

SENATOR MALDONADO: How about the two brothers that were here earlier? I don't know how many head they've got, but they're looking integrated.

MR. VAN DAM: Right. These folks produce; these folks transport to their processing plant, they process it, they probably do the pasteurization, homogenization, whatever you call it, they put it on a truck, and they deliver it to Costco.

SENATOR MALDONADO: Now why should they be penalized in the pool?

MR. VAN DAM: They aren't penalized. The point is, that on all their milk...

SENATOR MALDONADO: They said that they were.

MR. VAN DAM: Oh, of course.

SENATOR MALDONADO: Tell me why. Why are they saying that they are?

MR. VAN DAM: Because they don't want to pay that money into the pool. They would rather have the full Class 1 price for themselves. But the deal they made...

SENATOR MALDONADO: What's wrong...

MR. VAN DAM: But all their growth, they are competing on absolutely equal footing on all their growth with all other processors. That's

the key to this thing. They do not have an advantage over everybody else. They are competing on the same.

SENATOR MALDONADO: So the advantage that they have is, that once they produce, once they've processed the milk, they can go higher on their price at that level?

MR. VAN DAM: Certainly.

SENATOR MALDONADO: Not at pool level.

MR. VAN DAM: Right. But I can't afford a processing plant, so I'm stuck at the pool.

MS. LaMENDOLA: With all due respect...

MR. VAN DAM: Even if you did, you'd be in the pool.

MS. LaMENDOLA: With all due respect to them, I think, also if you listen carefully, their issue is with competition with out-of-state milk, and we have issues with interstate commerce that are very difficult to deal with. I think before this plant in Nevada came up, I'm not sure that that same concern would have been there for them but maybe they could testify to that.

SENATOR FLOREZ: Okay. Thank you. Appreciate the testimony.

MR. VAN DAM: It was great fun.

SENATOR MALDONADO: Great fun, huh?

SENATOR FLOREZ: All right. Let's hear from a raw-milk dairy and a consumer, if we could. Let's go ahead and have the next panel.

Mark McAfee and Christine Chessen come up, and this will be the last panel of the day. Oh, and we have some public testimony as well. I'm sorry.

Mr. McAfee, welcome.

MR. MARK McAFEE: Good afternoon.

SENATOR FLOREZ: Why don't you give us your thought process of what you've heard here. I have just a few questions. And obviously this was really a bigger issue, and we had the organic folks here earlier. We were going to include you on that panel. But as you know, I have a special

affinity to raw milk and I'd like to ask you—I'd like to get your overall opinion on this...

MR. McAFEE: Sure.

SENATOR FLOREZ: Senator Maldonado and I are trying to get—why don't you just do what, you know, make all this money that everybody's saying that you should make in the current system, given the premium?

SENATOR MALDONADO: I'd like to hear too, Senator, from the raw-milk folks of why it's bad to be in the pool.

SENATOR FLOREZ: Right.

MR. McAFEE: Well, it's indeed an honor to be here and thank you for the invitation to be here. We're a very small part of the very large market segment of two producers. One dairy is less than 50 cows. Claravale Dairy, they're not here today, and we milk about 350 cows at Organic Pastures Dairy in Fresno, California. I actually prepared a statement, comments, so that I wouldn't miss anything so I'd like to distribute that, if I can, so you have that before you in reference for later when you do some bedtime reading.

I've marveled at the comments made today. I've been in contact with many of the organic, vertically integrated operations in California, including Rockview Dairy ____ operation in Southern California. The Cloverstrand operation which is represented here today—I don't know if they're going to be able to speak or not—Albert Straus and Organic Valley and others. And I can't speak for them officially, but the comments I got from them was, we want out of the milk pool desperately and there were a lot of comments about being undercut from out-of-state pricing and so on and so forth. So those were kind of the general comments that I was given when I called others to kind of talk about these proceedings today.

As far as raw-milk producers are concerned, I think we are quantumly different than the balance of the pool. And I will kind of set forth the different issues that are very, very important and relevant today to talk about. There's actually eight points and some subpoints which I'd like to touch upon. I can't co-mingle any of my milk with the common milk pool. I

have to meet and exceed pasteurized milk standards without pasteurizing it. I have to have less than ten coliforms per milliliter of milk. And that's the same result you get after pasteurization when my neighbor down the street can have 750 coliforms per milliliter of milk when shipping it to a common milk tank at the local creamery. So there's a quantum difference. I cannot purchase milk from the milk pool, bring it to my small creamery, and process it into any of my products. So there is a massive departure from the milk pool. I can't participate in the milk pool, but yet I am required to pay \$13,000 to \$15,000 a month into the milk pool, and I can't even make all five products, all five classifications of product. I am prohibited from making any Class 3 products because they're pasteurized. So that's just the tip of the iceberg, and there's about six or seven more really very important points to make.

SENATOR MALDONADO: I just heard testimony that said raw milk is raw milk.

MR. McAFEE: Raw milk—there's two kinds of raw milk out there in the world today. Under the regulatory scheme in California, there's raw milk intended for people, which is what I do, human consumption, and there's raw milk intended for pasteurization and then people. There are two different steps of laws completely—different standards. The best of the best California milk producers averaged about a 30-coliform count in their milk tank on the dairy before being trucked to a common tank at a creamery. None of that milk would qualify to be bottled as raw whole in California under state law. So I take exception to the early comment that raw milk is raw milk. It is not. There are two different distinct sets of laws in California—one for pasteurization and one for human consumption.

SENATOR MALDONADO: But the raw milk that you use is the raw milk that you produce?

MR. McAFEE: We are vertically integrated from the earthworms in the soil, to the pastures, to the cows, to our milk barn, to our creamery, to our bottle, to our trucks, all the way to the consumer.

SENATOR MALDONADO: But the milk that you use is the milk that you produce?

MR. McAFEE: Correct, and it cannot come from any other dairy.

SENATOR FLOREZ: And the milk that you produce goes into the pool?

MR. McAFEE: It does not go to the pool, but I am...

SENATOR MALDONADO: But they pay into the pool.

SENATOR FLOREZ: No. He pays into it but...

MR. McAFEE: I have to pay into the pool for a benefit I cannot in any way, shape, or form benefit from. It is completely—I can use many words to describe it. Today I'll be kind. It's not just. It's just wrong. Why would I pay \$15 or \$15,000 a month into a milk pool? I can't structurally—under AB 1735, the law that was passed a year and a half ago—participate in the milk pool or purchase any milk to make products. And then furthermore, I can't make all of the debits and credits balance between all the classes of milk—Class 1, 2, 3, 4, 4a, 4b—which give you kind of this balancing act to keep perhaps to build down. I can't participate in that like all other producers might.

SENATOR MALDONADO: So the statement that was made earlier, all milk goes into the pool; and that once the milk is in the pool, there is a base price for the pool milk. And once the base price is there, if you have a commodity that somebody wants to buy, there is a plus. You're saying that that's not a correct statement?

MR. McAFEE: It is for 1,998 dairies in California but not the two that participate. It's vertically integrated raw dairies. And to a certain extent for the organic dairies, because they have a premium on top of this guaranteed milk price—the guaranteed milk price right now is guaranteed bankruptcy. If you're \$9.50 or \$10 per hundred weight, there's no way you can sustain your operation at that level. So they ride a rollercoaster, unfortunately, where last year was a pretty good milk price year; it was great; had a lot of dairymen clean up some old debt and did okay. But now dairymen are literally committing suicide from the milk prices being so low.

SENATOR MALDONADO: Suicide?

MR. McAFEE: Yes. It was in the *Modesto Bee*, *Merced Sun Star* a couple of months ago.

MS. CHESSEN: The *Merced Sun Star*.

MR. McAFEE: Yes. Two dairymen committed suicide.

SENATOR MALDONADO: I'm selling broccoli for \$2.50. I'm still here.

MR. McAFEE: I was trying to make a point here that it is a desperate time, and hopefully it will recover quickly because our dairymen need to have a living price for the hard work they do.

SENATOR MALDONADO: But the point where I'm confused here—and please help me—because I believe you. Where I'm confused is that you're saying that your milk never goes to the pool but yet you pay into the pool.

MR. McAFEE: Correct. And this pool is kind of a—it's a theoretical construct. So I never commingled my milk and I can't...

SENATOR MALDONADO: But you're vertically integrated.

MR. McAFEE: I'm vertically integrated...

SENATOR MALDONADO: Those two dairies that do that, you said of the 1998, two of them do that, are both vertically integrated.

MR. McAFEE: Correct.

SENATOR MALDONADO: So they're vertically integrated. So once that milk goes to your processing plant and you process it, you get a huge bonus on that milk.

MR. McAFEE: Yes, I do. I get to sell my milk into a free-market system in 420 stores in California. With all of my own sweat and equity, I manage all, every drop of milk we produce. It goes into a free market that either wants it or doesn't want it. And for that, I get a premium. But the problem I have is, I cannot participate in the milk pool by buying milk like other creameries might, and they do. They buy and sell truckloads of milk all the time. And I can't participate structurally and inherently in the milk pool.

SENATOR MALDONADO: So the bottom line, your point is that you produce milk, raw milk; you're in the pool system today, but you can't buy it from the pool system because the quality of the milk doesn't go to your standards?

MR. McAFEE: By law, correct. I cannot bring—there's a certain number of pathogens that would be statistically relevant to talk about—the coliform counts, the standard bacteria counts. When you've trucked it to a creamery, put it on a truck, pump it two or three times, get it to my dairy, it would not qualify. I can't do it. And then beyond that, my insurance company would freak out if I was to buy milk and bring it to our dairy because whose responsibility would it be if there was a pathogen and someone would be come ill?

SENATOR MALDONADO: So raw milk is not raw milk?

MR. McAFEE: No, it's not, absolutely. And clearly I think that, I think maybe I don't want to condemn what you said earlier because in its simplistic manner, it is, you know, raw milk is kind of like raw milk. But when you look at the details, it is not, absolutely, and the regulations and standards clearly state that. Remember that in 1967, Altadena was producing, I don't know, 15,000, 20,000 gallons of raw milk in the California/Arizona/Nevada markets. They went out of business in 1996 partially because of the pressures of this kind of an environment, but they were given the producer-distributor exemption. In fact, there's never been a raw-milk producer in California that did not have the PD exemption.

When I applied to CDFA to have my PD exemption, they told me, no thanks, and we even litigated over it. And the judge says, you need to change the law because I don't want to sit here at the bench and change the law. You shouldn't be in the milk pool because no previous milk pool—raw-milk producer—was ever in the milk pool because the milk pool and you are distinctively, can't, associated. So in '67 this was thought of and they were given an exemption because they didn't fit; they couldn't participate in that process. And that kind of brings me to my point. I mean, there's lots of points to be made here. But historically it's really important to understand

that producers-distributors that produce raw milk could not inherently structurally participate. And I think it's grossly unfair for me to be forced with my intensive testing protocols I have to adhere to, the different kind of milk that I produce, all the different costs I had, the insurance costs I had, the responsibilities I have to consumers to participate in a milk pool that takes a bunch of money from us, and I cannot get—cannot get—any benefit from the milk pool structurally. And I think that this argument can simply be made also for organic producers to a certain degree as well. I think if Albert Straus was here—he may be here at the next hearings—would elucidate a lot of these same comments because he's a vertically integrated yet pasteurized milk producer, and he would have a lot of the same concerns.

SENATOR MALDONADO: Do you have surplus raw milk?

MR. McAFEE: We are so short, it's not even funny. We struggle to keep our milk on our shelves. There's no lactose intolerance associated with raw milk. And if you do a good job of producing raw milk, it's extremely safe. So there's a market opportunity there and we're growing rapidly; but at the same time, it's burdened by the milk pool.

SENATOR MALDONADO: Senator Florez, where I was confused was that I really thought, that if you got Cow A and Cow B and you go over there and milk it, I thought you were milking raw milk. I still believe that raw milk was coming out of that cow.

MR. McAFEE: You are right. There is raw milk coming out of the cow.

SENATOR MALDONADO: You're saying, that if it's in a green barn and this cow's in a red barn because this one might have better sunlight, this one's considered different from this milk?

MR. McAFEE: It has to do with the conditions and the standards in which the milk is produced. If the expectations for that raw milk is to have a high-bacteria count, all the pathogens—who cares—it doesn't matter—and high levels of coliforms—you know, it's kind of a loose standard. And when you have that kind of production standard, which the dairy industry has—

we actually have a higher standard than the rest of the country, so we have a very high-quality milk shed in California for conventionally produced milk—it doesn't meet and exceed pasteurized standards and that's there for a reason. Pasteurization extends shelf life; it takes care of the liability issues. There's a reason for pasteurization. There's also a place for both people at the table, in terms of the, you know, the dinner table where pasteurized and raw milk can coexist together.

Raw milk takes a very specialized set of circumstances and environment—special care, testing, insurance—we use green-grass pastures, all organic technology—to make sure that the manure that the cow actually produces doesn't have pathogens in it. We actually test the pathogens in the manure to make sure it doesn't get in the milk. So we're doing—I mean we're doing laps around the track when other people are taking a couple of steps to make sure what we're doing is safe for the consumer.

SENATOR MALDONADO: I'm still not convinced but...

MR. McAFEE: If you go and drink raw milk, you'll think these thoughts because, if you read the studies, you'll understand that you want to trust that farmer that it comes from one place and it's safe.

SENATOR MALDONADO: I think what you're saying is that your raw milk has a different standard or your raw milk has a different farming practice. That's what you're saying to me here because, if I go to a dairy and the milk comes out and goes into a tank and I get a glass of raw milk, it's going to taste just like yours? Or yours might taste a little bit different because you give your cows different kind of feed or something?

MR. McAFEE: Well, we're not talking about how it tastes. We're talking about...

SENATOR MALDONADO: The coliform.

MR. McAFEE: ...the bacterial elements in it.

SENATOR MALDONADO: See, that, I don't know.

MR. McAFEE: Well, here's the thing, CDFA does a great job of inspecting our dairy every month, and we inspect our dairies five times a

week. We do pathogen testing. And that doesn't happen on the other dairies; there's no pathogen testing going on in these dairies at all, none, zero. There's no pathogen testing, but they intensively test our dairies for pathogens all the time, and we'll be shut down if they find a pathogen. One pathogen, you're shut down, period. They ask questions, recalls. So it's an entirely different process that we go through, very, very rigorous process. And this is not Mark McAfee talking today. These are state regulations; these are state statute; this is in the milk code, two different kinds of milk by regulation. And it's no stretch of the imagination. I'm not making this up here.

I think I've touched on most everything. But it's essential to understand that my cost to production is not even near what a mega-dairy down the street might be for 10,000 cows. I have 350 cow that I treat like 4H projects, you know, and really diligently manage the udders and manage the milk to make sure that I get the resulting bacterial counts, so it's a very intensive, very costly process.

We are also very, very consumer connected. One of the things that the McKinsey report really talked about was value added, consumer connected. We are that person, that entity. We have people touring our farms constantly wanting to know where their milk came from because my mug shot's on the side of my milk carton and I take personal responsibility. There's no pasteurizer between me and my consumer. I am fully responsible. If somebody's sick, I'm on the phone with them. I'm talking to them. I'm responsible. I wear the badge of honor or not if somebody gets ill from my milk. And so there is a very intimate relationship in the marketplace. Now that's putting the culture back in agriculture, and that's not for everybody. I'm not suggesting everybody goes out and does this because it's a specialized product; it has specialized markets; and people that want to build their immune systems, go drink it; people that don't, don't. But it's a very specialized thing that is for people that want to be involved in that.

Got questions, I'd be more than happy to answer them. I would ask that the old producer-distributor exemption be allowed to be arisen from the sunset and be brought back to activity for those people who want to be vertically integrated and produce raw milk. I would argue also that I think you're going to hear quite a few arguments from the organic community that they're going to want to be out of the milk pool as well and perhaps even the conventional communities so they can compete better because of this whole issue with Nevada, but that's for another day.

SENATOR FLOREZ: Great. Any questions?

Ms. Chessen.

MS. CHRISTINE CHESSEN: Thank you.

Thanks, Senators, for inviting a consumer perspective here today on something that consumers drink every day across the country

SENATOR MALDONADO: What's your organization name?

MS. CHESSEN: CReMA. It stands for the California Raw Milk Association. My name is Christine Chessen. I represent over 40,000 consumers of raw milk in California. I'm also a certified nutrition educator with 350 hours of education in holistic nutrition. And most important, I'm the mom of three young kids. And it's as a mom that I always try to provide the highest quality food that I can get for my family. We've seen so much growth over the last several years in consumer demand for organic milk, and now we're seeing similar growth in raw milk which is what I give to my family whenever I can find it. It flies off the shelves.

The last panel here, if I saw raw dairies popping up all over this state, I would be thrilled, really. Parents hear over and over from nutritionists: if you can afford one thing organic, it should probably be dairy, dairy that's free of antibiotics, free of hormones, free of pesticides, and dairy that's more likely to have their cows have access to green pasture. However, I think it's unfortunate and also unfair that some of this more nutritious milk is not affordable for everyone, especially now, during the economic crisis.

Last week I cruised the dairy aisle at my grocery store, and I found that the average price of a half gallon of organic milk at \$3.54 for a half

gallon was more than double the price of regular milk at \$1.64 per half gallon. And the price of a half gallon of raw milk at that same store at the same time was \$7.99 a gallon. So \$1.64 for conventional milk, \$3.54 for organic, and \$8 for raw milk. It's quite a variety.

SENATOR MALDONADO: So the pool has not come to you.

MR. McAFEE: Try writing a \$15,000 check every month when...

SENATOR MALDONADO: That kind of money.

MS. CHESSEN: It's expensive. As a nutrition educator, a concerned citizen, and a mom, I'm an active part of this movement towards wholesome, natural foods, and local, sustainable food systems. I want to know where my milk comes from; I want to know what the cows ate; I want to know how they were treated; and I want to support producers that minimize their impact on the environment. I'm starting to buy—I think a lot of people have already seen the growth in artisan products, like artisan bread, artisan cheese, and I kind of view the same thing with milk. It's like artisan milk. I want to know who made it. I've toured the farms. I want to know what the cows ate. There's actually—I cut this out of the paper the other day—in Sonoma, in a couple of weeks, there's an artisan cheese festival so people get together and celebrate these artisan foods now.

Although I live in San Francisco now, I did grow up in Fresno on local producer's milk that was delivered every week in purple cartons on our doorstep. Now I buy a lot of Straus organic products, like yogurt, which is local to me in Marin County. And I also buy raw milk whenever I can find it on the shelves. It just seems unfair to me that these conscientious producers of high-quality products are being burdened by the milk pool. It's not good for them; and more importantly, it's not good for me and consumers across the state.

I found it ironic in early January when I came across a few articles about dairies struggling in California to the point that the federal government is paying to store surplus dry milk in Fallon ??, and there are reports of a couple of suicides among dairy farmers due to hardship. I have a couple of those articles here, *Dire Times for Dairy Farmers; Some Even*

Committed Suicide; Dairies Struggle as Milk Prices Plunge; As Recession Deepens, so Does Milk Surplus, from the *New York Times*. It just seems to me that there is a glut of a certain kind of milk. Maybe this is just their regular, conventional milk that we've always produced. But there's certainly a shortage of affordable milk of the quality that consumers are now demanding.

So in an effort to understand the milk pool, I went online to read the CDFA documents, and I have to tell you, I also have an MBA with a background in accounting and information systems, and I found it very complicated and confusing and I couldn't understand it. But the one thing I did read on Page 1 of the *History of the California Milk Pooling Program* document was that the milk pool was meant to address, "The concerns of equitable prices among producers for compositionally similar milk." And I don't think we can view milk any longer as compositionally similar, or consumers wouldn't be paying anywhere from \$1.64 to \$8 for a half gallon of it.

So in the 40 years that the milk pool has been around, there's no question that food and dairy production and consumption patterns have changed dramatically. And I think now may be the time to evaluate the dairy regulations and the market structure of the dairy industry and see if they should start to catch up. Thank you.

SENATOR FLOREZ: Any questions?

SENATOR MALDONADO: I like your name, CReMA.

MS. CHESSEN: Yes, CReMA.

SENATOR FLOREZ: Okay. Seeing no questions, we will put this for the record, and I would say that we do have some public testimony.

We do have a bill, as you know, and so we would ask everyone to reconvene with us when we actually have the bill. Before us, we've heard a lot today, so we'll try to figure out how to make some sense out of it now, but I do think that on the organic and raw-milk side, that we should look at that. You know, we don't have to blow things up maybe, but we can maybe make some adjustments or make adjustments to make some sense 40 years

later, so we look forward to working with both of you on that, as well as the organic milk producers to see if there's any sort of opportunities here to make some sense of this.

And let me just make sure for the record, your milk can't be pooled with other milk in California?

MR. McAFEE: It cannot be commingled or shared.

SENATOR FLOREZ: You can't commingle. So this isn't—the pool is, in a sense...

MR. McAFEE: That theoretical pool out there, this is commonly traded. I cannot participate.

SENATOR FLOREZ: Right. You pour milk into a big vat; and all of a sudden, you're paying into it because your milk is actually pooled. This is simply an accounting mechanism, but you're not in any part and parcel part of this, the regular milk chain, in other words, even though it's milk? And the reason I would say that, for Senator Maldonado, your product isn't the product where I could walk into a store and really see it as a substitution, right? It's not like I go to the market at Whole Foods and I see milk and I go, wow, they're all out of milk, so I'll just grab a gallon of raw milk. It's milk.

MS. CHESSEN: People stand in line in some grocery stores for raw milk.

SENATOR FLOREZ: No, I get it, but it's not a substitution, per se. Raw milk, if you have a pool, it means kind of, regardless of price, milk is somewhat milk right? So if I go and I see Lucerne there and I see something else is there and they're out and I grab another gallon, it's homogenized milk, right? Do you see people going to the store and, for whatever reason, seeing the milk, the homogenized-milk portion of the, pasteurized milk portion of this market empty and then looking to your left and seeing a whole section of raw milk?

I mean, I don't see Senator Maldonado saying, well, you know, I'm just going to get the raw milk because the regular milk's not here. So it is a different product, correct?

MR. McAFEE: To really understand that best, if you stand at an active dairy case like Rainbow Market or Briarpatch up in Nevada City and watch the raw-milk consumer come in, they'll go right to the dairy case, grab the raw milk. If it's gone, they won't grab anything else. Maybe they go to some yogurt or some ice cream but the milk will be raw. And the reason is that many of them have lactose intolerance and can't drink pasteurized milk. Some of them can, and I'm not suggesting everybody, but many of them don't. And they're buying raw milk because of the probiotic value of what it does to the immune systems, especially their growing children.

SENATOR FLOREZ: I get the value of it. I'm just trying to get—I'm trying to get for Senator Maldonado who's not particular me. You know, when we heard earlier, it's kind of like you're in the pool because you're a milk product like everyone else. And so the next level of that is, regardless of the price you're getting, you're really not in the milk—you shouldn't be in the milk pool because you're a completely different item; is that correct?

MR. McAFEE: That is absolutely correct. We should not be in the milk pool.

SENATOR FLOREZ: Let me ask another question. I mean, I don't know if anybody agrees with me, but there's a thing called soy milk out there—soy milk isn't been part of the milk pool, right? Right. And the reason for that is, it's not really a direct substitute for milk.

MS. CHESSEN: Soy milk's not milk.

SENATOR FLOREZ: I get it, but I'm just saying, the point is, is that there's a lot of products we can call milk and a lot of products can be substituted in many cases, could function as milk, depending on how you want your own personal views, but we're not putting soy milk or...

MR. McAFEE: Or almond milk or rice milk.

SENATOR FLOREZ: ...almond milk in the milk pool. We're not doing that because it's never commingled. It doesn't make sense to commingle it, correct?

MR. McAFEE: Correct.

SENATOR FLOREZ: So why would we include raw milk, given that you're not a natural substitute?

MR. McAFEE: We are a financial resource for the milk pool and we're small, and we're having a hard time objecting, you know. We're here objecting, along with other people, for forced participation in this process.

SENATOR MALDONADO: So you're saying that if you didn't exist, the milk pool would be broke because of your money that you're sending to the...

MR. McAFEE: I don't think so. I don't \$15,000 a month is going to break the milk pool. I mean, if you look at the kind of dollars that producers shared with you today, a million dollars a month, that's some serious cash that I'm sure they can do some great stuff with their products—buy some new trucks, keep some chillers running, whatever it is.

SENATOR FLOREZ: Got it.

MR. McAFEE: Employ some new employees.

SENATOR FLOREZ: And the opposite is, if you're out of the milk pool, it wouldn't break the milk pool either?

MR. McAFEE: It would have virtually no effect, that I can think.

SENATOR FLOREZ: And in fact, your product is distinctly different as a completely different product than milk. You're not a substitute for milk. If people, if Senator Maldonado goes to his grocery store and the milk aisle is empty, he's not going to walk to the raw-milk section and pick up raw milk and say it doesn't matter; I'm going to give this to my kids, right?

MR. McAFEE: I will say this: Our milk has specialized insurance, has a government warning on it, that says, do not drink; one drop will kill you basically. I'm exaggerating but I mean, it's got this big warning that says it maybe contain bacteria that cause people with a depressed immune system to become ill. No other dairy-case product has that product that's been processed and pasteurized. So it's a distinct choice people make to have a bio-diverse, enzyme-rich whole food versus others. It is not the same product.

SENATOR FLOREZ: But the point is, you're paying into the milk pool as though were just a regular milk product?

MR. McAFEE: Exactly.

SENATOR FLOREZ: Okay. I guess that's my thought process.

SENATOR MALDONADO: I've never had raw milk so...

MS. CHESSEN: It's good.

SENATOR MALDONADO: I'm sure it is. I'll leave you with this. My grandfather, when I first ran for office, he says, because he speaks Spanish, CReMA is the cream.

MS. CHESSEN: Right.

SENATOR MALDONADO: And he said, son, why are you getting into this political business? You know what the difference between the dairy business and politics is? I said, no, grandpa; tell me. He says, every morning in the dairy business, the cream rises to the top. He says, not in politics. (Laughter)

MS. CHESSEN: That's not true.

SENATOR FLOREZ: With that, we will excuse this panel and thank you very much.

MS. CHESSEN: Thank you.

MR. McAFEE: Thank you very, very much. Appreciate it.

SENATOR FLOREZ: We do have Glenn Gleason who would like to give some public testimony. Thank you, Mr. Gleason, for being here.

Oh, and also, yes, we do, and Robert. Okay.

(Inaudible Comments)

Thank you for joining us.

And for the audience, this is our—we have public comment. This is our final and only person on public comment and then we'll adjourn the hearing.

MR. GLENN GLEASON: Good afternoon, Senators. My name is Glenn Gleason. My background is, I'm retired after 43 years with the California Department of Food and Agriculture. Thirty years of that time, I ran the milk pool so I have a little bit of knowledge, and really I'm here to

help you understand the regulatory structure in California. I actually started with the state in 1959 and worked with the what we call the distributor cost section at that time. And in '69 I was appointed to the milk pooling branch before it actually became an active branch. I was involved in the regulatory and structure.

Listening today, the one thing I think you need to separate is the pricing of the milk products—cheese, butter, powder—is a separate section of the regulatory structure from the milk pool. It's that pricing structure under the Code Chapters of 2 and the Code Chapters 1 and 2 that set the basis for the pool. And the pool merely redistributes funds derived from the pricing structures of Chapter 2. And how that happens is, every processor of all products within California report their activities monthly into the pool; and using those established prices under those formulas in Chapter 2 creates a value of all of the milk production within the state; it then uses the quota to take a portion of that money and set aside a premium to the quota holders of \$1.70 a hundred weight for their production and all of the rest of the producers and production within the state yet the rest of that blend price. And of course the price blend comes from the utilization each month of the production that's coming in, whether it's going into cheese, whether it's going into butter, powder, or whatever.

The initiation of the pool program in 1967 came from a lot of abuses, as has already been mentioned, in the marketing of milk, predominantly fluid, Class 1 milk, prior to the pool. There were extractions being taken by even major companies in order for the producers to be able to allow to supply their product to them. We also, when the pool was created, we had about an 80 percent Class 1, or the fluid value, within the state, the balance going into some minor products. What the concept was, that taking those contracts that had been negotiated and paid for that created a Class 1 payout to the producers during 1966 or 1967, to convert those Class 1 contracts into quota, once that conversion was made, if they also were given another element which was called the total production that they had, the

quota represented the fluid premium they were getting for the Class 1 milk, and then you put that over total production.

When that relationship of quota to total production was at the 95 percent-or-better level, that individual producer's quota at that time was frozen. All of the Class 1 sales that were generated in addition to the base line would be shared by those producers who were in the business and did not have the 95 percent level. So it was there—that was the equalization process that was provided for, to provide that you would grow to that level.

In addition, you brought all of the production in. You gave a few people, producers and handlers, special exemptions that they could maintain the Class 1 price level and not have to participate in the blend for a portion of their production. That today gives them an advantage in the production in the raw-product cost for that portion of their milk that they're still extracting the Class 1 price for is a premium they have to operate their processing plant over and above what other processors have. So they still have that premium even though they have competitive conditions with their correct ?? with out of state. Out of state is a major problem today. It was tried to be corrected with some pool language and we lost in court, in effect, so out of state is coming in as a problem for it.

The only way you could really correct that problem would be to go to a federal order. And producers and many meetings have not felt that that—that the problem was so significant, that they wanted to go to federal order because there's some other negatives in the federal order, particularly if they lose their quota. That quota, we need to remember, currently on the market, which is a market, producer to producer, is worth over \$1 billion. The calculation that was had by the Quota Review Committee, it was \$1,058,000,000 at the current value that it is being sold at. So it's a significant issue, when you, politically or whatever, are going to look at changing that. I'm not saying that there's changes that shouldn't happen. There are some.

Listening to the issue with the raw milk and the organic milk, just to give you an example, there used to be a time when you could buy jersey

milk at a premium. So would all the jersey milk producers be exempt? You get into all these little segments. And the concept being, that if you come into business and start supplying a product, Class 1 product or fluid that will develop a fluid milk, that's a sale that's being taken from the other producers in the state. So you're removing that sale. You're not creating a new sale. And that's the concept of trying to keep everything in the pool. There probably is room for the process, such as a small raw-milk producer-handler you have, had here. Probably you could look at the regulation or law and make some adjustments that would maybe take him out. In doing that, you would need to have somebody who not only produced all his own milk, as he does, and produces his own sales, not just a raw-milk producer that's shipping his raw milk to somebody else to convert it. So there's a distinction there between a producer-distributor doing raw milk and just a raw-milk producer.

The same thing is with organic milk. You know, he needs to be doing 100 percent organic milk, you know, and all of that and not have any way to go pasteurized. So you do it but with some very, very restrictive provisions to protect those sales from leaving the pool which is hurting all the other producers that are in the pool. With that, I'll be glad to take questions.

SENATOR FLOREZ: I have no questions. Very good testimony.

SENATOR MALDONADO: I appreciate your testimony.

MR. GLEASON: Okay. And I stand ready with your committees too. I've given both committees my information and I'll be glad to work with them. Just give me a call.

SENATOR FLOREZ: Great.

SENATOR MALDONADO: Thank you so very much.

MR. GLEASON: You're more than welcome.

SENATOR FLOREZ: Thank you.

Okay. We'll go ahead and close the hearing. I would like to say obviously we've learned a lot, and I appreciate the testimony and even more so would appreciate reading the transcript. So whenever we can get that completed, that would be great.

It's been 40 years, and obviously we wanted to ask the question, Does it still make sense? And I think we've had quite a bit of opportunities to listen to issues of market size and the status and consumer demands, and we've had an opportunity to take both accounts and very good testimony on both sides, and we look forward to having more discussions moving forward. As you do know, there's a bill out there we're trying to figure out what to do with. You know, I would appreciate more meetings with the folks in the industry, and we'll try to ferret most of this out. So I do want to thank everyone for coming, and thanks, Senator Maldonado, and the rest of our colleagues who were in and out of the hearing, and we'll adjourn the Senate Food and Ag Committee.

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