EXHIBIT
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BEFORE THE UNITED STATES
DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE
In the Matter of Milk in California;
Notice of Hearing on a Proposal to Establish
a Federal Milk Marketing Order
7 CFR Part 1051; Docket No. AO-15-0071; AMS-DA-14-0095
Clovis, California, September 22, 2015

Testimony of Scott Hofferber, CFO
Farmdale Creamery, Inc., San Bernardino, California

In this testimony the following definitions shall apply:

1. "We" or "we" or "Our" or "our" or "Farmdale" refer to Farmdale Creamery, Inc.
2. "COS" refers to the "California Order System" as previously defined in this hearing's record
3. "FMMO" refers to "Federal Milk Marketing Order"
4. "CDFA refers to the "The California Department of Food and Agriculture"
5. "Stab Plan" refers to the "Stabilization and Marketing Plans for Market Milk for the Northern California and Southern California Marketing Areas" as administered by CDFA, as well as any other related laws and regulations administered by CDFA.
6. "RDW" refers to "Roller-dried (popcorn) whey for animal feed"
7. "WPC-80" refers to "whey protein concentrate – 80% protein, human grade, powder"

I am Scott Hofferber, the Chief Financial Officer at Farmdale Creamery, Inc. and I am here at the direction and on the authority of its Board of Directors. I have been employed directly by Farmdale since May 1997 and was our outside Certified Public Accountant (CPA) in various capacities for most of the prior fifteen years while practicing public accountancy. I received my Bachelor of Science degrees from The University of Redlands in 1978 and my Masters of Business Administration from The University of Phoenix On-Line Campus in 2004. I achieved my CPA credential in 1988. I have actively served the California dairy industry during my tenure at Farmdale by testifying at hearings held by CDFA, serving on CDFA Secretary Kawamura's "Whey Review Committee", CDFA Secretary Ross' "Dairy Future Task Force" and as Vice-Chair of the Milk Producers Security Trust Fund

Farmdale is a third-generation family-owned and operated dairy processing facility in Southern California in the City of San Bernardino. Farmdale was established in 1979 by the Sibilio and Shotts families, who had been operating in the dairy industry around the Los Angeles area since the 1950s. With fewer than 500 employees, Farmdale processes an average 28 million pounds of milk and cream per month, or about 120 loads per week, into cheese, sour cream, WPC–80 and buttermilk. Farmdale is considered a "proprietary plant" because we have no ownership interest in cows and must rely on supply relationships with the dairy producer community.

We are here to:

1. Express our opposition to the Cooperatives' Proposal 1, and our concern over the use of the phrase "disorderly marketing" to describe the current milk marketing situation in California.

2. If a Federal Order is offered for California, Farmdale would advocate for the proposal proffered by the Dairy Institute of California, Proposal 2, which brings market-driven and market-clearing minimum values for milk, especially in valuing the whey stream, as a starting point for end-product-based value determinations,
3. Express our concern about the competitive disadvantage we face with the continuation of the preferential treatment enjoyed by Producer-Handlers in the milk pricing scheme.

Disorderly Marketing

The "Manufacturing" classes of milk in California are Classes 2, 3, 4a and 4b. Farmdale's operations have included California Classes 2, 4a and 4b. As such, we are periodically reminded of the "call provisions" within the Stab Plan wherein we would be put on notice that, if milk for the bottle should come into short supply, processors like us would be required to forego expected milk receipts in order to meet the needs of the fluid markets. This is a clear indication that the Stab Plan was designed to assure an orderly supply to California Class 1 utilization. We understand that, unless such a shortage occurs, all is well and orderly with the Stab Plan and the marketing of milk. To use the term "Disorderly Marketing" to apply to any other issues, such as the profitability of individuals or segments of the supply chain, is inappropriate in our view.

We also take exception to the phrase "The California Discount" as described by some producers. While there is clearly a difference between California Class 4b and the Federal Class III milk prices, the differences are explainable and are a significant part of this hearing process. We defer the detailed technical discussion of this issue to the testimony of others but will discuss the impact of inappropriate end-product price setting where the whey stream is concerned in a moment.

The phrase "The California Discount" could just as well been "The Federal Premium". Had that phrase been adopted instead, the tone of this debate might have turned away from raising minimum prices through the regulatory process to raising premiums charged to processors through face-to-face arms-length business negotiation, either through the producers' co-op leadership or directly with individual processors. The practice of adding a premium to the minimum regulated price has always been a tool available to the California dairy industry under the Stab Plan. The use of premiums could have been employed to appropriately recognize the widely varying methods for dealing with the whey stream which results from cheese-making.

The reality is best described by Land-o-Lakes' Vice-President Pete Garbani in his responses to CDFA Hearing Panel member Don Shippelhoute's questions from the June 3, 2015 CDFA hearing. That hearing was called by CDFA Secretary Ross to consider temporary changes to the whey factor in the California Class 4b formula for pricing milk used to make cheese. The relevant portion of that hearing's transcript is attached hereto in Items 1.1 through 1.3. The text is recounted here as:

"MR. SHIPPELHOUTE: You are marketing some of your member milk to proprietary cheese plants, are you not?

MR. GARBANI: Yes.

MR. SHIPPELHOUTE: And are you able to extract premiums above and beyond the class price?

MR. GARBANI: It's funny because when that negotiation happens the conversation usually heads towards, well go to the Department and get it.

MR. SHIPPELHOUTE: So I'll take that as a, no, you are not getting a premium?

MR. GARBANI: No, there – there are premiums but it's not nearly what we think the milk is worth.

MR. SHIPPELHOUTE: And so what keeps you from getting what you think the milk is worth?

MR. GARBANI: Supply and demand."

We applaud Mr. Garbani's courage to tell it like it is: "Supply and demand". To cause a regulatory body to force prices above what can be recovered from the end-products is as disorderly as any other concept under discussion in this proceeding. To tie the value of the whey stream to Dry Whey, or any other product of value, certainly places at fiscal risk all cheese-makers who do not process whey into a product of value.

For example, as a result of CDFA's hearing process, a variable whey factor tied to a product called "Dry Whey" was put into effect in 2003. At that time, we considered the cost of disposal of the whey stream, in the form of RDW, as an additional cost of making cheese and did not segregate the cost component for whey from the cost of fat, SNF and premium in the California Class 4b milk price. Also, the following figures are calculated using the full-absorption cost accounting method, meaning that general, administrative and overhead costs are allocated to the product lines, including RDW, in recognizing the profit or loss of any particular product line. For 2005, we lost $439,000 making cheese, including a $260,000 loss from our waste whey stream sold as RDW. For 2006, we lost $413,000 making cheese. This includes a $142,000 loss from our waste whey stream sold as RDW. In 2007, through August, we lost $347,000 making cheese. This includes a $1,383,000 GAIN from our waste whey stream sold as RDW.

We concluded that the cost of milk for cheese had become greater than our ability to recover that cost in the marketplace. Continuing to pay for the whey in the cheese milk at a price which was based on a product we weren't making, and at a level that was severely negatively impacting the cheese product line, was untenable. Upon the realization of this collapse in the viability of cheese making, we shut our plant down on August 12, 2007. We, along with a number of other smaller cheese-makers, immediately petitioned CDFA for a hearing on an expedited basis to correct this fatal error in the California Class 4b milk pricing formula. Thankfully, CDFA responded on an expedited basis with a call of a hearing that was held on October 10 & 11, 2007 and a hearing decision that was implemented on December 1, 2007. As an aside, we expect that this responsiveness by the COS will be lost with an FMMO; a concern of ours contributing to our reluctance to support the move to an FMMO for California. With cooperation from our supplier co-op and our customer base, we returned our plant to operation on August 19, 2007 and were able to stay afloat for the three month hearing process.

Following the 2007 Hearing Decision, repeated efforts to re-introduce a variable whey factor into the pricing formula finally succeeded on September 1, 2011 with subsequent repeated petitions for further increases. Recognizing that the COS had now been setup to repeat the terrifying situation we had experienced in 2005 through 2007, we had to take a hard look at our options, including going out of the cheese business altogether, and decided to bite the bullet and make the very significant investment in a higher-value whey processing facility. Our WPC-80 processing plant went into full operation in August, 2013. This so-called upgrade to our ability to efficiently eliminate the waste whey stream comes with great risk. The required capital investment, market development, global demand and other factors make this course of action worthy of our retaining any marginal improvements gained by affecting this change. It remains to be seen whether or not we made the right choice.

With the advent of the WPC-80 product line, and in consideration of the enormous capital investment required, we changed our cost accounting practice to including the whey component cost portion of the California Class 4b milk price in the WPC-80 department, rather than leaving it in the cheese milk cost. For the following analysis, we included the whey component cost portion of the California Class 4b price in the cost to process RDW in order to compare apples with apples.

The 18 months ending June 2013 of our RDW operation resulted in a loss of 1.21₵/lb. of cheese produced, a cost which was absorbed by the cheese operation. In the final six months ending June 2013 of the RDW operation, the result was a loss of 2.50₵/lb. of cheese produced. This increase in loss was directly attributable to the ~~to the~~ higher California Class 4b milk price resulting from the increased whey scale implemented on September 1, 2011 in combination with higher market prices for Dry Whey. It was this continued erosion in our ability to recover the costs of RDW that reaffirmed our decision to move to WPC-80.

The 25 months ending August 2015 of our WPC-80 operation resulted in a profit of 0.51₵/lb. of cheese produced; an improvement of 1.72₵/lb. of cheese produced (.0051- -.0121) over the aforementioned 18-month period in the RDW process. The most recent eight months ending August 2015 of the WPC-80 operation however, resulted in a loss of 7.57₵/lb. of cheese produced; an additional loss of 5.07₵/lb. of cheese produced (-.0757 - -.0250) over the similar RDW process' time frame.

The improvement to 0.51₵/lb. of cheese produced falls woefully short of the return on investment, or ROI, necessary to service the debt incurred on making the necessary investment. Further, the continuing price slump in the WPC-80 market strains our ability to service the debt and to remain in the cheese business.

The dramatic downturn in the market prices of WPC-80 in the last eight months, leading to the aforementioned loss of 7.57₵/lb. of cheese produced with our new operation, amplifies our earlier points regarding the risk we have undertaken to stay afloat in the cheese business. The inability of the pricing system to appropriately track the value of WPC-80 markets, or any particular whey disposal method, and translate that into appropriate milk pricing is obvious and not accounted for in the Stab Plan or the FMMO Proposal 1.

In 2007, a variable whey factor nearly ruined the smaller cheese-makers when Dry Whey prices went unexpectedly high. A hearing at that time returned the whey valuation to a reasonable flat rate of $0.25/cwt. However, as the economic model for dairy farming in California has continued to underperform, mostly due to an oversupply of milk into the existing and un-incented-to-expand processing complex, the outcry from the producer community has been reduced to the unwarranted, unjustified, and unproductive focus on the whey valuation in the 4b formula as a means to an end; that end being pure price enhancement.

Mandatory Pooling

We believe that the COS has responded to the needs of the whole dairy industry in a timely and orderly manner. Some of the hearing decisions have fostered growth and prosperity and some have provided significant challenges to our operation.

That said, if the USDA determines that disorderly marketing does, in fact, exist in the COS, then we must advocate in the strongest manner possible for the proposal offered by the Dairy Institute of California. The Co-op ~~Petition~~ Proposal is vastly overreaching in its assertion that mandatory pooling is necessary for the new FMMO. Mr. Garbani's words echo here: "Supply and Demand". To build a guaranteed price level at too high a cost to us, removing any ability to mitigate the costs of clearing the market in times of excess supply, would certainly put our operation at greater risk than we already face with our move into WPC-80.

To our knowledge no other FMMO has mandatory pooling. Rather, there is greater flexibility to find a market-clearing price level in the current FMMOs than would result from the structure requested in the Co-op's Proposal 1 for a FMMO for California.

Proposal 3 – Producer-Handlers

Farmdale is opposed to Proposal 3; the maintenance of a Producer-Handler, or Producer-Distributor, exemption. This is an extremely delicate topic for us as we have long-standing business relationships with some of the Producer-Handlers in the COS. It is, however, yet another peculiarity in the COS, a topic of disharmony within the producer community and a real item of business concern to Farmdale. We appreciate that the Federal Orders have appropriately regulated Producer-Handlers whose markets attain a specified volume, and support such regulation if a federal order is offered for California.

Farmdale is a "proprietary plant", meaning we have no source of milk or cream supply other than that which can be purchased from producers. In other words, we don't own or control any cows.

Sales-below-cost prohibitions exist in the Stab Plan in an attempt to prevent predatory pricing practices in the marketplace. Ostensibly this prohibition leads to orderly marketing and a level playing field among the purveyors of the end-products.

A Producer-Handler is, by definition, a cow-owning group who also manufactures end-products for sale into the marketplace. There is a limited volume of raw product that escapes certain costs relating to the pool and quota for these entities. This limited volume, however, is significant enough to create a competitive advantage at the customer-by-customer level over a proprietary plant which is fully regulated and supporting the pool and quota pricing system.

The raw product, being milk and cream, constitutes 64.7% of the total cost to make our California Class 2, or Federal Class I & II, end-products. A Producer-Handler could allocate that portion of raw product which benefits from preferential exempt quota treatment, segregating that product from its regulated price-based products, and target another's customer with that temporarily cheaper product, creating a predatory-pricing opportunity that escapes sales-below-cost prohibitions. This competitive advantage in favor of a Producer-Handler is a continuing threat to our California Class 2, or Federal Class I & II, operations.

Hypothetically, a Producer-Handler offers a competitive product to an existing customer of ours at a price below our cost to make it. We then would lose that customer to the Producer-Handler because their end-product is significantly cheaper. It then becomes quite a lot of effort to retrieve the customer. We frequently do get the customer back once pricing gets normalized, as it inevitably would. In the meantime, the Producer-Handler could shift its "small-volume" production focus to another customer. We agree that this would be an appropriate strategy if we had the same exemption that is afforded to the Producer-Handler. We don't have that exemption and have to find other measures to retain customers when we compete head-to-head with a Producer-Handler enjoying the exemption.

Where we have no direct evidence that this hypothetical practice occurs, as we do not nor should not have access to the books and records or internal communications of any Producer-Handler organizations, we have experienced circumstances in our market and our customer base which strongly suggest it has occurred and is occurring. It is time for this inappropriate opportunity to be removed from the conversation.

Respectfully submitted,
Farmdale Creamery, Inc.,
Scott Hofferber, CFO

STATE OF CALIFORNIA

DEPARTMENT OF FOOD AND AGRICULTURE

DAIRY MARKETING BRANCH

CONSOLIDATED PUBLIC HEARING TO CONSIDER AMENDMENTS TO THE STABILIZATION AND MARKETING PLANS FOR MARKET MILK FOR THE NORTHERN AND SOUTHERN CALIFORNIA MARKETING AREAS

CALIFORNIA DEPARTMENT OF FOOD & AGRICULTURE

DEPARTMENT AUDITORIUM

1220 N STREET

SACRAMENTO, CALIFORNIA

WEDNESDAY, JUNE 3, 2015

8:00 A.M.

Reported by: Ramona Cota

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ITEM 1.1

federal orders, et cetera. Did you get the figures for this table from, I assume the USDA website?

MR. VANDENBURG: I did.

MR. EASTMAN: Okay.

MR. VANDENBURG: And the gentleman that you see on the bottom, I did talk to him, discussed it with him, and that's where I got the information.

MR. EASTMAN: No, I didn't see that but I do now. Great, thank you.

HEARING OFFICER SUTHER: Thank you for your testimony, Mr. Vandenburg. Do you wish to request to file a post-hearing brief based on Mr. Shippelhoute's questions?

MR. VANDENBURG: Thank you for asking. Yes, I do.

HEARING OFFICER SUTHER: Thank you. Your request will be granted.

MR. VANDENBURG: Thank you.

Mr. Garbani.

Mr. Garbani, will you please state your full name, spell your last name and state your affiliation for the record, please.

MR. GARBANI: My name is Pete Garbani, spelled G-A-R-B-A-N-I, and I am a Vice President with Land O'Lakes, Inc.

Whereupon,

PETE GARBANI

Item 1.2

holdback from some of the value of the cheese operations so that we could, quote, get a return on investment and not have to share it with the pool, so it allows them more opportunity to pay more money for their milk directly and that's who we lose our producers to.

MR. SHIPPELHOUTE: You are marketing some of your member milk to proprietary cheese plants, are you not?

MR. GARBANI: Yes.

MR. SHIPPELHOUTE: And are you able to extract premiums above and beyond the class price?

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MR. GARBANI: No, there -- there are premiums but it's not nearly what we think the milk is worth.

MR. SHIPPELHOUTE: And so what keeps you from getting what you think the milk is worth?

MR. GARBANI: Supply and demand.

MR. SHIPPELHOUTE: A follow-up on prior discussion or testimony and that was suggesting that the co-ops should consider processing some whey and capturing some of that value. Do you folks receive any whey from any plants for any processing?

ITEM 1.3