



BEFORE THE UNITED STATES DEPARTMENT
OF AGRICULTURE
AGRICULTURE 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, October 2015

Testimony of Barry Murphy

Part 1

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on behalf of
BESTWHEY, LLC (Independent Whey & Small Cheese Plant Consultant)

Introduction

My name is Barry Murphy and I have worked in California's dairy industry for the past 25 years, first in the senior management corporate environment and for the past 15 years as a consultant to smaller cheese plants with specialty cheeses and whey handling/disposal needs. My background includes Dairy Science and Business post graduate degrees, technical and operations management, sales and marketing management and green field project development and financing. I live in San Francisco, CA.

Position on Proposals

BESTWHEY, LLC opposes the proposal (Proposal 1) from the three producer cooperatives, California Dairies (CDI), Land 'O Lakes (LOL) and Dairy Farmers of America (DFA), and strongly believes that this (Proposal) will restrict the growth of California's cheese industry and eliminate most small cheese businesses in the state. BESTWHEY, LLC supports the Dairy Institute of California's alternate proposal (Proposal 2) because it provides a more realistic value for whey in the other solids price calculation based on the value of liquid whey sold by cheese plants. The Class III formula used in the cooperatives' proposal assumes that cheese plants receive a dry whey finished product value for their whey stream. Based on my experience, this pricing formula over-

values milk for most cheesemakers in the state because they do not recover that assumed value from their whey operations.

Whey Powder and Whey Protein Concentrate

Of the 57 cheese plants in California, ONE (1) plant manufactures sweet whey powder (Kraft, Tulare), the next three (3) major cheese companies (Leprino, Saputo, Hilmar) process most of the whey solids into products other than the dry sweet whey factor in the Proposal I Class III whey valuation and for which the current markets are weak. Ten (10) other cheese companies process a liquid reverse osmosis (RO) whey or ultra-filtered (UF) whey for sale as liquid to animal feed, to other whey processors, and in four (4) of these plants, as dried whey protein. All 10 of these companies dispose of >85% of whey solids as animal feed at little or no value.

FACTS:

1. 13 of the 57 cheese plants in California can process whey to some degree per most recent CDFA data. (Hearing Exhibit 96)
2. Use of the dry whey powder market value in the Class III pricing formula does not make sense and it assumes that all plants utilize 100% of whey solids producing sweet whey, when in fact ONE (1) plant in the state can achieve this. A handful of additional plants can capture the value from the bulk of the whey solids, while the vast majority have minimal or no recovery of whey solids.

3. RO whey solids are sold in liquid form by 2 plants in the State and achieves 50-70% of the whey powder value minus freight costs. Longer distances separate plants further in California than most other states, and thereby make freight costs a significant issue. For example, the LOL WPC-34 liquid haul from Orland, CA to Kings County, CA is over 300 miles at a cost of \$1,200 per load or \$0.12/lb. solids of WPC-34. The haul from Industry, CA to Tulare, CA is 192 miles at a backhaul cost of \$475 per load or \$0.04-\$0.06/lb. of RO whey solids. Distances between plants and freight costs in California are such that there is no inter-plant movement of raw unconcentrated whey in the entire state when this is commonplace in Wisconsin.
4. Whey Protein Concentrate (WPC-34) liquid solids are sold by 3 plants in the state to dryers at 20-30 cents under (or at 50-70% of) the USDA Central/Western average of the Mostly series, WPC-34, delivered.
5. The smallest cheese companies, representing at least 70% of the 50+ cheese plants in the state have no ability or economies of scale to process whey and actually pay up to \$1.00/cwt. to dispose of whey. I work with a small cheese company now that pays \$250 per load of whey for disposal costs.

Conclusions:

- A. Using the Dairy Institute's proposal to index the other solids value in Class III milk to WPC-34 market value makes more sense than using the dry whey market value since only 1 plant in the state can utilize 100% of whey solids into sweet whey. I understand that the Dairy Institute will be presenting this proposal next

week. The concept of basing the Class III other solids price on the value attainable by cheese plants that sell some form of liquid whey makes sense, and is a better approach than using dry whey prices for representing the value of whey.

- B. Adopting the three cooperatives' proposal will wipe out a substantial portion of the smaller cheese plants and may result in reduced processing levels by the larger cheese plants, since they can move some of their volume to other states.

The cheese business is a tough, small margin business and for the smaller cheese companies without the ability to create value from the whey, it is even tougher. For the smaller plants, even with higher gross margins (value less milk cost) on cheese sales making a profit is a struggle. The relative overhead costs are so high with smaller cheese plants that they don't have the economies of scale to cover the base overhead comfortably.

I have been told that the proposed Class III milk price increase by the cooperatives would have averaged as much as \$1.80/CWT milk at times over the past few years. This would be roughly \$0.18/lb. of cheese value and would likely wipe out a substantial portion of the smaller cheese plants because this \$0.18/lb. would eliminate any potential profitability. California's specialty cheese business competes with products from across the US and some of these cheese businesses must be buying milk outside the federal pool since their cheese pricing does not match federal order Class III milk pricing in some cases.

My understanding is that many of these plants located in federal order areas operate as nonpool plants and can pay for milk based on the market. When milk is in excess, these nonpool plants are able to buy milk below class in order to help the market clear. These below class sales have been noted in USDA's *Dairy Market News*. My understanding is that both California's current system and Proposal 1 do not have the kind of options to buy milk below regulated class prices that exist in federal order areas.

Under the current California regulated system, cooperatives have the ability to assess plant losses back to the farmer members. In other words, if the regulated prices are too high for the plant to operate profitably, the cooperatives can reblend and pay their farmer owners on the basis of what the milk is really worth to the plant. The non-cooperative cheese business milk buyers do not have such an option when the regulated price is set too high. This is clearly inequitable and provides no mechanism to clear milk with respect to cheese plants, which are owned primarily by non-cooperative businesses.

Co-operatives versus Private Cheese Companies

Whey derived products markets' have collapsed in recent months as have the nonfat dry milk powder (NFDM) markets. The private cheese industry cannot assess losses to producers and therefore must absorb these losses.

DFA and Land O'Lakes have one cheese plant each in California. Based on my knowledge, both sell liquid WPC below market to private cheese plant dryers. Why have DFA and LOL not invested in WPC dryers, not to mention lactose or whey permeate handling dryer systems? One likely reason is the tens of millions of dollars required for investment in whey processing. If the three cooperatives proposal is adopted, with its higher regulated price for cheese milk, then both the DFA and LOL cheese plants will lose money or break even at best, based on my knowledge of the kind of operations they have and the normal costs associated with such operations.

Why have the California Dairy Co-operatives sold or closed down their large California cheese plants and not developed their remaining cheese making operations? One has to conclude that it was because they could not profitably operate large cheese plants. Yet now, producers and the cooperatives are proposing an increase that will force cheese plants to pay more for milk, despite the fact that when cooperatives were operating these cheese plants they, in all likelihood, could not operate them at a profit. Their math simply does not work. There is only so much money available with which to pay for a cheese plant, run a cheese making operation, pay dairy farmers for milk, and remain competitive with other cheese suppliers in the marketplace. The cooperatives' proposed Class III formula would simply increase the milk price too much for many cheese plants.

Final Conclusions:

Many of California's smaller cheese plants will be forced out of business should the cooperative's Class III milk pricing proposal be adopted. Several of the cheese plants that I have consulted for over the past several years will be forced out of business. The larger cheese plants may reduce milk use levels as they have the ability to move some cheese production out of state. If a modest percentage of cheese manufacturing is moved out of state or disappears due to plant closure, then this will likely provide for an over-supply of milk in California with no ability to sell below minimum mandated pricing to clear the market. **BESTWHEY supports the concept advanced by the Dairy Institute of California that the Class III other solids price should be based on the value of liquid whey. BESTWHEY opposes the Cooperatives' proposal with its too high (for California) Class III price and mandatory pooling.**