EXHIBIT
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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, November 2015

Testimony of Rob Blaufuss

Part 3

Class I Regulated Price Setting

As I stated in my earlier itestimony, the stated goals of the Agricultural Marketing Agreement Act are to "establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in section 8c(2) (the section which includes milk) as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and price."[i] It is these goals that have guided U.S. dairy policy since the 1930's. It is also why the Federal Order system has been predicated upon Class I. While the U.S. dairy industry has rapidly advanced in the decades that have followed, we continue to rely on depression era realities to shape our milk price regulations. In the past decade alone the U.S. has gone from an exporter of last resort to one where we are exporting approximately 15% of the total solids produced on an annual basis. Given the current market realities and relationships amongst the different value streams of milk, there begs a question – why should Class I milk continue to be treated as a special class of milk compared to all other classes of milk? What is the basis in maintaining Class I differentials and the 'higher-of' provision? The Cooperatives have provided absolutely no rationale as to why the current Federal Order classified pricing architecture should be maintained, especially as it relates to Class I.

The rationale for assigning Class I as the highest value in the pool is largely tied to the historic belief around the inelasticity of demand for fluid milk. Fluid milk has long been thought of as a highly inelastic product. The problem however is that studies conducted on the subject are decades old and have not been updated to reflect current market conditions. Fluid milk is no longer just competing against fruit juices and soda; it is also competing against a wide array of other beverages, a great many of which are made to resemble many of the same nutritional characteristics of fluid milk and used for the same purposes (such as for coffee or used on cereal). I won't sit here today and tell you price is the only issue currently impacting the fluid milk industry, nor will I tell you that fluid milk is a significantly elastic product. What I will say is that Dean strongly refutes the long held belief that some in the industry still share – that the price of fluid milk plays no role in sales. While consumers may not notice when the Class I price ranges from, say, $12-16 per cwt, they certainly do when that price ranges from $15 - $30 per cwt.

In the October 26, 2012 Cheese Market News there was an article that discussed a white paper titled "A Long-Term Turnaround for Fluid Milk: Dairy Industry Must Take a Trustee Approach."[ii] The white paper quoted in the article was not written by Dean Foods nor was it written by the International Dairy Foods Association. It was in-fact a Dairy Management Inc. report with the quotes in the article attributed to DMI's CEO, Tom Gallagher. As stated by Mr. Gallagher, "The problem is clear and the solution is even clearer: Fundamental change in how we handle, price and market the product is needed, and it is needed now." The article later went on to say that, "The problem is that each time this cycle occurs, we see more and more consumers leave the category or buy less milk than they did previously due to price pressures. But some consumers don't resume purchasing when the price drops back down. So over time, we essentially teach consumers that they can live without milk." While the article may be three years old, its reality still holds true today.

The data does not lie on fluid milk demand. Per-capita fluid milk consumption in the U.S. has declined from approximately 29 gallons in 1975 to 19 gallons in 2013.[iii] Maintaining a high Class I price though differentials and the 'higher-of' does nothing to help drive sales. In low Class I utilization markets, such as California and the Upper Midwest, the 'higher-of' provision is more about price enhancement than it is about orderly marketing. Basing Class I off of Class III would occasionally result in price inversions in where Class II and Class IV could be higher than Class I. Tighter pooling standards would help solve the issue but it would also require adequate shipping requirements, an important provision not included in the Cooperative proposal. Most Class I handlers have milk supply contracts that would keep fluid plants supplied during times of inversion. Even if additional money was needed to attract milk to Class I, it could be paid by Class I handlers through increased over-order premiums.

This FMMO promulgation hearing requires more than simply rote recital based at best on 1996 data as to the level of any Class I differential. Especially when the cooperatives propose no performance standards, the basis for any Class I differential in 2015 needs to be proved and the level justified fully.

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[i] Agricultural Marketing Agreement Act of 1937.
http://www.ams.usda.gov/sites/default/files/media/Agricultural_Marketing_Act_of_1937%5B1%5D.pdf

[ii] A Long-Term Turnaround for Fluid Milk: Dairy Industry Must Take a Trustee Approach. Cheese Market News. October 26, 2012. P.17. http://www.cheesemarketnews.com/articlearch/2012/10_26_12.pdf

[iii] USDA-ERS (http://www.ers.usda.gov/data-products/dairy-data.aspx), U.S. Census Bureau and Personal Calculations.