



**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, November 2015

Testimony of Frank Otis

In Support of Proposal 3 of the California Producer-Handlers Association

Proposal to Preserve Exempt Quota with Quota System in Any Federal Milk

Marketing Order for the State of California

My name is Frank Otis, and I am the President and CEO of Foster Dairy. I have brought with me Dennis Lund, Foster Dairy's Director of Cost Accounting, who has been with Foster Dairy for 28 years (and with ~~Knutson~~^{Knudsen} for 12 years). I am here today to testify about Foster Dairy's Producer-Handler operations, and how for nearly 50 years Foster Dairy has participated in the California quota system, which has since its inception in 1967 included a class of quota called "exempt" quota limited to Producer-Handlers. I offer this testimony in support of the Cooperative's proposal number 1 as combined with the California Producer-Handlers Association's proposal number 3.

I joined Foster Dairy in 2012, moving from Philadelphia, Pennsylvania, where I ran a specialty cheese company (Alouette USA) for five years. Prior to that I ~~owned~~^{was a minority owner of} and operated a large butter/powder company with DFA. I have worked in all segments of the dairy business, cheese, ice cream, butter, cultured, and powder over the last 27 years! Boy how time flies when you are in the dairy business. I have a BA from Southern Oregon University and an MBA from the University of Redlands. I have been married to my best friend Ann for 28 years, and we have two wonderful children, Ashley 26 and Ryan 21.

Foster Dairy operates under a d/b/a called Crystal Creamery for its plant side of the business dating back to the 1920s. Our dairy farms are operated under a separate entity called Foster Farms Dairy, which was originally founded in 1941 by Max and Verda Foster. The same family still owns and provides oversight of the business today, which sells branded products under the name of Crystal Creamery and Humboldt Creamery. Today Foster Farms Dairy has five separate farming and milking sites in Hickman, California.

Our administrative offices and five processing facilities are located in Modesto, California, and two other processing facilities in Fernbridge (Humboldt County), California. Crystal Creamery distributes its manufactured dairy products from eight distribution centers covering the Central Valley and Northern California markets. We manufacture and sell fluid milk, cultured sour cream, cottage cheese, ice cream, butter, nonfat dry milk powder, and cream, as well as fruit drinks and water. About 45% of our processed dairy product is Class 1 fluid milk.

Our production plant purchases 15% of our total raw milk supply from our own farms. We purchase approximately 75% from 19 independent producers in California. The remaining 10% we purchase from different milk brokers. Of the 15% that is produced at our farms, approximately 56% is exempt quota. That is, 18% of our total Class 1 production is exempt. That exempt quota does not offer our plant any pricing advantage. The entirety of our exemption benefit is isolated with our dairy farm.

Our entities each have their own profit and loss statements (P&Ls) and they are separate legal entities. Our exempt quota is on our dairy farm's P&L and is calculated as a benefit to our farm. **Our production plant and commercial operations do not receive any benefit from our exempt quota.**

Our creamery (plant) pays all of the independent producers the announced blend price for the milk. All processors ultimately pay the particular plant's "in plant" blend rate through the CDFA pool system to their producers. The amount we pay is based on how we use the milk, calculated through the pool system that is blended and distributed to producers. When our plant (creamery) pays our own farms, we pay the Class 1 rate for the exempt quota volumes that our farm produces and delivers to our plant.

The reason we pay that rate to our farm is because that volume is exempt from the pool system at the Class 1 rate. So we receive a credit from the pool for that Class 1 value that is the exact same as what we pay our farm. Our farms will realize the benefit, and the creamery pays the same rate as if it acquired the milk from any other source. **In sum, our creamery pays the same price regardless of whether we get the raw milk from our farm, from independent producers, or from the milk brokers.**

Foster Farms Dairy has specifically structured its family-owned business in a way that would preserve its exempt quota holdings since the quota system was created in 1967. This family ownership structure includes the investment of hundreds of millions of dollars in capital spending in the dairy farms, processing facilities, and distribution centers, over the last 50 years. In doing so, Foster Dairy established business relationships with thousands of retailers with the goal of promoting and selling dairy offerings to millions of northern California consumers and beyond.

Foster Dairy, under the leadership of Max Foster, was a key participant in the negotiations with the State Legislators, in the establishment of the Pooling Act of 1967. His participation resulted in all California producers securing fairer distributions of the monies that they received for the milk that they farmed. In these negotiations, which resulted in the 1967 Pooling Act, the Producer-Handlers, of which Foster Dairy was the largest, gave away significant advantages as a dairy farming and processing company. In exchange for this support of the 1967 Pooling Act, Foster Farms Dairy was given an initial exempt quota in 1967 based on its Class 1 fluid sales at the time. The exempt quota, even back then, was an asset that was booked for our farm.

Over the decades to follow, Foster Farms Dairy's exempt quota increased with the California Legislators' 1978 amendment. This particular amendment provided all Producer-Handlers the opportunity to convert any regular quota purchased between 1967 and 1977 to exempt quota, in which Foster Farms Dairy participated. With the 1993 amendment, any regular quota purchased from 1978 through 1993 was converted to exempt quota, and the Option 70 Producer-Handlers were able to purchase additional quota until March 1995. Again, Foster Farms Dairy invested further into its exempt quota and continued to maintain the benefit at its farm level. The exempt quota and the regular quota were given to producers to protect from the further dilution of their Class 1 markets.

Foster Farms Dairy has spent several millions of dollars to acquire exempt quota on just the 1993 amendment alone. Since March 1995, there have been no further allowances of additional exempt quota and these exempt quotas remain frozen with the 1995 volume that each Producer-Handler had at that time. Although these "exempt quotas" cannot be sold, they do represent a measurable financial asset to Foster Farms Dairy, which today has a value totaling millions of dollars on the Foster Farms Dairy balance sheet. In addition to the value listed in Foster Farms Dairy's balance sheet, the cost of maintaining exempt quota has been considerable for Foster Farms Dairy, including the additional cost related to forgoing strategic business opportunities in favor of maintaining exempt quota eligibility. Note that the asset is held by our dairy farm side of the business, and all value of the exempt quota is within the dairy farm side as well. Foster Farms Dairy does not own regular quota, it holds all of its producer benefit as ~~exempt~~ ^{exempt} quota.

Like I mentioned, our farm is the entity that receives the exempt quota as an asset that is identified on its balance sheet as a "milk pooling right." The quota is

booked as pounds of solid nonfat, which can be converted to hundredweight. The value of the exempt quota is worth more to my farm than just the booked value, as it is a legislative value that was created to compensate us for the markets that were created when the exempt quota was issued and then through the two subsequent amendments to increase exempt quota.

Exempt quota is a producer benefit. In this hearing, exempt quota holders have been accused of using our exempt quota to disrupt the commercial marketplace by targeting customer bids or somehow undercutting our competitors on price. This has NEVER occurred. We have to be competitive and be very good at what we do, and we do it as efficiently as possible. But we compete on a level playing field. We pay the exact same price to our farm as we pay to other independent producers. Even when the market is really good for our farm's milk prices, we do not use those benefits to cut costs at our plant or the commercial level. And when my farms are losing money, it does not impact how I price my product. They are separate entities.

Dean Foods has "assumed" that we have used a price advantage from exempt quota, but they are wrong. Dean Foods has not suffered at the hand of any exempt quota. Yes, there was one national bid that we won against Dean Foods, but it was not because of exempt quota. We won that bid on a level playing field for our raw cost of milk. We competed on all of the factors that Dean Foods uses for its bid and won fairly. Dean Foods has won more bids against us than we have won against them, and that is proof we do not have any pricing competitive advantage. In 2011 and 2013, Dean Foods won two separate bids against Foster Dairy for a total of 15 million gallons of milk per year. Adding that to the 10 million gallons of ^{milk per} year that they took from Producers Dairy, they have clearly exceeded what they claim we have taken from them. Simply stated, we have lost

more bids to Dean Foods than we have won. There is no advantage for our plant or in bidding on prices to customers. All of the benefits of exempt quota stay with our farm.

Exempt quota has been ingrained in California's quota system since its inception, and, indeed, it was necessary to achieve the consensus that led to the adoption of California's system. Exempt quota has been a win-win for all involved and has played a part in the significant dairy growth that the state of California has enjoyed for decades. It is for these reasons that Foster Dairy and Crystal Creamery believe preservation of the quota system intact and recognition of the value of California quota necessarily include the maintenance of both regular quota and exempt quota.

To be clear, the CPHA supports the Cooperative's proposal. We are not attempting to change or alter the proposed federal order Producer-Handler definition, and we do not oppose creating a Producer-Handler exemption for those that fit within that criteria even though we do not fit within the volume limitations. We are seeking to preserve the treatment of our exempt quota along with the rest of the regular quota that makes up the quota system, and we have proposed to include an "exempt quota" definition to treat us as exempt quota holders and avoid conflict with Producer-Handler definitions in federal orders. While we are proposing language through our federal order language expert, we are flexible in the approach and welcome help from the USDA to craft or modify the language to accomplish our goals as outlined in our testimony.

Thank you for allowing me to testify before you today.