



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 Rob Blaufuss

Part 1

## INTRODUCTION

My name is Rob Blaufuss and I am currently employed by Dean Foods as the Senior Manager of Dairy Risk Management and Economics. My business address is located at 2711 North Haskell Ave, Dallas, Texas, 75204. Dean Foods is the largest fluid milk processor in the U.S., with 67 plants in 32 states. While fluid milk represents the bulk of Dean Foods business we also manufacture ice cream, cultured products, juices and teas. We own and operate three bottling plants located in the state of California; Berkeley Farms, which serves northern California and Alta Dena and Heartland Farms both of which serve southern California. Dean also has one ice cream plant located in Buena Park.

### **Disorderly Marketing, or Lack Thereof**

The Proponents of Proposal 1 spend a great deal of time testifying to the regulated price differences between the California state order and the Federal Orders. However there was minimal data put into the record as to how these price differences have led to inefficient movements of milk both in and out of the state. While differences in regulated prices have the potential to cause disorderly marketing conditions, the mere fact that prices are different does not alone indicate disorderly marketing conditions.

The declared policy goals of the Agricultural Marketing Agreement Act of 1937, the Act which provides for the forming of FMMO's, 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<sup>1</sup>." With these goals in mind, Federal Milk

Marketing Orders have sought to ensure a stable supply of milk to the market. Historically speaking, this has routinely, consistently and only been interpreted to mean milk for fluid purposes.

While milk production in California has experienced year-over-year declines throughout January – September 2015, Dean Foods has not experienced problems in procuring an adequate supply of milk for our manufacturing facilities in the state. Historically we have felt comfortable with the amount of milk available to Class I bottlers as well as with the level of reserve supply which stands ready to meet the needs of Class I handlers. Consumers have experienced no interruptions in their ability to buy fresh, safe and wholesome fluid milk products.

Currently however, we are experiencing a significant milk supply issue. For the past two weeks we have struggled to source an adequate supply of milk for our Southern California facilities. We reached out to all the major Cooperatives in the state, as well as others, and found a limited response to make milk available. The severity of our current issue was such that the idea of asking for enacting the call provision in the state's statute was raised as an option. Thus far we have focused on the commercial options available to us, allowing the market to work. We think others could be having challenges as well, for legal reasons we have not worked to find out what is happening with our competitors. We have been in discussion with CDFSA staff around how this provision would ultimately work. Our current expectation is that our milk supply issue will last at least another two weeks. Should our supply issue not improve in the coming weeks we could still yet file a call petition with the state.

I will admit that a significant portion of our current predicament comes as a result of the rain and subsequent mudslides which impacted the state two weeks ago. Issues will always arise when one is dealing with production agriculture. Things happen, from natural disasters to farm

production issues to consumer trends. An individual Market Administrator has limited tools at their disposal to ensure an adequate supply of fluid milk to Class I handlers, with the main tool being the ability to adjust shipping percentage requirements. In the past Market Administrators have used this provision, a provision that is uniform to all Federal Orders, to adjust the amount of milk supply plants must ship to Class I plants. Dean believes it is critical that Federal Order language provide a Market Administrator the discretion to make changes to shipping percentages without requiring the administrative process of a Federal Order hearing. Changes happen quickly in the dairy industry and responses are needed in like fashion. In failing to include any shipping requirements in their California Federal Order proposal, the proponents of Proposal 1 have eliminated the Market Administrators main tool in the toolbox.

Dean Foods procures, manufactures and sells a significant amount of milk in the state of California. We are actively engaged in the California dairy market. Our milk supply is sourced through both a direct supply and through cooperative suppliers. All milk used in our fluid plants located in the state is sourced from California producers, we do not typically import bulk milk into our plants from out-of-state producers. A significant portion of our milk supply comes from producers located within 100 miles of our bottling plants. At our Alta Dena facility, 54% of our raw milk supply is located within 100 miles of the plant with the remainder of the milk located 250 miles or less from the facility. A map of our Alta Dena milk supplies can be found in Figure 1. At our Berkeley Farms facility, 99% of the milk is sourced from locations within 100 miles from the plant with the remaining 1% located within 250 miles. The sourcing footprint for this facility is highlighted in Figure 2. As for our Heartland Farms facility, 99% of the monthly milk supply comes from sources 250 miles or less from the plant with 1% of the plant's total milk supplies located within 100 miles of the facility. The supply locations for Heartland is provided

in Figure 3. The milk supply geographies in Figures 1-3 was reflective our milk supplies as of June 2015.

We have been given no indication from either our direct shippers or our cooperatives suppliers of instances of chaotic and inefficient movements of milk occurring in California. Significant changes in premiums paid in excess to the regulated classified minimum prices can often be indicative of disorder in a marketing order. Our California Class 1 over-order premiums have remained steady for quite some time. As a manufacturer of Class 1, 2 and 3 products in the state of California, I can tell you that we do not view current milk marketing conditions in California to be disorderly. The conditions as we see them can only be described as orderly.

In his opening statement, Mr. Hollon discussed in detail the regulated price differences between Federal Order Class II and California Class 2 and 3 prices. However, the comparison between FMMO regulated minimum prices for Class II and California Class 2 and 3 is not an apples-to-apples comparison. The cities mentioned as destination points for condensed skim, Denver, Kansas City and Nashville, are all areas regulated by the Federal Order system. What the Proponents of Proposal 1 fail to mention is that current Federal Order language allows all Class II, III and IV plants to de-pool from their respective orders when there are economic incentives to do so. Non-pool plants, per FMMO provisions, are not required to pay the regulated minimum Class prices. The Cooperatives specifically call out September 2014 as a month with a wide disparity of \$2.14<sup>per</sup> hundredweight<sup>ii</sup> between Federal Order regulated minimum Class II prices and California Class 2 prices. Class II plants located in Federal Order 32, the order in which both Denver and Kansas City are located, would have had very little incentive to be in the pool in September 2014. The regulated minimum Class II price in September 2014 was \$26.11 per hundredweight. The FMMO 32 blend price at base zone differential for the month

was \$24.83 per hundredweight. A Class II plant located in Kansas City, MO, which happens to be the base zone location for FO 32, would have chosen to de-pool in an effort to avoid having to pay \$1.28 per hundredweight into the Federal Order 32 Pool. A Class II plant in Denver would also have de-pooled from Order 32 to avoid paying into the pool a location adjusted \$0.73 per hundredweight. A Class II plant in Nashville would be regulated under Federal Order 7. The high Class I utilization in this order ultimately means that Class II plants would nearly always choose to ~~remain~~ pool due to the higher blend prices enjoyed in that area of the country. For the month of September 2014, a Class II facility located in Nashville, TN would have remained in the pool in order to draw from the pool a location adjusted value of \$0.85 per hundredweight. The monthly pool or de-pool decisions for plants in this hypothetical example for January 2014 – September 2015 can be found in Table 1.

Dean purchases a significant amount of bulk condensed skim milk, which is ultimately used in our facilities around the country. While at one time we were sourcing a portion of our condensed skim from California sources we have increasingly moved away from it as transportation costs escalated. It is our experience that bulk spot loads of condensed skim moving from California into the Federal Orders has not disrupted markets to any noticeable degree in recent years as a result of a price gap between CA and FO regulated minimum prices. If the Coops truly felt that there was disorderly marketing occurring in the state and inefficient movements of Class 2 & 3 milk were happening as a result of the state's pricing architecture why in recent years have they only petitioned for hearings on adjusting the Class 4b price? There has been absolutely no attempt to address the issues ostensibly causing disorderly marketing for Class 1, 2, 3 and 4a milk referenced by the proponents of Proposal 1 in their case-in-chief. While

differences in pricing systems have the potential to lead to disorderly marketing, it is not itself indicative of disorderly marketing.

Over the past decade there have been instances where unregulated milk, be it raw or packaged product, moving into California from neighboring states has caused disruptions in the California Class I market. Interstate commerce laws do not allow for California to regulate the milk being moved into the state from neighboring states. Speaking specifically from a Class I stand-point, such movement of milk is able to occur when the out-of state price of milk (typically the local statistical uniform price) is cheaper than the Class 1 price in California. Competitive pressures from both out-of-state bulk milk and packaged fluid milk were significantly reduced by federal statute, CDFA and Federal Order regulation changes which occurred in the mid-to-late 2000's.

In two separate hearings in the mid-2000's CDFA dealt with the disparity between California Class 1 price and uniform prices being paid in neighboring states. At the time, the wide disparity in prices had led to a loss in Class 1 sales for processors that produced, processed and sold California milk. These hearings resulted in a reduction to California Class 1 prices which reduced the economic benefit to import milk into California. Other significant regulatory changes occurred in 2006 when USDA and then the U.S. Congress set limits for entities seeking Producer-Handler status and in 2009 when USDA began fully regulating Producer-Handlers whose Class I route dispositions were in excess <sup>of</sup> 3 million pounds a month, including sales into California. These Federal Order regulation changes impacted a competitor in Arizona who was increasing his California Class I sales. In the years following the Federal Order 124/131 decision and adoption of the Milk Regulatory Equity Act, fluid milk sales moving into California from Arizona declined compared to levels experienced in the early 2000's<sup>iii</sup>. Dean has not seen a

noticeable change in milk import levels in the California market over the past year. While competition for fluid milk sales in the state remains highly competitive, our market intelligence on the California market does not point to any major changes in out-of-state competition which would indicate disorderly marketing. The main source of increased competition for fluid milk sales over the past year has not come from out-of-state plants but rather in-state producer-handlers.

While the proponents of Proposal 1 may try to bury the lead, make no mistake about it, this hearing is occurring because of dissatisfaction over the disparity between the California Class 4b price and the Federal Order Class III price. Producers are focused on increased revenue, and in this case revenue derived from cheese and whey. The Class III price and its relationship to the California Class 4b price however is not in-and of itself ~~definitive~~ <sup>indicative</sup> of disorderly marketing.

The California state order has served both producers and processors well throughout the years. Dean is not of the belief that the state order is so beyond repair as to require the forming of a new Federal Order in California. CDFA has typically been responsive in addressing issues that have arisen which impact the orderly and efficient marketing of milk in the state. When disorderly marketing conditions have occurred, CDFA made appropriate adjustments to regulatory language to address it.

Speaking as a Class I processor, Proposal 1 as it is written makes me exceedingly uneasy about having access to an adequate milk supply long term. As outlined by the evidence I have presented here, I do not share Mr. Hollon's view that, "The FMMO proposed by the cooperatives would not only promote and enhance orderly marketing conditions, but would also address long standing conditions of disorderly marketing."<sup>iv</sup> There are several key requirements that are uniformly found in all other Federal Orders ~~rely on~~ which seek to ensure orderly marketing



conditions. By simply repackaging California regulatory language into a Federal Order, the Coops have failed to account for those FMMO provisions. In order to provide for the orderly marketing of milk in a Federal Order construct, provisions such as shipping percentages and re-pooling restrictions were put in place to ensure that supply plants meet basic performance standards in order to have access to the additional value generated by the market-wide pool and especially the Class I proceeds. A market-wide Federal Order pool sans performance requirements, like the one proponents of Proposal 1 have proposed, could lead to disorderly marketing in California.

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<sup>i</sup> Agricultural Marketing Agreement Act of 1937.

[http://www.ams.usda.gov/sites/default/files/media/Agricultural\\_Marketing\\_Act\\_of\\_1937%5B1%5D.pdf](http://www.ams.usda.gov/sites/default/files/media/Agricultural_Marketing_Act_of_1937%5B1%5D.pdf)

<sup>ii</sup> Testimony of Elvin Hollon (Exhibit 19). P.19

<sup>iii</sup> California Department of Food and Agriculture Class I, 2 and 3 Hearing – October 30, 2008. Analysis for October 15, 2008 Workshop. Background Data: Figure 19.

<sup>iv</sup> Testimony of Elvin Hollon (Exhibit 19). P.2.