California's cheese manufacturers say they are being squeezed out of hundreds of millions of dollars by dairy farmers, and they want the state to change the complex formula used to determine the price they pay for milk.

Cheese makers claim that the current formula, changed four years ago when dairies were struggling with low milk prices, could drive smaller plants out of business because it raises the cost of making cheese in a competitive market where it is hard to recoup the added expense.

But the Golden State's dairy farmers -- who produce 1 out of every 5 glasses of milk drunk in America -- say that any change would lower the price they get for milk and could put their financial health in danger.

"This is your basic fight over who gets the change that's left on the table," said Leslie Butler, a UC Davis agriculture economist and milk pricing expert.

The battle pits two of California's most important food interests against each other. Farmers in the state produced $4.5 billion of milk last year, an amount larger than the total farm output of many states. Cheese makers purchased much of that milk and produced 2.2 billion pounds of cheese, second only to the 2.4 billion pounds made in Wisconsin.

The two groups are fighting over whether cheese makers should continue to reimburse dairies for a portion of the value of whey, a milk protein and cheese manufacturing byproduct used in products as diverse as infant formula, protein drinks and animal feed. This wasn't a big issue until the last year, when international demand sent whey prices soaring, Butler said.

The complaint has caught the attention of the California Department of Food and Agriculture, the agency that regulates milk pricing in the state. The CDFA has scheduled an Oct. 10 hearing to consider changes in the formula.

Under current state rules, cheese producers pay more for their milk any time the U.S. Department of Agriculture monthly average price for dry whey rises above 26.7 cents a pound. As of this week, dry whey cost 48.5 cents a pound, down 6.5 cents from the previous week and far off of its peak of more than 80 cents in May and June.

Farmdale Creamery Inc., a small family-owned producer of cheddar and jack cheese in San Bernardino, has lost $1.2 million over the last year because of the rule, said Nicholas Sibilio, the creamery's vice president.

"The cost of milk is more than what I can sell my cheese and the whey for," Sibilio said.
He said his small business didn't have the millions of dollars needed to invest in
sophisticated whey processing equipment. Larger cheese makers use such equipment to
fully recoup the expense by producing high-quality dry whey prized by world markets.

"I make an animal feed whey that gets a lower price," Sibilio said.

Industry experts said the whey price surge most affected small producers such as
Farmdale that didn't have the capital to invest in whey processing. According to the
industry newsletter Cheese Reporter, of the 62 cheese plants in California, only 11 can
make dry whey. Those 11 plants account for 62% of the cheese produced in the state.

Farmers say the rule is a fair way for them to recoup the full value of their milk. Right
now it works in their favor, but during stretches since the rule was adopted in 2003, whey
prices were below the level where cheese processors had to pay more.

During that period, the farmers were the ones forced to leave money on the table, said
Michael Marsh, chief executive of Western United Dairymen, a Modesto-based trade
association.

"Given the direction of whey prices, we don't think it will be long before the farmers are
paying the cheese processors again," Marsh said.

The elimination of the whey component in pricing would have cost California dairy
farmers $221 million over the last six months, according to the trade group.

A financial hit that large during times of escalating production costs would "force many
more dairy families out of business or out of state," Marsh said.

Although milk production is increasing in California, the state is losing many of its
smaller farms. Marsh said about 120 dairy families have left the business over the last 18
months.

Milk regulation dates to the Depression, when policymakers sought to keep dairy farmers
in business. The government used regulation to make sure that farmers received a fair
price for their milk and to ensure a steady supply of the highly perishable but important
food commodity. Gradual, regulated changes of pricing would give farmers the economic
cues to manage their business. They could increase dairy herds when prices rose or cut
back when prices dipped.

California is one of a handful of states that have opted out of the federal system and
created their own regulations.

However, federal regulations include a similar whey rule, and the price surge has been
felt particularly hard in Wisconsin, which has many more small cheese makers than
California, said Brian Gould, an agricultural economist at the University of Wisconsin-
"Whey has become quite an item in world dairy markets," economist Butler said, and the question of how or even whether farmers should be paid for it will stick around as long as prices remain high.

"We will have a hearing and everyone will argue and the CDFA will decide," he said. "There is no guessing which way it will go."