Milk Producers Council
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DATE: October 26, 2007
TO: DIRECTORS & MEMBERS

FROM: John Kaczor

MPC FRIDAY MARKET UPDATE

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<tr>
<th>CHICAGO MERCANTILE EXCHANGE</th>
<th>CHICAGO AA BUTTER</th>
<th>NON-FAT DRY MILK</th>
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<td>Blocks $1.525  $2.0000</td>
<td>Weekly Change N.C $1.2900</td>
<td>Week Ending 10/19 &amp; 20</td>
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<tr>
<td>Barrels +$.0325  $1.9100</td>
<td>Weekly Average  -$0.0100  $1.2900</td>
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*Weekly Average*

| Blocks +$.0460  $1.9025     | DRY WHEY |
| Barrels +$.0150  $1.8885    | NASS w/e 10/20/07 $.4151   |

| WEST MSTLY AVG w/e 10/25/07 $.4150 |

CHEESE MARKET COMMENTS: An outstanding week. After adding 17 cents per lb in the latter half of this week, block prices are again at the $2.00 level. Barrels also increased. The present differential between the two styles is now an unsustainable 9 cents but should be sorted out in the next week or so. All news related to the cheese market continues to be positive. Sales are steady, and do not yet reflect the expected heavy buying for the holidays, and Monday's much awaited report of cheese in cold storage showed that manufacturers have continued to hold production in line with sales ("the dairy story of the year"). USDA's release of its Outlook on Monday, which predicted higher milk production and lower prices for 2008, appeared to have a brief negative affect on the market, but the report, as usual, did not offer anything that was not obvious and already known. In that respect, regardless of the strength of the current market, it is not reasonable to expect prices to remain at their present prices for extended periods of time.

BUTTER MARKET COMMENTS: Monday's report of butter in cold storage verified what was expected -- there is more than enough butter on hand, and being manufactured, to satisfy demand for all usages for the foreseeable future. It looks like the only reason why butter prices did not drop on the CME this week is because sales are picking up and the current low prices are encouraging an increase in feature activity. The latest word on possible increases in exports is that it was short lived and is not likely to have a significant effect on supply or prices.

NONFAT DRY MILK: Prices last week decreased by a few cents per lb. USDA calls the market unsettled, and reports that some product in the pipeline is keeping newly manufactured product from the market. The price spread in the West's spot market last week widened by about 7 cents, reflecting exactly what USDA described. After a few weeks of strong sales, inventories are again building. New export contracts are being negotiated. Because of the continuing worldwide shortage of nfdm, U.S. sellers are expected to at least maintain whatever gains they have made over the past 15 months. Sales should pick up early next year. Look for prices to continue to hold around the $2.00 per lb level, depending on levels of export prices.

WHEY MARKET COMMENTS: Prices for dry whey continue their bounce off of what is hoped was the low point that was reached several weeks ago. The strong export market continues to be a major factor in helping to support prices at current levels. WPC prices are still on the weak side, but inventories are being cleared to export buyers. Lactose prices continue to be very weak and unsettled, but just why is not clear.

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FRED DOUMA’S PRICE PROJECTIONS...

Oct 26 Final: Quota cwt. $21.06 Overbase cwt. $19.36 Cls. 4a cwt. $21.32 Cls. 4b cwt. $17.65
Last Week  Quota cwt. $21.03 Overbase cwt. $19.33 Cls. 4a cwt. $21.30 Cls. 4b cwt. $17.59

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MORE COMMENTS ON THE CWAP HEARING: (By John Kaczor) Last week, in my report on CDFA's decision to make insignificant changes in the rules for reporting nonfat dry milk sales by California plants (which directly impacts the class 2, 3 and 4a prices), a number of criticisms were leveled at the decision, at the hearing panel, and at some CDFA principals.

Well, it turns out there is at least one other opinion on the issue. Last week’s edition of the Alliance's Weekly Update included this comment:

*This is a sensible decision that leaves our industry positioned to take advantage of world trade. To have limited reporting of CWAP to current (30 day maximum) sales only would have made it impossible to participate in long-term contracts that are the basis of all the large volume export business.*

That opinion expresses the viewpoint of plants that manufacture nonfat dry milk in California. So which viewpoint is right?

The central purpose for the hearing was to determine what should be done to prevent a recurrence of what happened earlier this year because of the use of nfdm sales whose price was set long before the shipment of product occurred. A related issue was to verify the importance of having California's prices and pricing provisions correspond to those in adjacent states and throughout the country.

The arguments made on behalf of manufacturing plants by the Alliance, CDI, and Dairy America for placing no limitations whatsoever on sales reports included the following:

- Large volumes of surplus nonfat dry milk can be sold internationally only with long-term fixed price contracts, and the lead time for negotiating those contracts can be as long as four months;
- There currently are no means available to protect sellers of fixed priced products against the risk of future cost increases, therefore producers must bear that risk;
- If exports of nfdm decrease, a surplus will overwhelm the U.S. market and prices could fall to Support levels;
- Regarding the statutory need for inter-state price alignment, Joe Heffington, CDI's CFO, stated, *"We also disagree with the thought that alignment with NASS reporting is necessarily in California producers' long-term best interest."*

The other side of the argument, presented by four producer organizations, centered on the law which clearly states the need for reasonable economic relationships between California's milk prices and national prices. This testimony included proposals on how the risks and benefits of long-term fixed price contracts can be reasonably shared by producers and manufacturing plants. Even some processors that support substantial change argued that there are practical as well as legal reasons why California's milk prices need to reflect current market conditions and be reasonably related to national prices.

Last week's criticisms were made because they accurately describe the CDFA Dairy Division’s complete lack of participation in this issue from the first they heard of it, through the Spring and Summer, through the hearing, and with their final decision. They did nothing that could be considered to be proactive until hearing petitions were submitted. It was apparent that someone in a position to do so had made a final decision without even bothering to go through the motions of a public hearing. That decision was to leave things alone. As far as CDFA was concerned, there was no problem.

The hearing itself was notable for the few pertinent and follow-up questions that were asked by the hearing panel. The points noted above that were offered as facts by the Dairy America group to support their case for doing nothing were made without a single reference to existing law and the hearing panel failed to ask a single question regarding charges made by MPC, WUD, CDC, and DI that the present system resulted in market conditions that were inconsistent with the law. At no time during the hearing did the panel members explore witnesses' views on the applicability of the standards and how much discretion may properly be used in applying general references over a principal standard.
Particularly noteworthy was the disinterest shown about the unique situation in California where one entity, because of its large market share and no restrictions on its sales reports, has in effect been setting its own raw milk cost for its major product line and in so doing has been affecting the prices for three other Classes of usage. In other words, California producers were being hit twice, and unnecessarily hard, by the low prices charged for exported nfdm while the sales agency’s profits were being shared with plants in other states – where limitations on sales reports do apply.

The hearing panel’s decision completely blew away the single purpose for the hearing -- which was to ensure that the debacle the industry experienced earlier this year will not be repeated. In fact, the "sensible decision" made to change the reporting requirements does nothing but permit a continuation of past practices, provided particular steps are taken by the seller. Here is the panel members' final take on it: they believe the current procedures are in compliance with the Code standards because they were "considered", but "out of an abundance of caution, the Panel strongly believes it is appropriate and reasonable to set some time limit on the duration of long-term fixed price contracts that can be included in the CWAP." Then, it is asked, why didn't they go ahead and actually do it?

Some ideas regarding possible improvements to the process will be outlined next week.

MANAGERS NOTE (By Rob VandenHeuvel): Dairy producers should be outraged by CDFA’s reaction (or lack thereof) to this huge issue for dairy producers. As John Kaczor wrote in previous editions of this newsletter, the California price reporting rules cost California producers more than $185 million from December 2006 – July 2007. These rules are in direct violation of the principal California law that requires our price formulas to result in milk values that are in a "sound and reasonable economic relationship" with national milk values. By making no practical change to the current policy, the Secretary is stating that principal California law is merely an afterthought in CDFA’s decision-making process. With California law viewed as a suggestion rather than a requirement, we nervously await the upcoming decision coming out of the recent class 4a/4b formula hearing.

AN UGLY WEEK FOR SOUTHERN CALIFORNIA DAIRIES (By Rob VandenHeuvel) It was a wild week in Southern California, with out-of-control winds and several fires filling the air with thick smoke. As you all know by now, the dairies did not escape unharmed. At least one dairy had significant fire and smoke damage (including substantial cow and feed losses), and nearly every dairy in the area had some level of wind damage.

Local fire officials are currently assessing the damage to dairies over the past week. They have expressed the importance of fully documenting the damage from the winds and fire (including photographs, when possible). This documentation will be important if and when there is government assistance available.

UPCOMING WDR WORKSHOPS IN CENTRAL VALLEY (By Rob VandenHeuvel) It’s a new week, so time for three more counties to have workshops on the new Waste Discharge Requirements for Central Valley dairies.

- **Kings County** (2 workshops)
  
  UC Cooperative Extension Office, 680 N. Campus Dr., Suite A, Hanford
  
  o Tuesday, Oct. 30, 9:30 am - 12:30 pm and 1:30 pm - 4:30 pm

- **Sacramento County** (1 workshop)
  
  Sacramento Farm Bureau office, 8970 Elk Grove Blvd., Elk Grove
  
  o Wednesday, Oct. 31, 9:30 am - 12:30 pm

- **Stanislaus County** (2 workshops)
  
  Stanislaus County Agricultural Center, corner of Service and Crows Landing Roads, Modesto
  
  o Thursday, Nov. 1, 9:30 am - 12:30 pm and 1:30 pm - 4:30 pm

* And a reminder, **next Saturday, November 3rd, is the deadline for Central Valley dairies to sample their domestic and agricultural wells.** Any MPC members that still need to do this should call Betsy Hunter at (661) 205-6721.

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