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DATE: June 27, 2014
TO: Directors & Members

PAGES: 8
FROM: Rob Vandenheuvel, General Manager

MPC FRIDAY MARKET UPDATE

CHICAGO CHEDDAR CHEESE

Blocks +\$.0200 \$2.0200
Barrels N/C \$2.0100

Weekly Average, Cheddar Cheese

Blocks +\$.0040 \$2.0240
Barrels +\$.0370 \$2.0300

CHICAGO AA BUTTER

Weekly Change +\$.1550 \$2.3900
Weekly Average +\$.1160 \$2.3365

DRY WHEY

Dairy Market News w/e 06/27/14 \$.6575
National Plants w/e 06/21/14 \$.6795

NON-FAT DRY MILK

Week Ending 6/20 & 6/21

Calif. Plants \$1.8256 10,238,432
Nat'l Plants \$1.8731 18,014,931

Prior Week Ending 6/13 & 6/14

Calif. Plants \$1.8407 11,242,285
Nat'l Plants \$1.8624 22,837,013

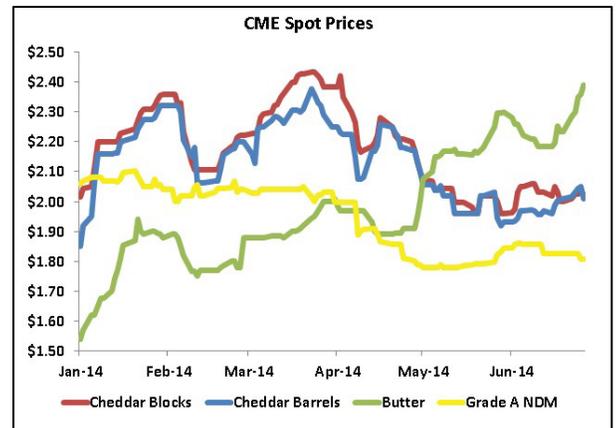
FRED DOUMA'S PRICE PROJECTIONS...

June 27 Final: Quota cwt. \$22.82 Overbase cwt. \$21.13 Cls. 4a cwt. \$23.27 Cls. 4b cwt. \$19.07
Last Week: Quota cwt. \$22.81 Overbase cwt. \$21.12 Cls. 4a cwt. \$23.27 Cls. 4b cwt. \$19.04

MARKET COMMENTARY: (By Sarina Sharp, Daily Dairy Report, sarina@dailydairyreport.com)

Milk & Dairy Markets

The laggard has become the leader. CME spot butter climbed 15.5¢ this week and reached \$2.39/lb., the highest spot price since the all-time high at \$2.81 in September 1998. July through October butter futures settled at their upward trading limit on Friday, adding a nickel. Although the rally was more muted Tuesday through Friday, butter futures continued to gain. Class IV futures also settled higher than last week, but the rise there was dampened by a weakening milk powder market. CME spot nonfat dry milk (NDM) dropped 1.75¢ to \$1.8075. The California Weighted Average Price for NDM lost 1.5¢ this week, while the National Dairy Product Sales Report showed the 30-day average up a penny.

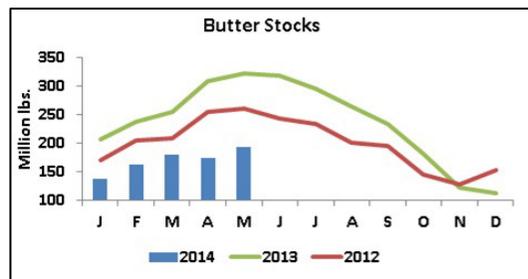


CME spot Cheddar blocks gained 2¢ this week, rising to \$2.02/lb. Cheddar barrels rose early in the week but then retreated and ended at \$2.01, steady with last week. Class III futures were mixed, but contracts in the fourth quarter gained 20 to 40¢.

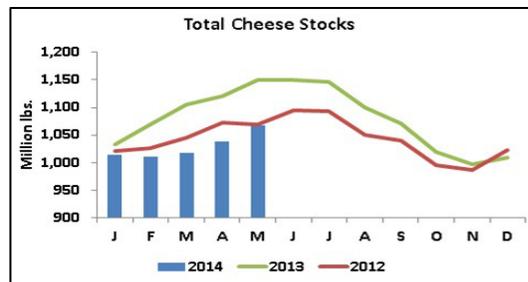
Demand for butter has proven surprisingly resilient to these high prices, and inventories are historically low for this time of year. According to USDA's Cold Storage report, butter stocks totaled 192.5 million lbs. as of May 31. This is 40% lower than last year but 10.6% greater than inventories at the end of April. Although the April to May butter build was larger than anticipated, it was not large enough to halt the butter rally. End users remain concerned that butter supplies could be very tight this fall during the traditional inventory draw-down period.

So far this year, butter manufacturers have added just 80 million lbs. to stocks. This increase in inventories is about half as large as it was in the first five months of 2012 or 2013. Although U.S. butter is no longer the best

value for global buyers, manufacturers are busy honoring export contracts made months ago. Meanwhile, domestic demand remains impressive. *Dairy Market News* reports that manufacturers are already cutting bulk butter into cubes for retail, a practice which erodes bulk supplies and doesn't usually begin this early in the year. Butter churns are now competing with ice cream makers for cream supplies, which has limited churning activity and further curtailed inventory growth.



The booming butter market has created a psychology of scarcity that is likely supporting cheese prices. Although supplies of cheese are adequate, there is a fear that high butter prices will entice milk away from cheese vats. But today there is no shortage of milk available to cheese plants. Cheese stocks totaled 1.07 billion lbs. at the end of last month. This is 2.9% greater than April but 7.2% lower than May 2013 levels.

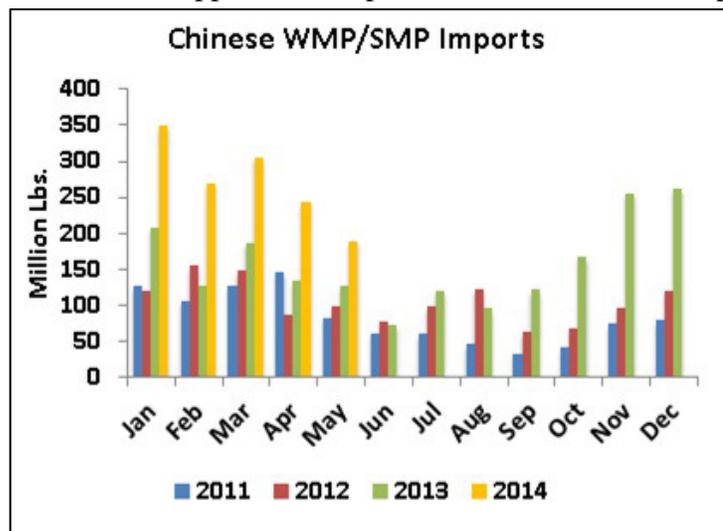


At some point, high prices will do their job, encouraging butter production and discouraging demand. This will eventually lead to lower prices. But for now, the bulls are ruling the butter market. As butter production ramps up, it will leave more skim milk available for driers. Thus, the strength in the butter market is likely to pressure rather than support NDM prices. Even without an uptick in butter production, milk powder inventories are

reportedly building and international demand seems to be waning.

China imported 41.9 million pounds of skim milk powder (SMP) in May. This was 43% more than the year before but it was down 17% from April. Similarly, Chinese imports of whole milk powder (WMP) in May were 27% lower than the previous month but 53% greater than last year. Combined imports of SMP and WMP were 31% lower in April and May on a daily average basis than they were in the first quarter.

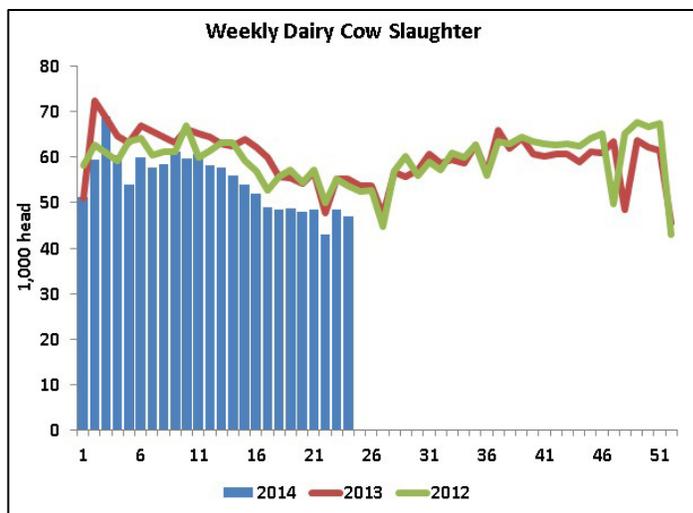
Although data out of China is murky at best, there is a growing consensus that China stockpiled much of the huge volumes of milk powder it has imported over the past seven months. Indeed, some importers are reportedly reselling previously contracted milk powder shipments



to buyers elsewhere rather than allowing them to reach China, where they are not needed.

For the week which ended June 14, dairy cow slaughter totaled 47,090 head. This is 14.8% lower than the same week last year and represents the lowest total in a non-holiday week so far this year. For the year to date, dairy cow slaughter is 10.7% lower than last year.

Live cattle and feeder cattle futures surged to new highs this week. These ascendant markets are helping to prop up dairy revenues as producers can receive ever more for their cull cows and bull calves.



Grain Markets

July corn futures lost a dime this week, and December futures dropped a nickel. The market is trading softly ahead of the quarterly Grain Stocks and Acreage reports, which will be released Monday. The Acreage report

will indicate how much of each major crop farmers were able to plant in contrast to their intentions earlier this spring. It is likely that farmers switched some acreage to soybeans this year.

The Grain Stocks report is notorious for causing large swings in the market. Analysts surveyed ahead of the report estimate that corn inventories on June 1 were much larger than they were in recent years, thanks to last year's record-large corn crop. While there is no shortage of corn, a smaller than expected inventory figure would imply very strong corn demand, which could send the market higher. Otherwise, the market is likely to continue its slide amidst adequate stocks and favorable weather for the growing crop.

July soybean futures gained 16.25¢ this week, while November futures lost a few cents. The Grain Stocks report is expected to show soybean inventories at their lowest level since 1977. Soybean supplies are undeniably tight, but the lack of a frenzy in the cash markets has caused some speculation that USDA may have understated the size of last year's crop. Monday's report should help to clarify just how much soybean users will need to ration between now and the harvest.

CDFA SECRETARY DENIES HEARING REQUEST: *(By Rob Vandenheuvel)* Last week, we reported on a petition submitted to CDFA by California Dairies, Inc. (CDI), asking that the make allowances for both butter and nonfat dry milk be increased in the Class 4a minimum price formula, which as we noted in our article, would have decreased the State's monthly Class 4a price by about \$.23 per hundredweight. Today, CDFA announced that Secretary Karen Ross had denied that request, stating that *"The Secretary does not want to impede the ongoing efforts of the California Dairy Future Task Force in developing potential alternative pricing scenarios that address the issues of our state's antiquated pricing system."*

It is worth noting that while this hearing request was denied, on an unrelated note, there will still be some changes to the formulas for all five classes of milk, due to the expiration of temporary price increases that expire on June 30th. Specifically, starting on July 1st:

- A \$.03/hundredweight temporary price increase will be eliminated on Class 1
- A \$.05/hundredweight temporary price increase will be eliminated on Classes 2 & 3
- A \$.15/hundredweight temporary price increase will be eliminated on Classes 4a & 4b

The total impact of this expiration will be about a \$.12/hundredweight drop in the Overbase price in July, compared to the formula used for the past year.

USDA RELEASES UPDATED Q&A ON A POTENTIAL CALIFORNIA FEDERAL ORDER: *(By Rob Vandenheuvel)* In March of this year, the U.S. Department of Agriculture (USDA) published an initial Q&A document regarding the recent discussions about California petitioning USDA to join the Federal Milk Marketing Order (FMMO) system. Since then, USDA has continued to meet and talk with dairy farmers and industry representatives, and has updated their original Q&A document based on those discussions. Since it's been several months since publishing that original document, I am pasting the entire updated Q&A list below. **If you have any trouble with the website links below, you can find the original Q&A document at: <http://goo.gl/dXWWkE>.**

Questions and Answers on a potential proposal for a California Federal milk marketing order

Dairy Programs has received a number of questions related to a potential proposal for a California Federal milk order. This working document represents current thinking on certain topics and is not intended to present binding department policy. As new details become available related to the proposed Federal milk order in California, answers may be modified.

For additional information, please visit the Dairy Programs Website at <http://www.ams.usda.gov/dairy> or contact a USDA Dairy Marketing Specialist at 202-720-4392.

USDA's statement on transparency can be viewed here: [Statement on Transparency](#)

RULEMAKING PROCESS

1. Who could participate in a hearing on California becoming a Federal milk order?

Federal milk order hearings are open to the public, including those from other regions. Anyone can participate. Individuals testifying at the hearing are subject to cross examination. Anyone attending a hearing can cross examine witnesses. A USDA appointed Administrative Law Judge oversees the hearing proceeding to maintain a fair and orderly process.

The Notice of Hearing defines the scope of the hearing and what topics and proposals will be considered. Hearing participants may only provide information relevant to the scope of the hearing.

Please see: [Federal Milk Marketing Orders](#)

2. I heard that a Federal milk order hearing can take a long time.

Federal milk order hearings can be lengthy because any interested party can testify and anyone can cross-examine witnesses. Administrative Law Judges preside over the hearings to help them run fairly and efficiently.

When deciding whether a new milk order should be established or whether an existing order should be changed, the USDA must rely on the “hearing record.” This means that decisions can only be based on what is said at the hearing, data presented at the hearing in the form of “exhibits”, officially noticed documents, and “briefs” submitted after the close of the hearing. For these reasons, it is very important to get as much relevant data and testimony as possible into the hearing record. This can be time consuming, but ensures a fair and complete process.

3. What is a “hearing record” and how does the Secretary use it to make decisions?

A hearing record includes hearing testimony, evidence presented at the hearing, post-hearing briefs, public comments in response to a recommended decision, and documents that the government takes official notice of such as previous formal rulemaking proceedings. The Secretary may only rely on what is in the hearing record as a basis for decisions on proposed orders or amendments to orders.

4. How long would it take to implement a new Federal order for California?

Changing from a State-operated program to a Federal order would be a significant shift. While there are similarities between the State and Federal systems, sufficient time would need to be provided for an orderly transition. USDA would work with the industry and the California Department of Food and Agriculture to ensure timely implementation.

5. How does a producer referendum operate in the Federal milk order program?

Establishing a new Federal milk order or changing an existing order must be approved by dairy farmers through a voting process called a referendum. Of those participating in a referendum, either two-thirds of the dairy farmers voting or producers representing two-thirds of the milk that would have been pooled during a designated month must approve the issuance of a new Federal order or an amendment to an existing order. Please refer to [7 CFR §§ 900.300-311](#).

6. Who will be allowed to participate in a California producer referendum?

Any farmer marketing milk and associated with the proposed order during a selected representative month (typically the month the hearing is held) would be allowed to vote in a referendum. Each dairy farmer gets one vote, even if they belong to more than one cooperative or own more than one farm. Please refer to [7 CFR §§ 900.300-311](#).

7. If my cooperative decides to bloc vote, can I still request my own individual ballot?

No, Federal milk orders do not allow for modified bloc voting. Therefore, if a cooperative decides to bloc

vote, individual ballots will not be mailed to its members. However, a cooperative has the option to not bloc vote and request ballots be sent to all its members.

8. How are Federal milk order provisions, including pricing formulas, amended?

Procedures for amending a Federal order can be found here: [Federal order rulemaking brochure](#)

9. Who determines whether or not a proposed Federal order hearing is held?

The USDA determines whether a Federal order hearing will be held. Please refer to [7 CFR §§ 900.3](#)

10. If California dairy farmers vote not to adopt a proposed California Federal milk order, could they still propose a California Federal order in the future?

Yes.

PROVISIONS

11. Would a California order automatically adopt the current Federal milk order price formulas?

Currently, Federal milk order pricing formulas are identical in all Federal orders. For a California Federal order, an interested party could propose an alternative milk pricing scheme. Proponents of whatever pricing scheme is proposed must submit economic justification into the hearing record in support of its adoption.

Currently, six Federal milk orders operate under a multiple component pricing system, while four orders operate under a skim and fat only system.

12. What are the differences between the FMMO price formulas and the current California price formulas?

Current Federal milk marketing order price formulas can be viewed here: [FMMO Price Formulas](#)

Current California State milk order price formulas can be viewed here: [California Price Formulas](#)

13. How will milk be priced under a California Federal order?

The way milk would be priced in a California Federal order depends on what is proposed and what evidence is introduced into the hearing record.

Currently, Class II, III and IV milk is priced identically in all Federal orders and is determined through price formulas that factor in AMS surveyed wholesale prices of commodity cheese, butter, nonfat dry milk and dry whey. Class I milk is priced at the higher of either the Class III or IV price, plus the county specific Class I differential of the plant of first receipt.

Current Federal order price formulas can be found here: [Federal Order Price Formulas](#)

14. Will there be lower manufacturing milk prices to reflect the large volume of processing for the export market done in California?

Whether or not manufacturing prices in a California order reflect prices received for product manufactured specifically for the export market depends on what is proposed and what evidence is introduced into the hearing record.

Current Federal order price formulas use AMS surveyed prices for commodities meeting certain specifications. Exported products are not specifically excluded from the AMS survey.

15. Will the Class I differentials in a California Federal order be different than what is currently in place?

California Class I differentials will be determined based on what is proposed and what evidence is introduced into the hearing record.

16. Will California fluid milk fortification standards still exist if California joins the Federal order system?

California fluid milk fortification standards are based on California state regulations that are different from the regulations authorizing the milk pooling and marketing plans. Federal law prohibits any changes to the California solids standard (see, [7 USC 7254](#)). Adoption of a Federal order cannot change the state standards.

Federal milk orders price nonfat solids used to fortify fluid milk slightly different than the current California state order. In Federal orders, fluid milk bottlers are required to account to the pool for any increase in total milk pounds resulting from fortification and they do not receive any kind of fortification credits.

17. Can a Federal milk order require a handler to participate in an order?

Currently, Federal milk orders require fluid milk bottlers to participate in the pool every month. Non-fluid handlers have the option of participating in the pool each month. When non-fluid handlers previously participating in the marketwide pool elect to not pool milk, it is described as “de-pooling.” Some Federal orders have pooling provisions that deter de-pooling by restricting the volume of milk that can be re-pooled after leaving.

18. What is a pool plant? If I don’t ship to a pool plant will I still get my quota price?

Federal milk orders specify the criteria that determine how producers, producer milk and milk handlers are able to participate in the marketwide pool. Marketwide pooling is how dairy farmers share in the benefits arising from classified pricing of milk.

A pool plant is a plant qualified to participate in a Federal milk order marketwide pool. Standards for plants to be considered pool plants vary by order. A pool plant contributes to or draws from the marketwide pool depending on how it uses the producer milk received. A producer qualifies to participate in the pool by delivering milk to a pool plant. The specific producer standards for delivering milk to a pool plant vary by order.

The quota payment for milk delivered to pool and/or nonpool plants will depend on what is contained in the proposal and what evidence is introduced into the hearing record.

19. What is de-pooling?

“De-pooling” is when milk normally associated with a market is not pooled during a particular month. Currently in all Federal orders only Class I milk is required to be pooled. Handlers may opt to not pool Class II, III or IV milk when manufacturing class-use values are higher than the uniform price. A handler that de-pools milk does not contribute into the marketwide pool and retains the higher valued manufacturing class use-value. Federal orders do not enforce minimum blend price payments for milk not pooled on the order.

When the uniform price rises above the manufacturing class use-value of milk, the same handler may opt to “re-pool” their milk receipts and draw from the pool to pay their producer suppliers. The ability of manufacturing handlers and cooperatives to engage in the unlimited de-pooling and re-pooling of manufacturing milk has been found to be inequitable to both producers and handlers in certain situations based on rulemaking proceedings.

Generally, it is the reporting handler or cooperative, not the individual producer making the de-pooling and re-pooling decision.

To limit de-pooling, certain orders have adopted re-pooling standards based on rulemaking proceedings. These standards limit the volume of milk a handler or cooperative may pool during a month based on the volume of milk pooled the prior month. For example, a handler may only pool 120 percent of the volume

of milk it pooled during the prior month. Re-pooling standards vary by order.

20. Does the Agricultural Marketing Agreement Act of 1937 (AMAA) allow for the “mandatory” pooling of manufacturing class milk (Class II, III and IV) under a Federal order?

The AMAA does not expressly prohibit mandatory pooling of all classes of milk.

21. How would the California quota program operate in a Federal order?

The California quota program would operate in a Federal order based on the proposal that is submitted to USDA and the evidence introduced into the hearing record.

22. Will the current transportation credit system in California remain?

Whether or not there is a similar transportation credit system adopted in a Federal order depends on the proposal and evidence introduced into the hearing record.

23. Do any Federal orders have only 2 classes of milk?

No. Currently all Federal orders recognize 4 classes of milk.

OTHER

24. What is in the 2014 Farm Bill regarding California becoming a Federal milk order? Would there be one California marketing order? Or two, a Northern and Southern California order?

The 2014 Farm Bill (section 1410(d)) references the 1996 Farm Bill (section 143(2)), “Upon the petition and approval of California dairy producers in the manner provided in section 8c of the Agricultural Adjustment Act (7 U.S.C. 608c), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, the Secretary shall designate the State of California as a separate Federal milk marketing order. The order covering California shall have the right to reblend and distribute order receipts to recognize quota value.”

25. Will I make more money if California adopts a Federal order?

This is not known at this time. If a proposal is submitted, USDA intends to conduct an economic impact analysis to simulate and estimate comparisons between the current system and the proposed Federal order.

Federal milk orders are not an income enhancement tool. They are a combination of marketing tools that, among other things, provide a regulated minimum price that dairy farmers must be paid for pooled milk.

26. Are Federal milk orders designed to enhance producer income?

Federal milk orders are marketing tools designed to provide orderly marketing conditions for milk and dairy products. Through marketwide pooling and classified pricing, dairy farmers whose milk participates in the program are paid a minimum uniform price reflective of the market prices for cheese, butter, nonfat dry milk and dry whey. Federal orders also ensure accurate milk weighing and testing, provide market data and news, verify milk use reporting by milk bottlers and dairy product manufacturers, and ensure timely payments.

27. How did the quota plan function in Oregon?

Prior to 1970, the State of Oregon operated a quota plan for Oregon producers. During the rulemaking process to establish the Oregon-Washington Federal order, producers requested authority for the State of Oregon to operate a voluntary quota plan for producers located in Oregon. The State-managed program operated concurrently with the Oregon-Washington Federal milk order which included a separate base/excess plan. Each month, the Oregon-Washington Federal milk order would transfer the Oregon proceeds from the milk pooling process to the State of Oregon. The State then redistributed available money through the Oregon Quota/Base price plan.

28. Did de-pooling lead to the demise of the Oregon quota plan?

It was not de-pooling, but the pooling of a lot more milk on the order, that was not from producers participating in the voluntary Oregon quota plan, that fueled its demise. Over time, this led to a decline in the total percentage of milk pooled as Class I, and a decline in the total dollars available to the producer settlement fund. Producers realized that they could enjoy higher returns from the Federal order blend base-excess price compared to participating in the Oregon Quota/Base price program. By 1987, less than one third of Oregon's dairy industry participated in the State's voluntary program and it was abolished.

29. How does the Virginia quota program operate?

The State of Virginia operates a base plan. A dairy farmer does not have to be a resident of Virginia to own quota, and most of the quota is owned by cooperatives.

Please refer to the State of Virginia website here: <http://www.vdacs.virginia.gov/smc/>

30. Are California farmers paying for USDA travel and outreach for an anticipated hearing?

No, California dairy farmers are not paying for the expenses associated with pre-hearing and hearing activities related to establishing an order for California. The only expenses incurred by the California dairy industry are those related to personal involvement in attending and having representation at the pre-hearing and hearing activities. Usually, Federal milk order amendment hearings are paid for by the specific milk order to which the proposed change in order provisions applies. For a promulgation hearing for a new order, the entire cost is borne by USDA. If a California Federal order is established, the cost for maintaining the program will be funded through an assessment on pooled handlers.

31. If we don't like how a California Federal order is operating, can we return to the State marketing order regulations?

At any time, producers can petition the Department to dissolve an order. Such proposed action would need to be voted on by producers. Whether or not producers could return to the California state marketing order regulations would be determined by the California Department of Food and Agriculture.

32. Will a California Federal order impact the commodity prices of forages and feed inputs?

The Department cannot speculate as to any potential impact on commodity prices of forages and feed inputs.

33. Will transitioning from the CDFA 4A/B price to the Federal order Class III/IV price impact risk management strategies that are currently in place? Will this impact the new margin insurance program?

The Department cannot speculate as to any potential impact on current risk management strategies or the Dairy Margin Protection Program.

34. Who would administer a California Federal order?

The administration of a California Federal order would be determined by the Department once an order has been proposed and approved by California producers. Federal orders are currently administered by a Market Administrator appointed by the Secretary of Agriculture.