



# Milk Producers Council

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DATE: September 13, 2013

TO: Directors & Members

PAGES: 8

FROM: Rob Vandenheuvel, General Manager

## MPC FRIDAY MARKET UPDATE

### CHICAGO CHEDDAR CHEESE

Blocks	+\$ .0300	\$1.8400
Barrels	+\$ .0125	\$1.8125

### Weekly Average, Cheddar Cheese

Blocks	+\$ .0406	\$1.8300
Barrels	+\$ .0294	\$1.8075

### CHICAGO AA BUTTER

Weekly Change	+\$ .1000	\$1.5300
Weekly Average	+\$ .0512	\$1.4800

### DRY WHEY

Dairy Market News	w/e 09/13/13	\$5.5650
National Plants	w/e 09/07/13	\$5.782

### NON-FAT DRY MILK

#### Week Ending 9/6 & 9/7

Calif. Plants	\$1.7770	7,198,613
Nat'l Plants	\$1.7950	12,299,833

#### Prior Week Ending 8/30 & 8/31

Calif. Plants	\$1.7594	6,510,667
Nat'l Plants	\$1.7839	17,425,627

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## FRED DOUMA'S PRICE PROJECTIONS...

Sept 13 Est:	Quota cwt. \$19.46	Overbase cwt. \$17.76	Cls. 4a cwt. \$19.26	Cls. 4b cwt. \$16.83
Last Week:	Quota cwt. \$19.27	Overbase cwt. \$17.58	Cls. 4a cwt. \$18.89	Cls. 4b cwt. \$16.67

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

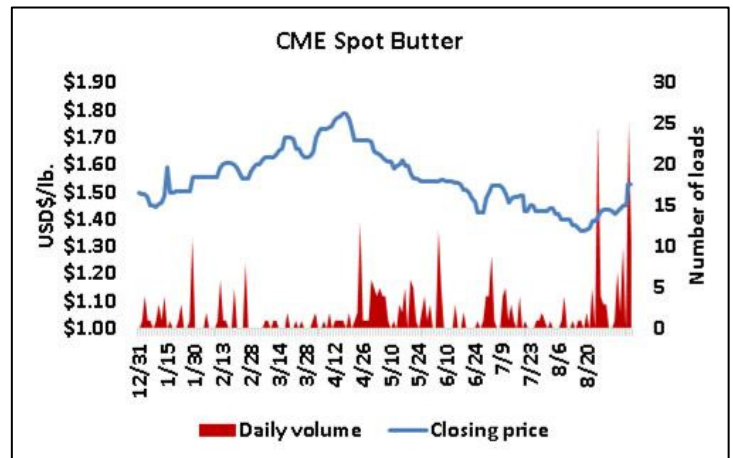
### Milk & Dairy Markets

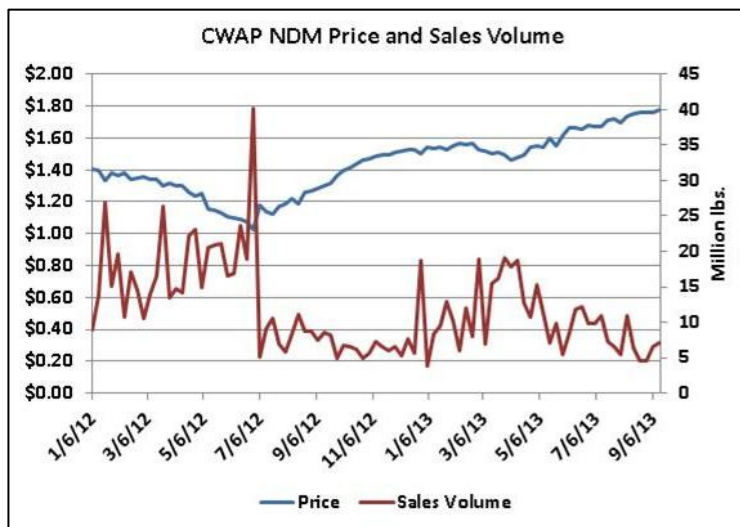
After a months' long slump, the butter market has found its footing. Processors report firm demand from both domestic and foreign buyers. Orders will likely accelerate as the holiday season approaches. CME spot butter added a dime this week to close at \$1.53/lb., the highest level in nearly three months. Volume was impressive, with a total of 47 loads changing hands. Most of the work was done on Thursday, when prices jumped 8¢ and 25 loads traded.

Butter futures were sharply higher and nonfat dry milk (NDM) prices also climbed. Class IV futures contracts in the fourth quarter posted an average weekly gain of 61¢. October and November both settled above the closely watched \$20 mark. 2014 contracts were also notably higher.

Bids were not as thick and fast in the cheese market, but prices climbed nonetheless. Blocks added 3¢ and barrels closed at \$1.8125/lb., their highest level since November 2012. Class III futures gained between 12 and 41¢ in 2013, but 2014 settlements were steady to a little lower than last week. Class IV contracts hold a \$2.19/cwt. premium to Class III in the fourth quarter. California producers will continue to benefit from this spread. It is a boon that their competitors in the traditional cheese states do not enjoy.

Milk powder prices continued to move higher. Prices reported by the National Dairy Product Sales Report and *Dairy Market News* were both higher than the previous week. The California Weighted Average Price for NDM





reached \$1.777/lb., up 1.76¢ from the week before. This was the highest average price since December 2007. Sales volume increased, as export demand remains firm.

Weeks of above normal temperatures have crimped milk production in most of the country. Producers in southern California and Arizona have further struggled with heavy rains. The drop in production has helped to put a bid under dairy product markets over the past few weeks, and cream multiples have climbed. But it is beginning to feel like fall in the Corn Belt, and the hot weather premium may begin to fade.

*Dairy Market News* reported only slight changes in international dairy product prices. Milk powder prices in Europe were mixed, while butter and Cheddar held steady. Butter, whole milk powder and whey prices in Oceania lost a little ground. Prices for all products remain well above U.S. prices, meaning that there is room for more rallies in domestic dairy product prices, even if prices overseas show no inclination to move higher. U.S. dairy product exports will continue to boom until this price gap narrows.

Cooperatives in Europe and Oceania continue to increase their milk price forecasts, hinting that they expect dairy product prices to remain at historically high levels well into next year. These lofty payouts will doubtless encourage production. Fonterra reported that the season is off to a robust start, with June through August milk collections up 5% from a year ago. Rains have fallen regularly, and the grass is greener in New Zealand.

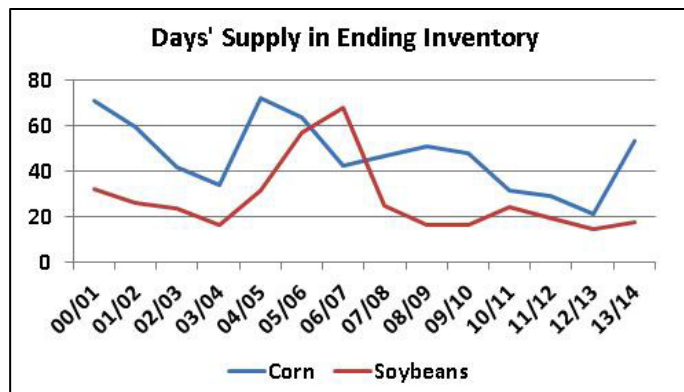
Weekly dairy cow slaughter totaled 62,645 head, the largest weekly slaughter since April. Slaughter was particularly strong in Region 9, which includes California and Arizona, and Region 10, which covers Oregon, Washington and Idaho. Year to date slaughter is 2.5% higher than a year ago.

### Grain and Hay Markets

December corn futures trimmed nearly a dime this week in the wake of the bearish World Agricultural Supply and Demand Estimates and Crop Production reports. USDA surprised the market by increasing its estimate of the national average corn yield to 155.3 bushels per acre, up from 154.4 bushels per acre in August. Hot dry weather over the past month was surely detrimental to the corn crop. However, analysts who surveyed crop conditions ahead of the previous Crop Production report felt that USDA's estimate of corn yields before the dry spell was too low, and it seems that USDA has conceded the point.

USDA made no changes to its forecast of corn or soybean acreage, although it may trim those estimates in the future. This year's corn crop is expected tot total 13.84 billion bushels. A record large corn crop is all but assured despite yields that have fallen below trend-line. This suggests that grain could be abundant – and cheaper – in the years to come even if corn acreage declines.

Grain is finally getting cheaper in California. The basis in Central California has fallen, and the shift from September to December corn futures allowed for a drop of nearly \$50/ton in the past two weeks. Alfalfa prices remain stubbornly high, and soybean meal is still a strain on the budget. Soybean meal prices increased by \$14/ton this week in Chicago. As expected, USDA lowered its estimate of soybean yields to 41.2 bushels per acre, down from 42.6 bushels per acre on the August report. The decline in production was greater than USDA's downward revisions



to 2013-14 soybean crushing and export demand, and ending stocks are now forecast at 150 million bushels. This is only slightly higher than the minimal supplies remaining for the 2012-13 season, and it represent just 17 days' usage.

Fortunately, canola and other oilseeds are plentiful, and they provide a ready substitute for many soybean meal users. It may be more difficult for soybean meal prices to rally from their current levels as grain prices continue to weaken. The market is sending a clear signal to end users to ration demand, and South American farmers are encouraged to plant more soybeans and less corn.

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**COOPERATIVE MEETINGS SCHEDULED FOR NEXT WEEK TO DISCUSS RESULTS OF THE CALIFORNIA FEDERAL ORDER STUDY:** *(By Rob Vandenheuvel)* If you're a member of California Dairies Inc. (CDI), Dairy Farmers of America (DFA) or Land O'Lakes (LOL), you've probably seen the announcement on the upcoming "California Federal Order" meetings for cooperative members. But just in case you hadn't, the meetings are scheduled for:

- **Wednesday, September 18th, 10 a.m.** *(Eagles Hall, 6381 County Road 200, Orland)*
- **Thursday, September 19th, 9 a.m.** *(Stanislaus Ag Center, 3800 Cornucopia Way, Modesto)*
- **Thursday, September 19th, 3 p.m.** *(International Agri Center, 4500 S. Laspina, Tulare)*
- **Friday, September 20th, 10 a.m.** *(Chino Fairgrounds, 5410 Edison Avenue, Chino)*

At the meetings, cooperative staff are expected to go over the results of the economic analysis done earlier this year by Drs. Mark Stephenson (University of Wisconsin-Madison) and Chuck Nicholson (Penn State). A press release regarding the results of that study can be found at: <http://goo.gl/AEzU2i>. Since that study was paid for by the members of CDI, DFA and LOL, **only members of those cooperatives may attend the meetings next week.**

For those of us who aren't a member of those cooperatives, rest assured that there will be opportunities for education and input in the future. The process of considering a California Federal Order is lengthy, and includes drafting proposed Order language, submitting it as a petition to USDA, holding a hearing, and ultimately voting on the USDA-approved Order. While it is critically important that the cooperative members attend these meetings, this is certainly not the end of the process, but rather the beginning.

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**NOTIFICATION REQUIREMENT FOR OBAMACARE:** *(By Rob Vandenheuvel)* On October 1, 2013, the "Health Insurance Marketplace" – formerly referred to as the "Health Insurance Exchange" – will be launching. This "Marketplace" is aimed at providing individuals an opportunity to purchase a health insurance policy that is eligible for federal subsidies. This is all part of the Obamacare package that was signed into law in 2010.

While much of the law's requirements apply to businesses with 50 or more employees, there is a "Notification" requirement that applies to all businesses that receive at least \$500,000 a year in revenue (not profit). The reason for the notification is to let your employees know about the "Health Insurance Marketplace."

All current employees must receive notice about this by October 1<sup>st</sup>, and all new hires need to receive notice within 14 days of hiring. While this notification has not been talked about much in agriculture, dairy farms are required to participate.

The Department of Labor has provided "model notifications" in both English and Spanish. You can use these documents as your notification. Your obligation is to make a copy of these forms available to each of your employees. However you choose to provide it is your choice (hand it to them at work, include it with their next pay check, mail it individually, email it, fax it, etc.).

There are two different forms – one for employers who already provide health insurance to one or more of their employees, and another form for employers who do not.

- Form for employers who provide insurance for one or more of their employees:
  - <http://www.dol.gov/ebsa/pdf/FLSAwithplans.pdf> (English)
  - <http://www.dol.gov/ebsa/pdf/FLSAwithplanssp.pdf> (Spanish)
- Form for employers who do NOT provide insurance for any employees:
  - <http://www.dol.gov/ebsa/pdf/FLSAwithoutplans.pdf> (English) or
  - <http://www.dol.gov/ebsa/pdf/FLSAwithoutplanssp.pdf> (Spanish)

**IMPORTANT NOTE:** *“Part A” of the documents is the “notification” that is required by law. “Part B” is optional, so it is your decision whether or not to fill out and distribute this portion when you give the notice to your employees.*

There is a penalty outlined in law of \$100 per day per employee for a failure to provide this notification. So it is recommended that all dairies take the steps to provide this notification to your employees. MPC members with any questions on this should contact Rob, Kevin or Betsy or call the MPC office at (909) 628-6018.

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**CDFA CONDUCTS HEARING ON CLASS 4B PRICE; BIZARRE TESTIMONY FROM STATE’S PROCESSORS:** *(By Rob Vandenheuvel)* Yesterday, the California Department of Food and Agriculture (CDFA) conducted their scheduled hearing to consider a proposal to raise the Class 4b price by approximately \$0.68 per hundredweight, given current market prices for dairy products. Most of the increase was proposed as a temporary measure, expiring after one year.

As we’ve written in previous issues of this newsletter, this proposal – which is significant less than what dairy farmers have been advocating for in recent years – was based on a written offer by the Dairy Institute of California (on behalf of the State’s cheese manufacturers) outlining this exact proposal (their July 8, 2013 letter to Assemblyman Richard Pan is at: <http://www.milkproducers.org/070813dairyinstitute.pdf>).

So it all sounds fairly straight-forward, right? One of those rare hearings where the producers and processors agree? Guess again. While producer groups and cooperatives testified in support of the proposal (despite the significant concession it represented), processors and their representatives testified one-after-another in strong opposition to the proposal, even going so far as to claim that there was never an agreement or that “they heard that producers had walked away from an agreement.”

Fortunately for producers (and unfortunately for the Dairy Institute), we had a paper trail (the July 8<sup>th</sup> letter) and eyewitness accounts from California Legislators. Seven members of the California Assembly and Senate took the time to come and testify at the hearing.

- Senator Cathleen Galgiani (D-Stockton, Chair of Senate Agriculture Committee)
- Senator Anthony Cannella (R-Merced, Vice-Chair of Senate Agriculture Committee)
- Senator Tom Berryhill (R-Modesto, Member of the Senate Agriculture Committee)
- Senator Ed Hernandez (D-Covina)
- Assemblywoman Kristin Olsen (R-Oakdale, Vice-Chair of Assembly Agriculture Committee)
- Assemblyman Adam Gray (D-Merced)
- Assemblyman Richard Pan (D-Lodi)

MPC greatly appreciates the support of these Legislators. While all their testimony was helpful, Senator Galgiani’s testimony was particularly strong, as she serves as Chair of the Senate Ag Committee and presided over the July 11<sup>th</sup> hearing where both producers and processors supported this agreement.

MPC joined our fellow dairy farmer groups and cooperatives in providing CDFA with the factual, economic and legal testimony to support the proposal being considered. I've included MPC's testimony below. We certainly hope that the Secretary will honor this agreement and implement the proposal as soon as possible. CDFA is expected to announce the results of this hearing by mid-October, in time to implement any changes by November 1<sup>st</sup>.

### **CDFA Hearing Testimony**

September 12, 2013

*Testimony of Rob Vandenheuvel, General Manager, Milk Producers Council*

Before going into the issues before us in this hearing, it's important to remember one of the reasons why CDFA is even involved in the business of establishing minimum milk prices. As stated in California law, one specific purpose is to:

*"Enable the dairy industry, with the aid of the state, to develop and maintain satisfactory marketing conditions, bring about and maintain a reasonable amount of stability and prosperity in the production of market milk, and provide a means for carrying on essential educational activities." (Section 61805(d))*

Obviously, we are here today because among other things, that particular goal is not being achieved.

As for the details of this particular hearing, MPC's Board of Directors expresses its strong support for the proposal before the panel today. While the proposal certainly represents a significant concession on the part of California's dairy families – when compared to the pricing reform we have been seeking in recent years – it is nonetheless an important modification to our Class 4b formula.

This is certainly not the first hearing on Class 4b prices or on temporary price relief, and since all the testimony from previous hearings is already submitted into the record by reference, and in order to keep today's testimony focused, let me go through the specific items outlined by the Notice of Hearing published by CDFA staff.

**The Notice of Hearing requests that witnesses address, at a minimum, "economic conditions that have changed that would warrant adjustments to the current temporary price established as a result of the May 20, 2013 hearing."**

At the time of the May 20, 2013 hearing, the most recent publicly-available data from CDFA on the cost of producing milk in California was from the fourth quarter of 2012. Included in the Panel Report from that hearing was commentary that "by the end of 2012, the estimated average margins were positive, suggesting improved conditions." The report went on to state that the improved margins were due to "increased mailbox milk prices at levels sufficient to cover production costs, including allowances for return on investment and return for management" (page 10 of the Panel Report).

The Panel Report continued, "Since the hearing record is void of any concrete data indicating the level of estimated margins on dairies for 2013, the most current data available indicates that estimated margins were positive again and that the income received by dairies in relation to the cost of production of market milk appeared adequate."

It is unfortunate that CDFA's data on the first quarter's Cost of Production was unable to be used in that previous hearing. In the case of this current hearing, I have spoken with CDFA staff who have indicated that the second quarter's report will be released publicly on or around September 20<sup>th</sup>. Since that will likely be after the close of the hearing record, I would officially request that information be shared by CDFA's Cost of Production Unit – even in a preliminary format – in order to provide the Panel with the most current data possible on the cost of producing milk in California.



In the meantime, I have no choice but to focus this portion of my testimony on the most recent data that is publicly available. Before addressing the first quarter of 2013, there is some question as to whether or not the data for the fourth quarter of 2012 truly indicates what CDFA staff wrote in the Panel Report.

Included in Appendix A of this testimony is the “Statewide Cost Comparison Summary” published by CDFA for the fourth quarter of 2012. The average reported cost of production – including allowances for return on investment and return on management – was \$20.08 per hundredweight. During that same quarter, the announced mailbox milk prices were \$19.40 (October 2012), \$19.71 (November 2012) and \$18.48 (December 2012) per hundredweight. A simple average of those three months provides an average mailbox price of \$19.20 per hundredweight – \$0.88 *below* the reported cost of production. So it is unclear why the Panel Report states that mailbox milk prices were “at levels sufficient to cover production costs, including allowances for return on investment and return for management.”

Moving forward, we now have that CDFA-generated data from the first quarter of 2013. The average Statewide cost of production for the quarter was announced to be \$19.16 per hundredweight. Compare that to the average mailbox milk price of \$17.45 per hundredweight – an estimated loss of \$1.71 per hundredweight. Clearly, any assumptions that were made in the May 20, 2013 hearing about California dairy farmers being profitable in the first quarter of 2013 are not supported by the data.

In addition, the continued barrage of dispersal sales being conducted on California dairy farms is evidence that we are far from out of the woods financially. I submit for the record a stack of fliers for dispersal sales conducted over the past year (can be found at: <http://www.milkproducerscouncil.org/dispersals.pdf>). This is not an all-inclusive list, but rather just the fliers I was able to find on the internet and through email.

**The Notice of Hearing requests that witnesses address “the sufficiency of the calculation of the whey factor by reference to quantifiable economic data and methodologies; such as but not limited to: manufacturing cost data, marketing and sales data, and whey stream valuation directly applicable to California plants.”**

The modified “sliding scale” being proposed for inclusion in the Class 4b formula is based on a letter sent by Joseph Lang, a representative of the Dairy Institute of California, to Assemblyman Richard Pan during discussions about milk price changes in California (<http://www.milkproducers.org/070813dairyinstitute.pdf>). Dairy farmers have indicated in the past that we see a fundamental weakness in the sliding scale methodology, in that it inherently creates a floor and ceiling on one particular piece of the formula, resulting in a Class 4b price that is not in a reasonable and sound economic relationship with the Federal Milk Marketing Order (FMMO) Class III price that serves as a benchmark price for milk sold to cheese manufacturers around the country.

However, dairy farmers and their organizations have stepped up to support this modification in the interest of providing much needed revenue for dairy farmers in a form that our processor representatives can support.

The process of coming to this proposal was an exercise in balance, with political concessions made by both sides of the industry. It is with that same idea of balance that we ask CDFA to accept the proposal. The standards outlined in the Notice of Hearing for determining the “sufficiency” of the whey factor calculation are exclusively focused on the manufacturing side of the equation. Those items are part of CDFA’s consideration – to be sure (Section 62076). However, of equal weight is the consideration CDFA must make with regard to dairy *farmer* profitability (Section 62062). It is not an accident that both of those sections of the Food and Agricultural Code (the “Code”) use identical language: “shall take into consideration.”

In addition, part of the challenge that CDFA staff have expressed with regard to the dry whey component of the Class 4b price is a lack of available data. That same concern is also beginning to impact the Cheddar cheese component of the Class 4b formula. It is worth pointing out that under our formulas – as well as under the formulas used by the FMMO system – use basic commodity dairy products to drive the end product pricing formulas. Forty-pound blocks of Cheddar cheese are not the most prominently produced cheese in the state, but

yet it is used to establish our regulated milk price. The same goes for dry whey, which is also not the most prominently produced whey product in the state. That is intentionally done, as it provides an incentive for manufacturers to move up the value chain, thereby giving them an opportunity to enhance their margins by selling higher value products even though their regulated milk prices are based on lower value products.

There is a fundamental unfairness when you consider that the system incentivizes value-added production, and when that system appears to work (i.e., most cheese manufacturers do not make those specific products, but instead make higher value products), producers are then punished with a further limitation on the regulated formula, with the expressed reason that there is a lack of data on “manufacturing cost” and “marketing and sales data” for those lower value products. Dairy farmers seem to lose on both ends.

**The Notice of Hearing requests that witnesses “include the factual basis, economic and other evidence and legal authority in support of the whey factor, any temporary price adjustment and any proposed amendments to the Plans.”**

There has already been testimony about the facts that led to the development and submittal of this proposal. The economic evidence that relief is needed is also included in earlier parts of this testimony.

As for the legal authority, the Secretary has been granted broad discretion by California law to implement the proposal before the panel today. While additional discussions towards long-term reforms will continue to be needed, this proposal does move us in the right direction towards a more reasonable relationship with the national value of manufactured milk products (Section 62062), and a more reasonable relationship between the various classes (Section 62062(c)). Also, given the documented financial condition of the California dairy producing sector, the proposal addresses – in an admittedly modest way – the consideration of the cost of producing milk relative to the combined income from all classes of milk (Section 62062(a)).

**The Notice of Hearing requests that witnesses “address the extent to which the [whey] factor can be transparently calculated as a component of the Class 4b price and fairly imposed on processors.”**

Before getting into the transparency that certainly exists in this proposal, I must dispute the contention that somehow we are “imposing” something on processors.

Our dairy farmers work tirelessly everyday to produce a product that our manufacturers desperately need. Those dairymen even pay the hauling costs to get the milk to the manufacturer, on the plants’ schedule and in the quantity and quality they need. And all those dairymen have asked in recent years is to receive a milk price that is in a closer relationship to what our out-of-state colleagues already receive for the same quality of milk. To characterize our request for a fair price as some sort of an imposition is an offensive notion, and it truly lacks the balance that is often referenced by CDFA in terms of considering the needs of producers, processor and consumers.

As for the specifics of the proposal, the modified sliding scale is certainly just as transparent as the current sliding scale, with a clear and defined relationship between the market value of dry whey and the resulting impact on the Class 4b minimum price.

### **Other Consideration**

In addition to the items listed in the Notice of Hearing, I want to bring up one additional item that was mentioned in the May 20, 2013 Panel Report and which struck me as odd. In the conclusion of the report (page 11), a statement about the Panel’s concerns for being cautious with temporary relief. Rather than characterize the paragraph, I’ve included it below:

*“As a result of the uncertainty regarding the current condition of the dairy industry because of the lack of concrete data, the Panel is concerned and needs to be cautious in recommending temporary price relief, so*

*that the normal marketing conditions of the state's milk supplies or finished dairy products are not disrupted. If, for example, during a period when temporary price relief was in place, dairy markets were to increase significantly, the competitive balance of marketing dairy products could be disrupted. Because dairy markets are dynamic and volatile, these markets can change significantly in a matter of days or weeks depending on changes in such market factors as domestic and global milk supplies, international demand, and production costs such as feed corn. Therefore, the Panel is concerned with the uncertain impact that these relevant economic factors may exert on dairy markets when potential temporary price relief would be in effect."*

The reason this strikes me as odd is because we operate in an end-product pricing structure very similar to the structure used around the country in FMMOs. Under those similar structures, it's all about "relative position"; whether that's relative position to your fellow in-State manufacturers or relative position to your out-of-state colleagues. In other words, if dairy product prices escalate or fall during a time when we have temporary relief, a plant's relative position in the marketplace remains the same, as the prices paid by all plants are rising and falling as well. So it's unclear how the "competitive balance of marketing dairy products could be disrupted."

## **Conclusion**

The proposal before the panel today meets the political, economic and legal standards being sought by CDFA. Very rarely have we had the opportunity to present a proposal to CDFA that was drafted in writing by the processors and supported by the producers. Economically, there is ample evidence that California's dairy farmers are in much need of this pricing change. And the Secretary holds all the legal discretion needed to implement this proposal as soon as possible. While it's too late for the dairies that have already sold their herds, the dairy families that remain are desperately counting on it.