

DPAC Executive Board & Action Group Activities Report

June 7, 2010

June 3 — DPAC connects with Dairy Industry Advisory Committee (DIAC) at their second meeting in Washington, D.C.

SUMMARY OF MEETING WITH SEC. VILSACK'S DIAC:

Denny Wolff and Rob Barley gave the attached presentation on June 3 to the full Dairy Industry Advisory Committee (DIAC) in Washington, D.C. Cliff Hawbaker and Sherry Bunting also attended. Tioga County, PA dairy producer Erick Coolidge is vice chair of the DIAC and Cornell dairy economist Andrew Novakovic is chairman.

The DIAC members showed good interest in DPAC's proposals, and this led to good interaction with all members of the committee during the Q&A. Coolidge said we were the first presenters to their Committee, who were able to engage virtually all members in discussion. "They were all leaning forward," he said. "You caught everyone's attention."

Daily electronic reporting and expansion to report prices on more products were key points in DPAC's presentation to the DIAC. Denny and Rob talked about DPAC's efforts to get the funding for Daily Electronic Reporting and our proposal to expand the reporting to cover more products, not just cheddar, butter, nonfat dry milk and whey (see attached presentation).

One word resonated, and Jay Bryant from Maryland-Virginia (who sits on DIAC) thanked Rob for zeroing in on that word: **Trust**.

When Rob Barley answered a question about whether or not DPAC has done any studies to know what our proposals would achieve. Rob replied that, "Right now, the bottom line is we don't trust the tools we have. We need to make the tools better (with daily reporting and more products reported). To look forward, to make decisions, or get protection, we have to first understand what is going on in the market. The CME is not heavily traded enough to justify having the influence it does right now on our milk price. We need price reporting that is done on a daily basis (and includes more products) so farmers can see every day what happened every day. We as dairy farmers feel very inadequate in being able to look at what's happening in our market the way it's done right now."

Denny added that, "Dairy farmers feel strongly that we need improved price discovery with good information and a broad cross-section of products."

"We know it won't get rid of volatility, but it will reduce volatility and restore trust," said Rob. "We feel this is the first step."

Denny and Rob did a terrific job. Rob did the introduction and conclusion of the presentation and Denny talked about the specifics in the middle. They answered the Committee's questions together. They answered questions with confidence, and they both gave good examples drawing from their experiences as dairy producers, and in Denny's case as someone who is familiar with the political aspects of dairy policy and has been down this road in the past Farm Bill.

In short, DPAC really connected with the DIAC. Vice chair Erick Coolidge said they must have some things written for the Secretary of Agriculture by September, and longer term solutions by March. He believes DPAC has given the Committee some things for chairman Andrew Novakovic to start writing for the September deadline.

Coolidge also said he sees DPAC as being instrumental in building consensus among dairy farmers while the DIAC builds consensus among the different segments of the industry and that, **together, we can get something good accomplished.**

Our presentation was right before lunch. As Committee members were leaving and returning in pairs and small groups, they were interested in further discussion with DPAC... This meant that

Denny, Rob, Cliff and I did not get to lunch because we were busy the whole lunch hour having additional one-on-one break-time discussions with practically every member of the Committee.

We also met influential visitors like Jeff Lyon, who is the director of government relations and dairy policy for the Wisconsin Farm Bureau. He was very interested in our presentation and wants to stay in touch to help in any way they can. (I will mention this to the PA Farm Bureau when I give the presentation to them on June 8). We also met Ben Yale, an attorney from Ohio who is well versed in USDA Federal Order regulations and hearings, and who writes a column for Progressive Dairyman about milk pricing.

The speakers who were on after us were from Maine and they have a competitive pay price proposal that is detailed and of value. I believe Denny has been in contact with them, and our correspondence with University of Wisconsin dairy economist Bob Cropp indicates he believes competitive pay prices and two milk classes has real merit.

The discussion of two milk classes in conjunction with no price support purchases was presented, but most of the DIAC members' questions centered on the price reporting. One of the thoughts we left with the committee is that Class IV can behave as a global class in the absence of guaranteed margins and government purchases of nonfat dry milk. It can expand to include more products that the marketplace wants. The other manufacturing products can be combined, and price discovery of more product value can be used in conjunction with traditional competitive pay price scenarios that use "competitive regions" where plants compete for milk for competing uses.

Denny also talked about Section 1509 of the current Farm Bill. "Congress specifically wanted an evaluation of the current Federal Order system. That Commission is now your committee," he told the DIAC. "We need your help to simplify the current system. Expanding the Daily Electronic Reporting to include more products will be critically important in that process."

He also talked about discontinuing the Dairy Product Price Support Program with suggestions for how to help processors and coops with large investment in plants that were built based on old, failed policies. He discussed low interest loans and grants as a way to take money that was previously spent on support purchases and using that to encourage plants to retrofit and become more competitive with products for the domestic and global marketplace.

Committee members did raise concerns about the specific interests of California or regions where plants have made huge investments. "We appreciate that some of our proposals do not align with the manufacturing decisions in the past," Denny responded. "Those plants that made that investment should have dollars available to make the transition. If the government does not spend money buying product, we believe grants and low interest loans can help those plants make the transition."

On price discovery, we had some good questions, including one from Sue Taylor from Leprino. She said cheddar is a uniform product (to which Robert Wills of Cedar Grove Cheese said it's not as uniform as you think). She asked how daily electronic reporting would handle all the different moistures and yields that vary on mozzarella. Denny used the beef report as an example with the long list of different beef cuts. "You code that product, that description, and report sales in that category each day," Denny explained.

We were asked about supply management, to which Denny and Rob explained that DPAC has not taken a position to support or oppose current proposals on supply management. Concerns we raised are that the U.S. does not want to keep balancing the world supply, and if we manage our own supply, what is to keep imports from coming in to offset that. With transparency and price discovery, that's the cornerstone to getting out of the situation where we "push the rock uphill and then it drops off the cliff."

He explained how the relationship between pricing formulas with fixed "make allowances" along with government support purchases provide no incentive for product innovation in the market.

“Why risk making something else for the market when the system guarantees a profit making marginal products that don’t fit the demands of the marketplace.”

Good example is the world wants skim milk powder and whole milk powder. The U.S. still makes primarily nonfat dry milk. There is a difference.

The bottom line, Denny told the DIAC, is we need to encourage competition, provide market transparency, utilize better reporting and encourage fairness in dairy pricing.

Rob wrapped up with the statement that, “The current system is too complex, lacks good price discovery, and too few people truly understand it, and this allows ‘gaming’ the system. We need policy that is broader, simpler, and more transparent. We want producers to be able to make money, and for processors to make money, and so on. But the market risk needs to be shared on both sides as well as the opportunity to lose money. We’re not looking for a guarantee that as producers we will always make money, we’re looking for a fair system that gives us the opportunity to operate our businesses profitably.”

“We need to fund section 1510 of the current Farm Bill,” Denny added. “We are talking about a million dollars for daily reporting and quarterly auditing. The federal government blows its nose and spends more than that.”

The DIAC left us feeling we will be back with their group in the future as the industry-wide conversation continues and ideas develop more fully on the number of classes and competitive pay price.

SUMMARY OF MEETING WITH NATIONAL MILK (NMPF)

After the DIAC meeting, we went to National Milk’s offices in Arlington to meet with Jaime Castaneda. Jerry Kozack also joined us for the beginning of our meeting. He told us first-off that IDFA (International Dairy Foods Assn) is okay with electronic reporting, but they want it to be weekly. Cliff and Rob stressed that DPAC will continue pushing for this to be daily, and Kozack said “we won’t stand in your way.”

National Milk is walking a tight rope working on federal dairy policy with IDFA. We are aligned on some concepts with National Milk (eliminating price support program and reducing the number of milk classes using a competitive pay price), but the details of their proposals on the milk pricing system are not detailed enough to make an effective program. Most of the detail in NMPF’s foundation for the future is in the “revenue protection” program, and we talked about how they envision that would be administered through FSA.

National Milk knows we exist, and we needed that as we continue down the road we are going on these issues of price discovery and the classified pricing.

We left them with a few questions on the “revenue protection” program, and we also emphasized that some of the details of change for how milk is priced—even the voluntary tools available for protecting a margin in dairy production—can be rendered ineffective unless the industry has daily reporting, greater market transparency and a price discovery process that reflects broad supply and demand factors.

WHAT WE LEARNED FROM NASS’ PRESENTATION AT DIAC MEETING:

Before we presented to the Dairy Industry Advisory Committee (DIAC)... USDA chief economist John Mengel and NASS statistician Joe Gaynor presented information to the DIAC about current price and inventory reporting. It was interesting to say the least. Both the processors and producers on the DIAC had some tough questions for them about the current price reporting and the formulas used to determine milk prices. They wanted to know the cost of the NASS weekly price survey, which is the way it is done now. Mengel said the current cost is \$575,000.

(Our daily electronic reporting proposal would add \$1 million to this, but the majority of that cost is for bumping up the auditing to quarterly instead of annual).

Several people on the DIAC noted that cheddar cheese is now the minority part of the market and they wondered if USDA has received any proposals to expand the products reported. Mengel said they have “received no request to do this.” (!???) They agreed cheddar is a marginal product and that mozzarella is a higher use product, but Mengel said that, “It would have to be demonstrated that these other cheeses could be used to set a minimum price.”

That answer did not sit well with many members of the DIAC.

DIAC members wanted clarification: “Does this mean USDA is setting minimum milk prices on the lower value products?” Mengel’s answer was: “Correct. But we set the minimum price. Mozzarella is a premium product. Suppliers negotiate for premiums.”

As far as DPAC is concerned, this is all the more reason to fund and implement Daily Electronic Reporting because it would reflect broad supply and demand factors, where the current system does not. It is difficult to negotiate in a market where a few large players have more information than other participants.

The DIAC showed an obvious interest in price reporting before DPAC even began our presentation, judging by the questions they had for the speakers from NASS.

During the NASS presentation before us... DIAC member Robert Wills of Cedar Grove Cheese said there is a difference between reporting to find “average prices” versus what NASS is currently doing, which is the reporting of “marginal prices.” Committee members showed concern that today’s reporting reflects marginal prices for commodities and the question was asked: “Does that make sense as the basis for pricing milk?” On cheese, for example, only cheese that is 4 to 30 days old is reported and Wills, the cheese maker, observed tongue-in-cheek: “So it’s even easier to withhold pricing: If I want my product not to be counted or priced, I keep my cheese 31 days?” The response from NASS was: “Yes.” And the reply from Wills (tongue in cheek): “That’s good to know.”

The DIAC also brought up standards of identity for cheese. There were questions about the enforceability of these standards where some cheeses may use milk protein concentrates (MPC) and others may not.

The DIAC also seemed troubled by the fact that there is no administrative or legal recourse for producers when a mistake or mis-reporting takes place on the NASS Survey. In answer to chairman Andrew Novakovic’s question about whether there was any legal authority for recourse on the \$50 million mistake in powder reporting in 2006-07, Mengel said: “We did not have the \$50 million to pay the farmers, and Congress did not see fit to provide it.” He explained that Milk is priced at a “set rate using a weekly survey of marginal products. Once that rate is set, there is no recourse for a mistake or misreporting.”

Joe Gaynor noted that the cheese survey includes 27 plants, which represent 28% of the total supply. The nonfat dry milk survey is 61 plants representing 20% of the supply. The report is weighted by volume and any weekly discrepancies are averaged into the 4 to 5 week average.

June 2 — The PA Milk Marketing Board (PMMB) issued a decision on the staff’s petition to change the over order premium calculation for milk dealers and handlers that source farm milk both in-state and out-of-state. Effective October 1, 2010, the over order premium rate will be due to Pennsylvania producers on either the pounds of milk procured from Pennsylvania producers or the pounds of Pennsylvania Class I utilization, whichever amount is the lower.

This PMMB Order is expected to capture and return to dairy farmers \$5 to \$7 million in over order premiums that are currently reduced by the pounds of out-of-state producer milk, even when Class I sales in PA equal the Class I farm milk purchased in PA.

The new PMMB calculation simply means that the milk dealers and handlers will now have to pay the full over order premium on Pennsylvania farm milk to the extent that they have Class I sales within the state.

DPAC's Pennsylvania State Issues Action Group, made up of three DPAC Board members who had previously helped form the PA Dairy Farmers' Voice (now a constituency of DPAC) have been attending PMMB meetings and hearings and communicating about changes to the Milk Marketing Law as well as the future direction of the Milk Marketing Board in the Commonwealth.

Currently, Pennsylvania consumers pay more than 25 cents per gallon in over order premiums intended by law for the dairy farmers – over and above the Federal Order price and the dealer/handler and retailer cost recoveries and the dealer/handler and retailer profit margins.

An estimated \$15 to \$26 million in over order premiums paid by consumers were 'stranded' in the system last year. The June 2 Order by the PMMB addresses \$5 to \$7 million of that total.

Below are excerpts from the draft version of the joint news release that will be sent to media this week by DPAC and the City of Philadelphia consumer affairs office:

"Any step toward collecting any stranded premiums should be applauded, but we are a long way from the end," said Daniel Brandt, DPAC vice chair and member of the PA State Issues Action Group when he heard the PMMB decision last Wednesday. "There are still concerns about where the rest of this money is going and how well it is distributed."

"If dairy farmers had not been involved in talking with their legislators and being present at the PMMB meetings, we may not be at this point," added Nelson Troutman, DPAC board member. "Dairy farmers became informed and involved through the DPAC network. It's not often that we see a unanimous 3 to 0 decision like this. It shows what can be accomplished if people work together and don't give up."

During the February 16 PMMB hearing where the staff presented its proposal asking the board to change the over order premium calculation—a move endorsed by the PA Department of Agriculture and the Governor's office—witnesses for the milk dealers stated that a decision to make this change could prompt them to buy more out-of-state milk for sale to consumers in Pennsylvania or to divert milk to out-of-state distribution centers before sale to PA retailers as a way of circumventing the new Order that now enforces the full payment on their Class I sales commensurate with their raw milk purchases from PA dairy farms.

"That's a concern," said Lance Haver, director of the consumer affairs office for the City of Philadelphia. "This over order premium is meant for the farmers. The dealers already have their cost recovery and profit margin built into the retail price consumers pay. The milk marketing law says the over order premium is set to help the Commonwealth's dairy producers cover cost of production in undue times. This is the farmers' money, and if consumers have to pay that 25 cents extra per gallon, they want to know the money is going to the farms."

"It doesn't matter if the dealer's milk comes from in or out of state, that premium should not even be figured into their business model," Brandt adds. "That premium should be set aside for the dairy producers. There should be no incentive to the milk dealers to get out-of-state milk. Every penny of that premium should go into a pool and be paid back to Pennsylvania farmers because the law says that is what that premium is designed for – no matter where the milk comes from."

DPAC continues to work with legislators on changes to the milk marketing law to address other loopholes for 'stranded' premiums.

May 27 — The DPAC Milk Pricing Action Group had a teleconference work session to zero in on milk classes. This was a follow up to the May 13 DPAC Board meeting where Dave Forgey (Indiana) presented the idea of a two-class system that could decouple Class IV as a “global” market class. Consensus of third party experts is that a “global” or “export” class would be an issue with the World Trade Organization (WTO). Furthermore, removing the price support purchase program and reducing the number of milk classes using a competitive pay price instead of end product pricing would allow Class IV to be more competitive in exporting and for U.S. manufacturers in terms of reducing the need for certain imported ingredients. This could be achieved without designating it as an export class.

A two-class milk pricing system and competitive pay price are credible ideas. The consensus of the Milk Pricing Action Group meeting was that, “We want to work with others (DIAC, NMPF, third party experts / economists) on the details of a long-term solution, bearing in mind what is achievable.” National Milk (NMPF) was looking at a two-class system, but their most recent draft of the Foundation for the Future includes discussion of a three-class system, but the competitive pay price aspect of this is vague.

Summary Statements on #4 of DPAC’s policy framework – reducing the number of classes:

- The U.S. dairy industry needs to be actively involved in the world market with products that fit that market. This is a marketing opportunity, and also a way to increase the competitiveness of U.S. products as a deterrent to imports further reducing our market share.
- DPAC is concerned that without a long term change in the current pricing system, the U.S. dairy industry can at best grow 1% per year and at worst, could lose up to 20% of current market share as imported proteins would continue to chip away at our industry, while we would also be losing export opportunities at the same time.
- **DPAC is looking for long-term solutions that do not ignore the global marketplace. We believe there is a better way to price milk:**
 - Elements of the current system interfere with product innovation for both the domestic and international markets.
 - The current system continues to disadvantage the dairy farmers by reducing their ability to be competitive while at the same time forcing them to shoulder all the market risk.
- **We believe a true long-term solution involves a change in the number and composition of milk classes to move milk to its highest value use.**
 - Product innovation brings alignment issues within the current four milk classes. Since we can never have enough classes to cover every conceivable product, the alternative is to simplify and broaden the classes and to remove the fixed make allowances and yields via competitive pay price.
- Moving to a two-class or three-class system is a credible idea. DPAC has been working with knowledgeable third party experts on this idea, and the Milk Pricing Action Group has discussed the idea of “decoupling” Class IV so that these products, which represent the majority of U.S. exports and imports, are free to move at global prices with less impact on milk purchased for products that are primarily sold domestically.
- **We want to work with others on the details for a long-term solution that helps the U.S. dairy industry be more competitive...** more innovative on the product side and more innovative in marketing versus a continuation of a system that pigeon-holes the milk with fixed margins and fixed yields and formulas.

- **The bottom line is to simplify and reduce the number of milk classes but expand and increase the number of products that are included in daily price reporting to broaden the price discovery process for milk.**
- Competitive pay price could use price information in regions where plants compete for milk. At the same time, expanded daily reporting of more products would inform the price discovery process.

Background:

- A quote from University of Wisconsin dairy economist Bob Cropp via email conversation: *“The dairy product price support program and federal milk marketing orders with classified pricing using product price formulas with fixed make allowances, fixed product yields and market wide pooling interfere with product innovation--products for both the domestic and international markets.”*

World market factors to consider:

- World market is not a “free market.”
 - Product specs, EU subsidies, etc. keep dairy products from being a commodity that trades like wheat or corn.
 - 7% of world milk production is traded on the world market.
- 10% of U.S. milk is currently used to make butter/powder (Class IV).
- A major share (50%) of U.S. powder and protein products is exported.
- Global market does now, and will increasingly, influence NFD, SMP, whey protein prices.
- Less commonly produced products like MPC and WMP are priced on international markets, but used by U.S. manufacturers.
- Less than 3% of U.S. cheese is exported
- 10% of U.S. butter is exported.
- Powder and protein are the class of products with the highest share being currently exported and the most pressure from incoming imports.
- Global prices do not have the same degree of influence over cheese prices, and U.S. cheese (Class III) is still largely a domestic market.

May 17 — The DPAC Executive Board and PA State Issues Action Group had a teleconference with the City of Philadelphia consumer affairs office: Lance Haver, director and Marc Zecca, general counsel. The purpose was to discuss ways of working together (producers and consumers) on the issue of ‘stranded’ over order premiums paid by consumers and intended for dairy farmers. A joint press release is in the works responding to the June 2 PMMB decision, which addresses one part of this issue, even as the legislative efforts continue.

UPCOMING EVENTS

PA Farm Bureau Dairy Issues Forum

- **June 8 —** DPAC has accepted the invitation to participate in the Pennsylvania Farm Bureau’s Dairy Policy Forum in Camp Hill. This is a committee setting that will focus on federal dairy policy issues. DPAC’s time slot with the committee is 11 to 11:40. Sherry will begin presenting and Denny Wolff and Dan Brandt will join the discussion after their meeting with Sen. Scarnati at the Capitol. The purpose of the forum is to identify common ground for 2011 policy development.

Rescheduled meeting with Sen. Joe Scarnati, President Pro Tempore of the PA Senate

- **June 8** — DPAC is scheduled to meet with Sen. Joe Scarnati to discuss legislative changes to the PA Milk Marketing Law.

Maryland Dairy Industry Oversight and Advisory Council

- **June 15** — Denny Wolff has been invited to brief the Maryland Dairy Industry Oversight and Advisory Council about DPAC. The Council is made up of dairy farmers, milk processors and other affiliated dairy industry representatives. Its function in Maryland state government is to advise the Governor on dairy issues.

Family Dairies based in Madison Wisconsin

- **June 24** — DPAC has been invited to meet with the Board of Directors for Family Dairies based in Madison, Wisconsin the day before the USDA / DOJ workshop on market transparency. Chairman Cliff Hawbaker, along with Alan Kozak and correspondence secretary Sherry Bunting and adhoc member Laura Covert are planning to travel to Wisconsin for the workshop and meeting with Wisconsin dairy producers. (Denny Wolff will also attend if DPAC is given a slot on the panel to testify on June 25.)
- Other DPAC board members who are interested in attending should let Sherry or Cliff know.

USDA / Dept. of Justice workshop / hearing in Wisconsin:

- **June 25** — The DOJ / USDA workshop hearing on dairy market transparency, concentration and vertical integration was rescheduled from June 7 to June 25 in Madison, Wisconsin. Denny Wolff has provided introductory written comments and his resume to be considered for a slot representing DPAC on the panel. We are waiting to hear if DPAC will have the opportunity to provide oral comments, but if not, written comments will still be submitted, and there will be opportunities to talk to other producers about what DPAC is doing and gain support from the Midwest.

Respectfully submitted

Sherry Bunting

DPAC Correspondence Secretary

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