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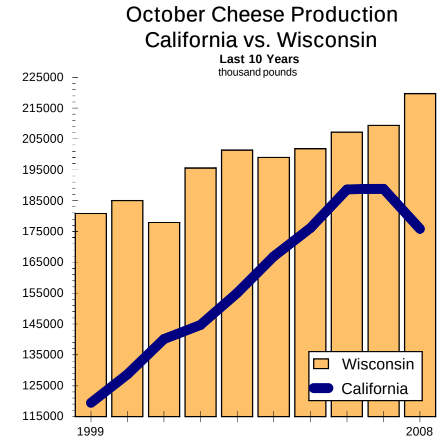

DFA, Two Former Executives To Pay $12 Million To Settle CFTC Charges

CFTC Believes DFA, Hanman, Bos Attempted To Manipulate Class III Futures Prices By Buying Cheese On CME Cash Market

Washington—Dairy Farmers of America (DFA), its former chief executive officer Gary Hanman, and its former chief financial officer Gerald Bos will pay a $12 million civil monetary penalty for attempting to manipulate the Class III milk futures contract and exceeding speculative position limits in that contract, the US Commodity Futures Trading Commission (CFTC) announced Tuesday.

Also, Frank Otis, former president and CEO of a DFA subsidiary, and Glenn Millar, former executive vice president of that subsidiary, will pay $150,000 for aiding and abetting DFA's speculative position limit violation, the CFTC said.

In addition to imposing civil penalties, the DFA administrative order bars Hanman and Bos from trading futures for five years.

It also bars DFA from engaging in speculative trading in Class III milk futures contracts for two years, and orders DFA to comply with certain undertakings, including:

■ Implement and maintain a compliance and ethics program designed to detect and prevent violations of the Commodity Exchange Act and CFTC regulations by any DFA director, officer, employee or agent.

■ Retain a monitor, at DFA's expense, to review for a period of two years: DFA's futures trading for compliance with speculative trading prohibition; and DFA's cheese purchases on the Chicago Mercantile Exchange (CME) cash cheese market to ensure that any such cheese purchases are made for "legitimate business purposes," and "not in an attempt to manipulate Class III milk futures contracts."

■ The monitor's authority and duties are to be broadly construed. In order to determine DFA's compliance with the order, the monitor will inspect such DFA documents as reasonably necessary relating to DFA's transactions in Class III milk futures and/or the CME cash cheese market; and meet with and interview such employees, officers, and directors of DFA, and any other relevant persons, relating to DFA's activities in the Class III milk futures and the CME cash cheese markets.

The monitor will prepare a confidential annual report on the yearly anniversary of the engagement that will describe the execution of his responsibilities required by the order. DFA will be required to cooperative fully with the monitor, and the monitor will have the authority to take such reasonable steps, in his view, as may be necessary to be fully informed about the operations of DFA within the scope of his responsibilities as set forth in the order.

DFA is also required to provide future cooperation to the CFTC.

DFA said the settlement ends the CFTC's investigation into DFA's trading activities on the Chicago Mercantile Exchange (CME). Rick Smith, who succeeded Hanman as DFA's president and CEO, said that agreeing to the settlement, which it did without admitting or denying the CFTC's findings in the administrative order, was in the best interests of the cooperative and its members.

According to a summary con-

• See **DFA Settles Charges**, p. 7

Milk Production Increased 1.4% In November; Cow Numbers Rose For Second Consecutive Month

Washington—US milk production in the 23 reporting states during November totaled 14.032 billion pounds, up 1.4 percent from November 2007, the US Department of Agriculture (USDA) reported Thursday.

October's milk production was revised up by 16 million pounds, so output was up 1.6 percent from October 2007, rather than up 1.5 percent as originally estimated.

For the entire US during November, milk production was estimated at 15.182 billion pounds, up 1.1 percent from November 2007.

The number of milk cows on farms in the 23 reporting states during November was 8.468 million head, 99,000 head more than in November 2007 and 6,000 head more than October 2008. Milk cow numbers in the 23 reporting states have now risen for two consecutive months after declining by 11,000 head in August and September.

Production per cow in the 23 reporting states averaged 1,657 pounds for November, three pounds above November 2007.

California's November milk production totaled 3.303 billion pounds, down 0.3 percent from November 2007, due to 10,000 more milk cows but 15 less pounds of milk per cow. November marked the fourth time in five months that California's milk output has declined from a year earlier.

California's October milk production was revised up by 2.0 million pounds, so output was down 0.8 percent from October 2007, rather than down 0.9 percent as initially estimated.

Wisconsin's November milk production totaled 1.963 billion pounds, up 1.4 percent from November 2007, due to 5,000 more milk cows and 15 more pounds of milk per cow. Wisconsin's October milk output had been up 1.9 percent from October 2007.

November milk production in

• See **More Milk In Nov.**, p. 6

Cooperatives Working Together Will Continue To Be Funded In 2009

Arlington, VA—Cooperatives Working Together (CWT) has received commitments from its members that they will continue to fund the program in 2009, CWT officials said Wednesday.

CWT is funded by dairy cooperatives and individual dairy farmers, who are paying an assessment of 10 cents per hundredweight on their milk production.

Money raised by CWT is being used in two supply management programs designed to strengthen and stabilize milk prices: a herd retirement program and an export assistance program.

"Now more than ever, CWT is the only answer to the question of what can farmers do to positively impact their milk price," said Jerry Kozak, president and CEO of the National Milk Producers Federation (NMPF), which manages CWT.

"Both world and US dairy mar-

• See **CWT To Continue**, p. 9

California Decides To Reduce Class 1, 2, 3 Prices; Surplus Milk Supplies A Concern

Sacramento, CA—The California Department of Food and Agriculture (CDFA) on Wednesday decided to reduce the state's Class 1 price approximately 35 cents per hundredweight and reduce the Class 2 and 3 prices by about 26 cents per hundred.

The changes will take effect for milk delivered to processing plants on or after January 1, 2009.

The CDFA had held a public hearing at the end of October after being petitioned by the Alliance of Western Milk Producers, Western United Dairymen and the California Dairy Women Association. They were seeking a $1.00 per hundredweight surcharge on the regulated minimum prices for Class 1, 2 and 3 milk for six months.

Two alternative proposals were also submitted for the hearing. Dairy Institute of California proposed a $1.35 per hundred reduction in Class 1 prices and reductions of about 26 to 27 cents in the Class 2 and 3 prices, while Milk Producers Council (MPC) proposed implementing a Class 1 "transportation surcharge."

In analyzing current economic conditions facing California's dairy industry, the CDFA hearing panel noted that, despite a "deteriorating financial situation" facing dairy producers, the state's milk supply "is in a surplus condition due to continual milk production increases and lack of corresponding increases in processing capacity."

In order to find a home for all of its milk, California's dairy industry has been shipping milk to out-of-state processors and to calf ranches, the hearing panel noted. There have been "periodic occasions" when milk couldn't be processed.

In response to the surplus milk conditions, "many organizations have placed restrictions on the amount of milk they will receive

• See **CA Reduces Prices**, p. 11

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CA Reduces Prices

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from producers," the panel continued. The three major producer cooperatives have instituted production bases to restrict production growth, and major proprietary processors have also placed limits on the amount of milk they will receive from their contracted producers.

Two major cooperatives are in the process of building or remodeling/expanding their butter/powder plants to help alleviate their inability to handle all of their member milk production, the panel pointed out. But the new plant capacity "is already committed to the increased production that is already planned" by the co-ops' members."

> ...despite a "deteriorating financial situation" facing dairy producers, the state's milk supply "is in a surplus condition due to continual milk production increases and lack of corresponding increases in processing capacity."
>
> —CDFA Panel

In addition to production restrictions, two major California fluid milk processors have given termination notices to over 40 dairies producing approximately 26 loads of milk per day due to reduced milk procurement needs.

While the first group of termination notices was first effective for about half the producers on July 1 and the termination notices for the second half of producers was effective on November 1, "neither group has had much success in securing a permanent buyer for their production," the panel noted.

California's "constant and steady" milk production expansion has resulted in "dramatic changes" in milk usage, the panel said. In 1987, Class 1, 2 and 3 utilization of the statewide pool represented 35.7 percent, 6.1 percent, and 6.5 percent respectively, or about 48 percent of the total pool.

But as the state's cheese industry grew and as more milk was moved into butter/powder production, the Class 1, 2 and 3 utilization declined, reaching about 14.2 percent, 4.4 percent, and 4.0 percent currently, or about 23 percent of the total pool.

This downward trend in pool utilization of the highest valued milk classes translates into lower pool prices over time, the panel explained. Another way to state this is that over time the pool utilization of the manufacturing classes of 4a (butter/powder) and 4b (cheese), which provide the lowest value to the pool, has increased and is becoming a larger portion of the overall pool.

Further, as more and more milk is produced, it appears that the increased production will continue to be used primarily in Class 4a. It "appears likely" that the current decline of Class 1, 2, 3 and possible 4b utilization, coupled with increasing Class 4a utilization, will continue to reduce the pool price that producers receive, even if prices remain at their current levels, the panel said.

Class 1 Price Adjustments

At the hearing, producer organizations testified that the financial strain on producers has caused negative operating margins on some producers. Although feed costs have tempered slightly in recent months, the current levels are still above the long-term average trend of the last number of years.

Producers also testified about the negative impact of the higher costs relating to waste management, environmental regulations, higher diesel and gas prices, and the increased costs associated with tighter credit conditions relating to their operating loans.

Processors testified that Class 1 sales have been lost already to out-of-state processors due to the competitive advantage in raw product prices that out-of-state processors enjoy relative to California processors. Because of lost sales, California processors testified they had idle processing capacity available that could be used if their sales were to rise.

Further, multi-state processors with plants both inside and outside of California testified that their California operations are not as competitive as their out-of-state facilities. These conditions provide economic incentives to expand at the expense of their California operations.

At a time when fluid milk sales are flat and California has surplus milk, an increase in Class 1 prices, even on a temporary basis, "would intensify this situation further and worsen the long-term economic prospects for producers," the panel noted. As sales are lost, additional milk supplies would need to find a processing "home" out of state or be processed in the lower-valued classes.

At the hearing, there was "significant testimony" regarding the competitive disadvantage California processors procuring California milk are currently experiencing. The testimony revolved around the manner in which processors can procure milk that "circumvents" minimum pricing.

For example, there currently is an out-of-state fluid processor that is procuring California milk and selling its finished product in California. This processor enjoys a raw product cost advantage because California milk shipped outside the state is not subject to minimum prices.

There are also out-of-state milk supplies that are shipped into California fluid plants that enjoy a raw product cost advantage because these out-of-state milk shipments are not subject to minimum price regulations.

Further, the panel noted, producer-distributors both in and outside of California continue to have cost advantages over conventional dairy processors that have enabled them to capture greater market shares.

The hearing panel concluded that it is "necessary and appropriate" to lower the Class 1 price. This action will help prevent, or at the very least, limit some of the negative consequences impacting California's dairy industry, including surplus milk supplies, the potential loss of Class 1 sales, negative trends in per capita consumption, deteriorating competitive advantage of California fluid plants, and the further increase in the pool utilization of lower-valued class milk.

Classes 2, 3 Similar To Class 1

Similar to Class 1, petitioners proposed a temporary price increase on Classes 2 and 3, while processor witnesses sought reductions of these prices on the basis of reduced competitiveness of California products relative to reduced federal order prices.

Potential Class 2 and 3 sales losses were documented by processors' testimony. According to the Dairy Institute, not only would these losses occur if there is a price increase, they would also occur if no change in the Class 2 and 3 formulas are made.

The Institute testified that a key issue is the competitive disadvantage facing California processors that existed prior to reductions in federal order Class II prices. Witnesses testified that this competitive disadvantage was further magnified by the recent reductions in federal order prices when make allowances were increased.

Given the oversupply situation in the state, the hearing panel said increasing the Class 2 and 3 prices "is not appropriate." The CDFA decision will reduce Class 2 and 3 prices by approximately 26 cents per hundred.

Transportation Surcharge Denied

MPC's proposed transportation surcharge on Class 1 milk would result in an increase of 11 cents per hundred on Class 1 and an estimated combined pool price increase of two cents per hundred for a five-year average of October 2003 through September 2008.

MPC calculated that the impact of the last milk movement hearing provided a 26 percent increase in the amount of pool revenues needed to fund the milk movement incentives, and proposed a transportation surcharge that would offset this increase.

Adoption of this proposal would "seemingly raise fundamental policy issues" about some of the basic tenets of the current pooling system, the hearing panel said.