



January 12, 2017

Erik Rasmussen
Market Administrator
Federal Milk Marketing Order 1
89 South Street
Boston, MA 02205-1478

Dear Market Administrator,

Because of the significant and unprecedented imbalance between supply and demand in the Federal Milk Marketing Order FMMO 1 marketing area, Dairy Farmers of America, Inc. (DFA) is requesting that FMMO 1, Section 1001.12 (b) (5) and (6) be interpreted and applied for the period April 1, 2017 until September 30, 2017, in a manner which conforms strictly with its purpose while allowing the marketers of milk critical flexibility in marketing. Our request would allow a handler to pool, or not pool, all or any portion of a delivery to a non-pool plant in these months without losing the ability to pool the producer the following month. Additionally, this would allow the handler the ability to pay for the milk delivered to the non-pool plant a return that reflects the value of the milk.

Without the requested flexibility it is highly probable that many producers, and especially those qualifying as small businesses, will lose their market for milk during the early months of 2017 or be forced to accept a significant reduction in the price they will be paid for milk. Additionally, the cost to serve Order 1 markets will increase noticeably as milk assembly and transport systems will be significantly revised into less economic units to accommodate new but necessary market realities.

DFA is a qualified Capper Volstead Cooperative. We market approximately 22% of the nation's milk supplies from 8,448 members. Also, through our relationships with other cooperatives and businesses, we market an additional 8% of the nation's milk production (for a total of 30% of U.S.). In FMMO 1 DFA markets well over 700 loads of milk daily from more than 4,700 member-owners and other producers who are associated with affiliated cooperatives or not members of any cooperative. Specifically, and included in the above total, we market in excess of 80 million pounds of milk per month from more than 900 independent producers through various marketing agreements. In total, the milk we market is delivered to approximately 100 plants owned by more than 60 different firms. We also own and operate three fluid bottling plants and three manufacturing plants in the Order.

USDA defines a dairy farm as a small business if it markets less than 750,000 pounds of milk per year. Following this guideline, there are approximately 460 small business non-member dairy farms that we market and payroll each month and another 440 non-member dairy farms that we market that do not meet the small business definition. If we include our own members and marketing arrangements with other cooperatives, an additional 1,440 farms would be classified as small businesses. If the entire burden of dealing with the market's supply and demand imbalance were to be borne solely by cooperative members their livelihood would be severely impacted.

DFA markets milk in 9 of the 10 FMMOs in the U.S. We are uniquely qualified to comment on milk marketing conditions across the entire country. Multiple factors including the supply-demand imbalance in FMMO 1 with milk supplies greatly exceeding current market demand, the highly variable demand and delivery system for serving the Class I needs of this market, the increasingly variable daily run-time schedules, and the lack of available balancing capacity, are combining to creating severe disorderly marketing conditions. From our vantage point, these conditions are much worse in FMMO 1 than in the other FMMOs. It will take some time for this

imbalance to correct itself. Market conditions as we see them will become even more disorderly if our request is denied.

The FMMO 1 marketing area is a very diverse market. The states that comprise the marketing area are Connecticut, Delaware, Massachusetts, Maryland, New Hampshire, New Jersey, Rhode Island, Vermont and portions of New York, Pennsylvania and Virginia. This geographic area represents 70.3 million people or 21.9% of the U.S. population. (<http://www.census.gov/popest/data/state/totals/2015/index.html>) Six of the largest U.S. Metropolitan Statistical Areas are located within these 11 states. They include the metro areas of New York City, Washington DC, Philadelphia, Boston and Baltimore, totaling approximately 40 million people. (<https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkml>) The population density requires extensive market balancing to serve the population's demands for dairy products.

The October FMMO 1 handler/plant list identifies 318 plants which received pool milk during the month. During the month of October 2016, 11,509 producers were pooled on the Order. The processing plants in FMMO 1 manufacture significant quantities of products including all of the FMMO classifications. The diversity of the Order 1 dairy sector is both a positive marketing opportunity and a significant challenge to supply and balance. Increasingly, plants that historically operated six and seven days per week now seek to process fewer days resulting in additional supplies needed to fill an unchanged total demand but now squeezed into fewer days. The result is more milk to balance on "down days" during the week and specifically, on weekends.

Many of the Order's manufacturing plants now run less than full weekly schedules. More plants now take extended down time on holidays in order to accommodate both their work schedules and to balance their product inventories. Several of the manufacturing plants we serve have days, or in some cases weeks, in the month devoted to manufacturing non-dairy items. Milk suppliers are working to meet these changes. We comingle milk from different cooperatives and independent farms to achieve maximum transportation and marketing efficiencies.

A new concern is that Canada's dairy regulatory system has recently put in place policies that will effectively close off the market for U.S. (primarily Northeast region produced) ultra-filtered (UF) milk. In a November 5, 2016 *Cheese Reporter* article New York Governor Andrew M. Cuomo voiced his concerns over Canada's milk pricing policies in a letter to Canadian Prime Minister Justin Trudeau.

Cuomo told Trudeau that he was "distressed" to hear that Ontario and the Canadian Milk Supply Management Committee have embarked on regulatory regimes, including a proposed new National Ingredient Strategy, that "could effectively block" New York exports of (UF) milk, potentially violating World Trade Organization commitments.

Industry analysts estimate that manufacturers in New York alone are selling in excess of 300 million pounds of skim milk equivalent on an annualized basis of UF milk. If this policy remains in place, that milk will be seeking a market outlet in an already surplus market.

Market Conditions - Milk Supplies

Milk production is at record levels in the FMMO 1 marketing area. A quick review of National Agricultural Statistical Service (NASS) and FMMO 1 data documents this point. NASS publishes the *Milk Production* report monthly. It contains data on cow numbers, milk production per cow and total milk production for the 23 largest milk production states. MAP 1 **YTD U.S. Milk Production (attached)** depicts the NASS January – October year-to-date milk production for the Top – 23 states. This includes the Top – 3 milk production states in FMMO 1 – New York, Pennsylvania and Vermont. These three states accounted for 89.9% of the Order's total milk production in calendar year 2015. Through ten months of 2016, production in these three states increased over the prior year 4.6% in New York, 0.5% in Pennsylvania and 2.0% in Vermont. Collectively, the increase from the three states was 3.0%.

Focusing on the most recent month's data – October 2016, **Map 2 U.S. Milk Production (attached)** shows New York with a 4.7% increase in milk production, Pennsylvania a 2.2% increase and Vermont a 3.2% increase. Averaged together, the three states production grew by 3.6% October to October, or 82 million pounds of additional milk.

A “day-to-day” method to view the data is to express the changes in terms of loads of milk per day that must be marketed. NASS publishes production data for all states on a quarterly basis. For the third quarter of 2016 versus 2015 total production in the eleven states comprising FMMO 1 showed an increase of 140.2 million pounds. Using a typical load weight for the market of 60,000 pounds and 92 days in the third quarter, each day had 25 more loads per day to be marketed than the third quarter of 2015. Note this is an average per day and does not reflect the weekly demand patterns, particularly the fluid-use market demand patterns. If the variations of the Class I use demand were factored in, this average would trend higher on weekends and lower during the week. As we look to the 2017 flush production months, the pressure of the “25 more loads” will increase.

Chart 1 FMMO 1 - Total Milk Pooled (attached) plots FMMO 1 total milk pooled since 2006 and shows a steady upward trend with a compound annual growth rate (CAGR) of 1.2%. The increasing milk production shown by the NASS *Milk Production* report is largely being pooled on FMMO 1.

Chart 2 NASS Quarterly Milk Production (attached) plots the quarterly NASS milk production trends for the eleven states from 2006Q1 through 2016Q3. Noticeably there is a change in the CAGR trend beginning in 2013 where the slope of the trend line begins to increase. This increasing trend is not slowing and continues to pressure marketing conditions in FMMO 1.

Lastly, **Chart 3 Pounds at Minimum Price Class Utilization (attached)** displays the milk marketed each month in the “minimum class price use”. Typically, this volume reflects milk accounted for in 1000.40 (d) “Other Uses described as “...used for animal feed, destroyed, or lost by a handler in a vehicular accident, flood, fire, or similar occurrence beyond the handler's control...”. As noted in Chart 3, there is some milk that fits the standard definition every month. FMMO 1 published data shows an average of 6.4 million pounds was pooled via this provision in January – March 2016.

Since the spring flush season of 2014 the Market Administrator has allowed milk to be pooled but dumped at a farm under certain circumstances, if proper documentation is presented. This allowance was in response to market requests for assistance to deal with the serious imbalance between milk supplies and milk demand. The allowance enabled milk to be pooled while avoiding the cost of transportation, receiving and in-plant disposal. All milk meeting the reporting requirements was able to be pooled and receive the difference between the lowest class price and the Statistical Uniform Price. Note that while this payment was better than the zero return from dumping the milk without the pooling benefit, the return was well below any commercially-based return. For example, in FMMO 1 this provision was in effect for the period April 1 – August 15, 2016. The payment per hundredweight received if the reporting requirements were met was April - \$2.17, May - \$1.97, June - \$1.79, July - \$1.38 and August - \$2.32. This is the value in the base zone of the Order. All payments would be adjusted based on the location differential of the farm and in all cases would be lower. Thus, a marketer would only utilize this option if no other return was available.

Handlers are also processing portions of their milk supplies by separating and selling the cream and then marketing the remaining skim wherever possible. Many times the return from marketing the skim is the dumped milk value. However, this return -- while above the return from disposing milk at the farm and gaining only the difference between the lowest Class price and the Statistical Uniform Price -- is still well below the prevailing applicable class price. In June of 2016, a month in which significant volumes of cream were marketed in this manner, the return on the 100 pounds of milk producing the cream and skim was \$7.43 per cwt versus a lowest Class price of \$13.22 – not a scenario any marketer would choose if there was a better alternative.

In spite of these minimal returns, Chart 3 shows sizable quantities of milk were marketed using one of these two methods. After making an adjustment for the “typical usage in this category” of 6.4 million pounds and using the 60,000-pound typical volume for an FMMO 1 load of milk, an estimated 578 loads of milk were pooled in June of 2016 under the temporary allowance. This further indicates the severity of the FMMO 1 market’s supply and demand situation.

Marketing Conditions – Sales and Balancing Capacity

The market must balance milk production with milk sales. This means for the Class I and associated Class II markets recognizing the variation in milk demands within a week (more needed Tuesday thru Friday and less Saturday thru Monday), variation across the weeks of a month (generally based on Government food assistance payments and variation seasonally with flush and short production and holiday needs). Balancing these demands for milk is inextricably tied to varying demands in the manufacturing products markets (non-fluid associated Class II, Class III and Class IV markets). Those variations are heavily influenced by the seasonality of cheese and butter demands.

As a part of the balancing equation, available plant capacity is a key factor. The FMMO 1 market has significant plant capacity as noted earlier. DFA operates plants at Reading PA, Middlebury Center PA and Linwood NY with milk pooled on FMMO 1. Reading and Middlebury Center market condensed milk products and milk powders. At peak milk balancing times, holiday periods and the flush production months of the year, our plants run at full capacity like many other cooperative plants in the market. Other plants in the Marketing Area may not be able to run at full capacity due to a lack of sale for the product produced, a proprietary claim on the use of the capacity, labor, equipment and perhaps expertise limitations. Some plants choose not to take any additional milk volumes because the products they produce from the additional milk can’t be marketed profitably at a future date. In many cases the risk of inventorying the product outweighs the possible gain from a future sale. Unless the milk can be discounted significantly into the plant, plant operators are unwilling to make additional capacity available, even if they have any.

Putting aside the just outlined reasons, while there may be physical capacity available for balancing milk at stress times, the fact that significant volumes of milk have been dumped at the farm or skimmed, the cream sold, and the remaining skim marketed at a significant decrease in revenue, demonstrates that capacity is difficult to secure.

There have been notable losses and some additions to milk processing capacity in all Class uses in the FMMO 1 market in recent years. Our survey of the FMMO 1 marketplace notes that the following plants have closed or reduced or redirected production volumes to other markets since 2013. The list of plants includes:

Class I Plants

Grants Dairy / Portland, ME
Marcus Dairy/ Danbury, CT
Oaktree Dairy / East Northport, NY
Farmland Dairies / Wallington, NJ,
Rosenberger’s Dairy (HP Hood) / Hatfield, PA
Elmhurst Dairy (Worcester Dairy) / Jamaica, NY
Shenandoah’s Pride / Springfield, VA

Class II Plants

Chobani / South Edmeston, NY
Quaker-Mueller / Batavia, NY

Class III

Kraft – Pollio / Campbell, NY

Our estimate of the closed or reduced capacity is 325,000,000 pounds of milk per month.

Over this same period, plants manufacturing Class II - Fage/ Johnstown, NY, Class III - Kraft – Heinz / Lowville, NY, Yancy’s Fancy, Pembroke NY and Multiple Classes - Cayuga/ NY have expanded capacity. The sum of the new capacity at these plants is estimated at 161,000,000 pounds per month.

Obviously, not all “closed capacity” is completely eliminated and not all expanded capacity is completely filled. However, even if adjusted for “not closed “or “not filled” there has been much more capacity lost than gained. Again, it is important to note that balancing capacity for Class I and associated fluid use Class II markets is intertwined with the capacity available for processing the other Class use markets. Retrofitting or expanding processing capacity requires capital expenditures, and perhaps even more time and effort to develop and expand markets for additional milk production. These decisions are not made quickly.

We continue to seek outlets outside the Order boundaries to balance milk. However, these balancing sales come with significantly higher transportation costs and lower sales prices. It is becoming more difficult to locate capacity even when reaching into the Mideast and Upper Midwest Orders where DFA has current marketing arrangements.

We expect that as the market conditions described previously continue to deteriorate, the immediate solution will be for marketers to sever milk purchase relationships with producers. This has already occurred in Order 1. Media and newspaper reports have reported recently that Byrne Dairy, Queensboro Farms, Fleur de Lait-East, Cloverland – Greenspring Dairy, Midland Farms and Harrisburg Dairies have all released producers / farms from their milk supplies. Industry estimates are that 15 – 20 million pounds of milk was affected.

While some of these producers may have located new markets, some have ceased dairy farming entirely. In the near term we expect there to be very few options for new markets. In some cases, a producer who loses a market will seek to displace some of the supply of other producers in the closest available plant, causing a ripple effect of the displaced milk looking for a home, that milk displacing other milk, and on and on throughout the market. What we seek here is greater market stability throughout this period of rebalancing supply with demand. If a marketer is able to depool some milk voluntarily in order to pay all its producers a price reflecting the current market value these extraordinary balancing costs are shared. Our proposal will allow the sharing of balancing costs to buffer the effects to any one group and maintain a more orderly process as the market finds its new equilibrium during this six-month period.

Requested Application of DFOM Provision

Sections 1001.12(b) (5) and (6) of Order 1 are known as the “Dairy Farmer for Other Markets” provision. The purpose of this Order provision, was explained in the Market Administrator’s “Reminder” dated October 23, 2007 (posted at: http://www.fmmone.com/Misc_Docs/DFOMReminder0907.pdf): *“This provision addresses the issue of “riding” the Federal order pool to balance supply and discourages handlers from voluntarily depooling producer milk to take advantage of inverted class price relationships.”* In other words, these provisions discourage, by limiting the ability of producers to voluntarily pool and depool their milk, transactions which financially benefit individual producers at the expense of all pool participants. Historically the precedent for this practice, sometimes referred to as “pool riding”, involved producers making higher-valued deliveries to unregulated Class I plants outside of the Order and then pooling lower-valued, balancing Class II/III/IV deliveries onto the Order. More recently, the same financial result could be possible when Class II/III/IV prices were “inverted” i.e. possibly higher than pool blend prices and occasionally higher than Class I prices and the DFOM language effectively discouraged these inequitable transactions also.

As this explanation makes clear, the DFOM language was never intended to discourage, or limit, the voluntary non-pooling of deliveries which do not add value to the pool but, in fact, reduce the value of the pool for all producers. Unfortunately, in current market conditions if the language were to be applied without nuance it will

have the unintended consequence of essentially prohibiting voluntary depooling of portions of the current extraordinary surpluses of producer milk and thereby exacerbate those disorderly conditions.

In view of these circumstances, we are requesting that for the months of April to September 2017, the DFOM provisions of Order 1 be interpreted and applied so as to allow a producer and any portion of such producer's milk to be pooled even if a portion of such producer's milk is disposed to low-valued Class II/III/IV utilization and not reported for pooling. If such application and interpretation is not made, the provisions will literally force all milk to be included in the Order pool every day of every month in order to retain pool status for the producer for any volumes; or excluded from the pool every day of every month until the start of the next marketing year even if it might be feasible and beneficial to not pool only a portion of the month.

Given the existing market supply / demand imbalance, current application of DFOM provisions limits market flexibility and, unless the provisions are interpreted as we request to carry out their intent, disorderly marketing conditions will greatly increase. Our requested interpretation will not only carry out the intent of the DFOM provision under present market conditions, it will allow milk marketers more flexibility in balancing supplies of milk with demand. The expected response when an existing supply relationship is terminated with a producer due to the inability of the marketer to process the milk is either that the producer will not be able to secure a new market, displace supply into an existing market by undercutting the existing market pricing, or be forced to accept a market where the milk is never pooled (per the current DFOM provisions) and the available returns from this marketing are paid to the producer. Applying the DFOM provision in accordance with its intent will allow marketing solutions that can mitigate all of the above disorderly marketing situations.

This temporary application of the DFOM provision will have the following salutary effects in the present marketplace and promote orderly marketing:

1. It will equate payments for milk with the returns from milk and better enable milk buyers to retain supply relationships with dairy farmers.
2. It will enable milk buyers to formulate a milk price, equitable to all producers, that is representative of market returns and lessens the pressure to terminate supply relationships.
3. It will enable a producer to retain the Order prices for a majority of their deliveries while losing some of the value for a few days instead of losing the entire month's value.
4. It will enable the alignment of daily milk deliveries with monthly milk pooling regulations and avoid the situation where milk would need to be pooled for an entire month in order to be eligible to be included in the pool.
5. It may enable marketers to incent a plant to take additional milk by delivering and pricing milk reflective of market conditions to a non-pool plant.
6. It will allow marketers to avoid damaging efficient milk assembly and transport routes that may arise if marketers are forced to terminate supply relationships.
7. It will retain the FMMO 1 DFOM provision by structuring this action as a temporary interpretation so long as current marketing conditions exist.
8. In an effort to help and support the independent producers, DFA will continue marketing the independent milk, for a minimum period of 6 months, and potentially longer, without providing termination notices, provided that required quality standards are maintained.

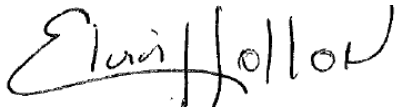
This application of the DFOM provision will mean that for milk delivered to non-pool plants the handler would have the option to not pool all or some portion of the delivery and not be required to pay the minimum order value to the producer for the non-pooled portion of the delivery. If some or all of a producer's milk is not pooled in a given month that producer's milk can return to the pool in the following month provided the other pooling requirements as established by the Order are met.

As the market supply/demand relationships converge to a more balanced position this temporary interpretation will not be necessary and the Order can revert back to the current DFOM provision/interpretation as the proper methodology to manage pooling relationships in FMMO 1.

We are requesting that this action be taken for the period April – September 2017 and that it be accomplished in the most efficient manner possible, while providing due notice to the industry in Order 1.

Thank you for your consideration of our request. We are available to answer any questions or provide any further information which you may need.

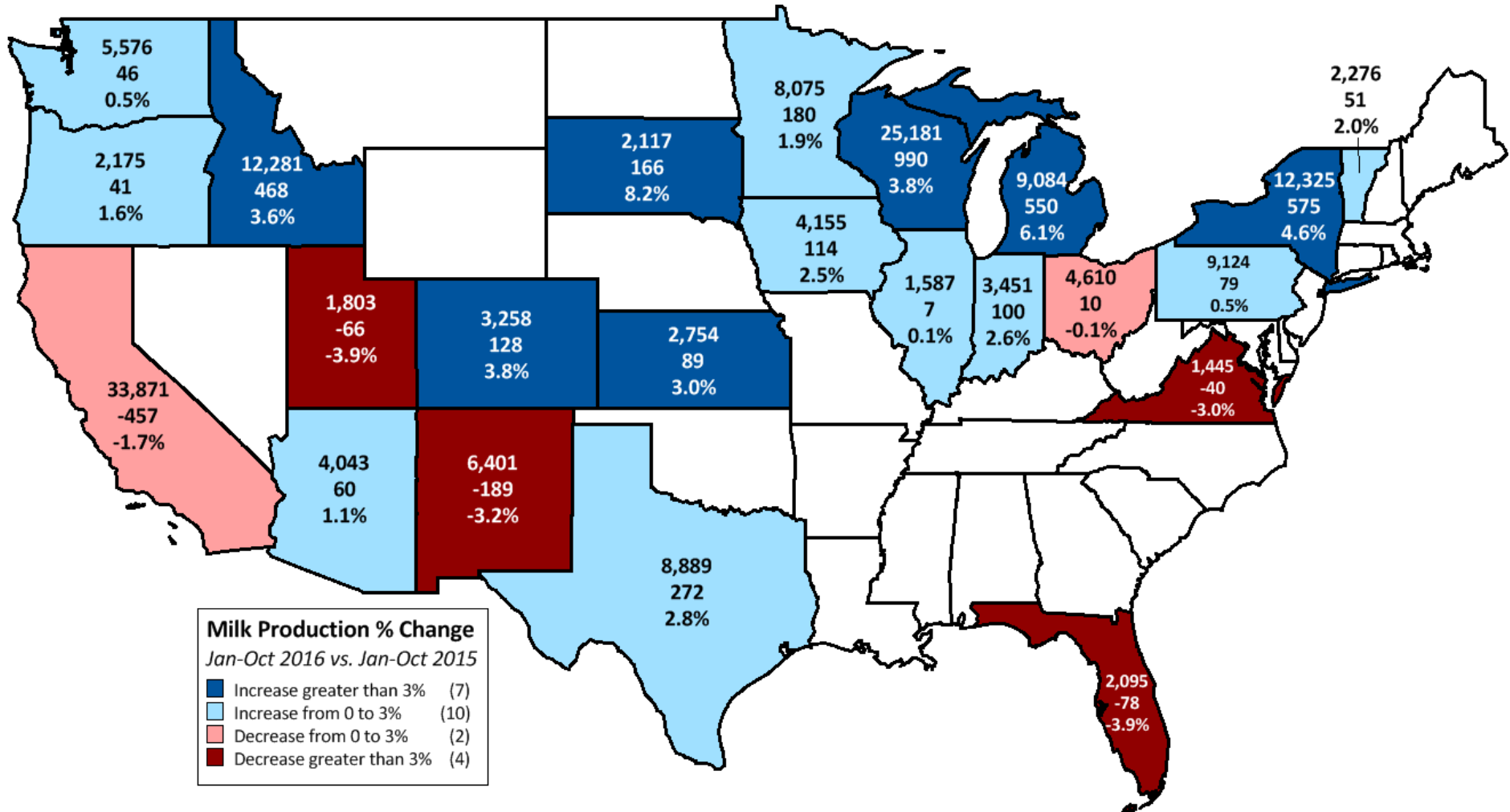
Sincerely,

A handwritten signature in black ink that reads "Elvin Hollon". The signature is written in a cursive style with a large initial 'E' and a stylized 'H'.

Elvin Hollon
Vice President, Fluid Marketing/Economic Analysis

Map 1: YTD U.S. Milk Production

Jan-Oct 2016 vs. Jan-Oct 2015 (million pounds)



Milk Production % Change
 Jan-Oct 2016 vs. Jan-Oct 2015

- Increase greater than 3% (7)
- Increase from 0 to 3% (10)
- Decrease from 0 to 3% (2)
- Decrease greater than 3% (4)

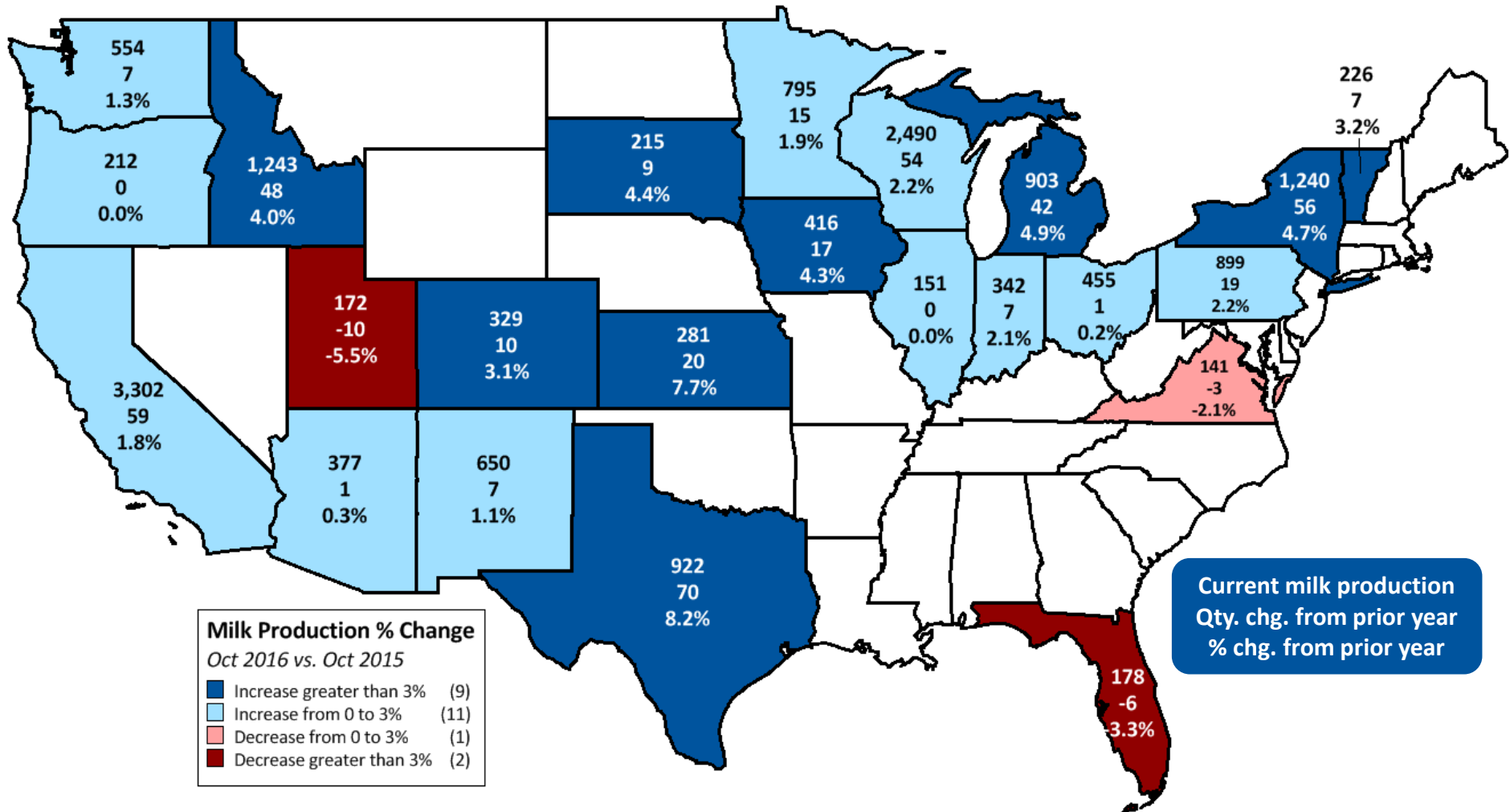
Select 23 state milk production was up 1.6%* year to date

YTD 2016 milk production Qty. chg. from prior year % chg. from prior year*

Source: USDA National Agricultural Statistics Service
 *Leap-year adjusted

Map 2: U.S. Milk Production

October 2016 vs. October 2015 (million pounds)



Milk Production % Change
Oct 2016 vs. Oct 2015

- Increase greater than 3% (9)
- Increase from 0 to 3% (11)
- Decrease from 0 to 3% (1)
- Decrease greater than 3% (2)

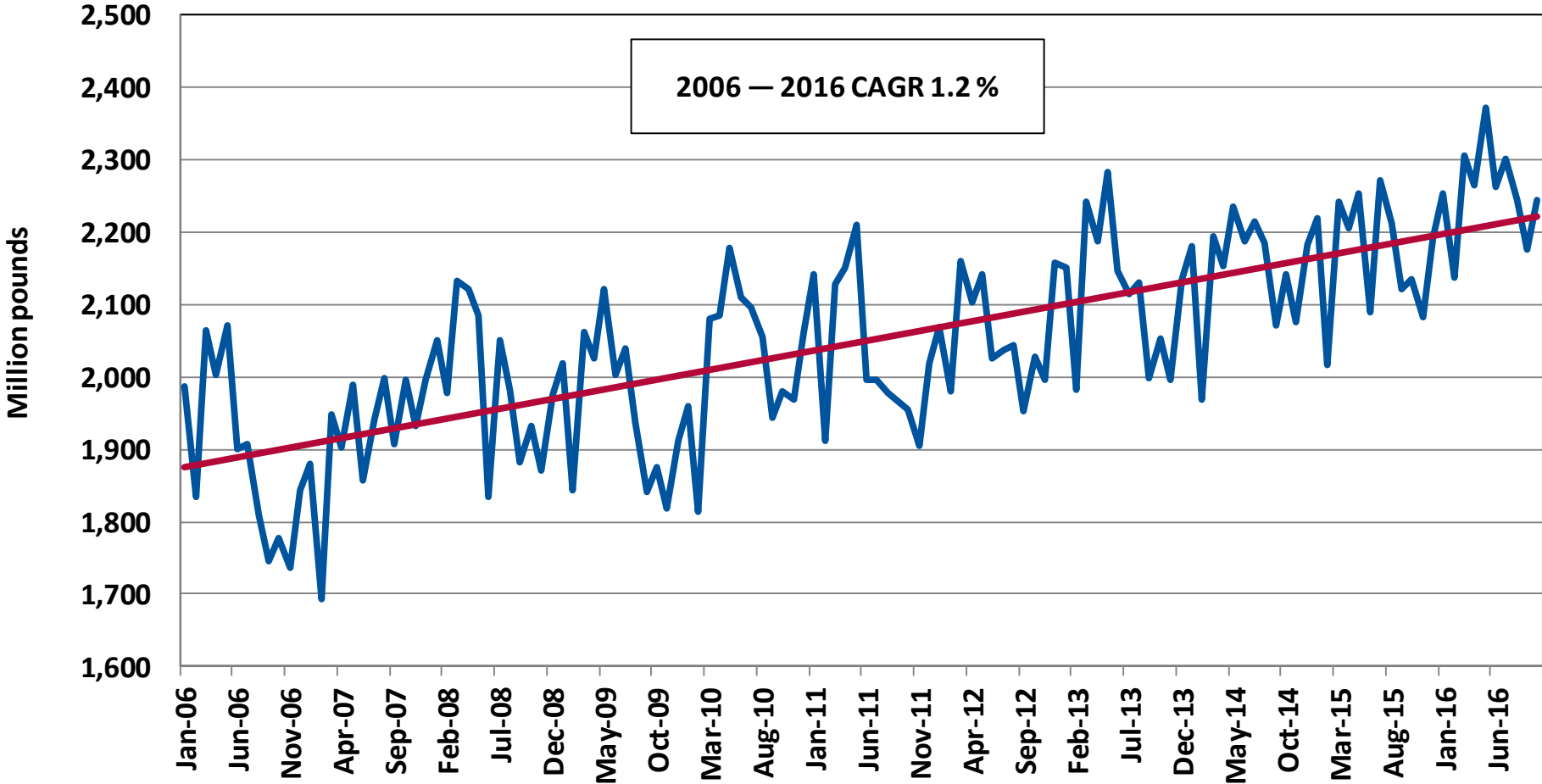
Current milk production
Qty. chg. from prior year
% chg. from prior year

Select 23 state milk production was up 2.7% from prior year

Current milk production Qty. change from prior year % change from prior year

Chart 1: FMMO-1 Total Milk Pooled

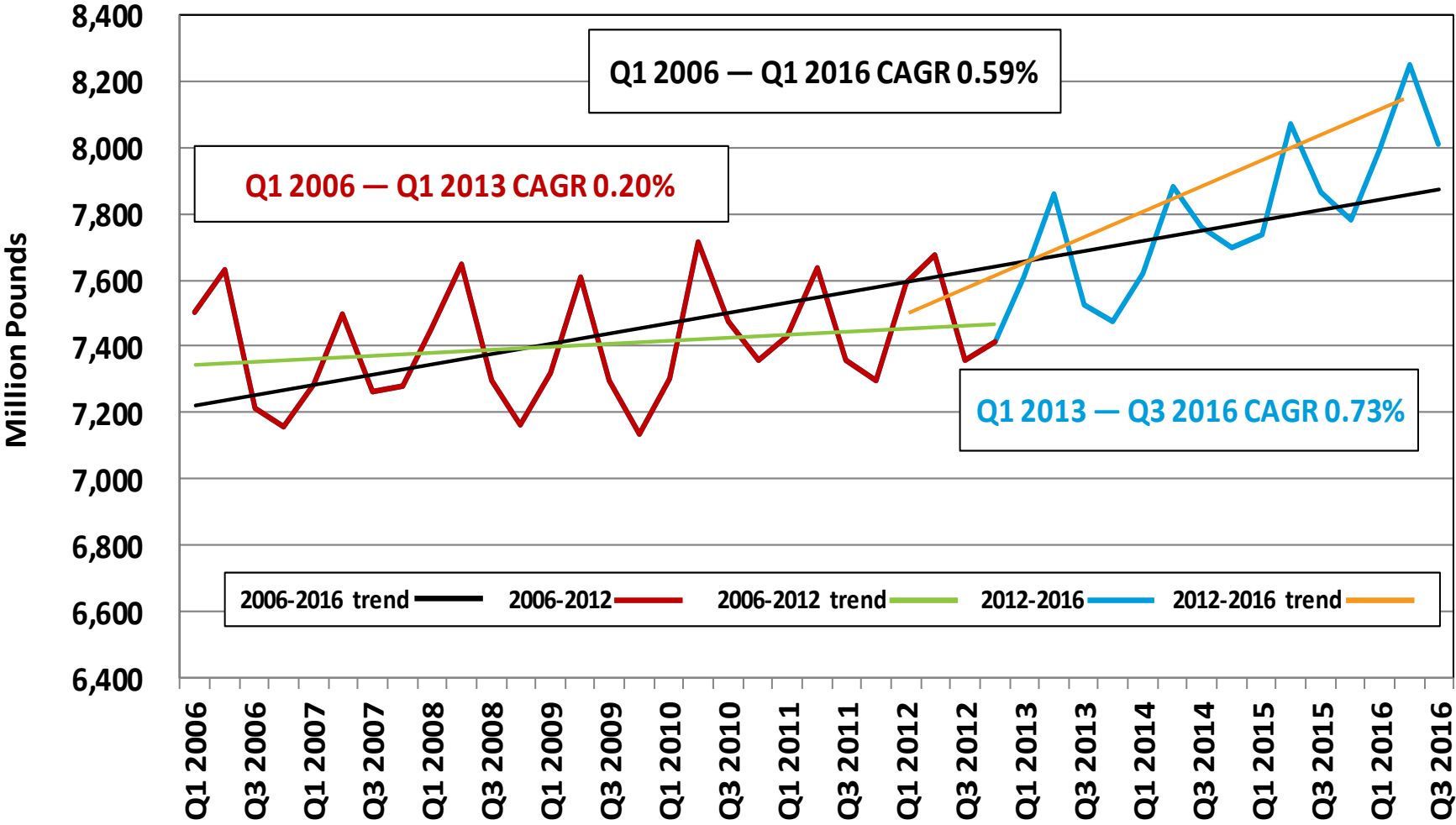
monthly



Source: Federal Milk Marketing Order 1

Chart 2: NASS Quarterly Milk Production

All FMO 1 states



Source: USDA National Agricultural Statistics Service

Chart 3: FMMO-1 Milk Pooled at Minimum Class Price

monthly

