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Is dairy co-op milking the system?

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The Kansas City Star

A consortium of consumer and family farm groups is pushing a Senate committee to investigate Kansas City-based Dairy Farmers of America amid claims of coercion and deceit.

A letter to the Senate Judiciary Committee claims the dairy cooperative has undue influence over prices that dairy farmers receive, controls more of the dairy market than it admits and overall has been detrimental to the majority of dairy farmers and the dairy-buying public.

With consumers paying prices near historical highs for the milk in their cereal and the cheese on their pizzas, it is an issue bound to get attention.

There is no doubt that collectively the 20,000-farmer-member organization, by far the largest dairy cooperative in the U.S., is a powerful force in an industry that generates more than \$30 billion in annual retail sales. And the DFA, formed in 1998 through the merger of four regional farmer-owned co-ops, has been controversial almost from the start.

But DFA officials defend its place in the increasingly complex worldwide dairy industry. It was formed 10 years ago when the U.S. dairy industry became alarmed by the advent of multibillion-dollar international dairy conglomerates, which it believed would outmarket them here as well as abroad.

Randy Mooney, a producer based in Rogersville, Mo., and first vice chairman of the DFA, says the cooperative has helped the industry, even those who are not members, by building national brands like Borden and Keller's and by speaking for it in Washington.

"They help with a lot of issues, including going to Washington with one footprint," Mooney said. "For instance, they were instrumental in getting some important changes to the farm bill that were beneficial to dairy," including increasing payments made to producers when prices go down.

But chief executive Rick Smith acknowledges that today, 10 years after the formation of the co-op, controversy still swirls.

"If you are not the one involved in the consolidation, it can be unsettling and disconcerting if you're not the one getting bigger," Smith said.

To critics, the DFA's enormous size is at the heart of what they see as its negative influence on the industry.

The Department of Justice has brought several antitrust cases against the DFA, including one alleging that collusion by the DFA led to higher milk prices for Appalachian schoolchildren. The co-op undid an acquisition to resolve that case. The most recent lawsuit accusing the DFA and others of illegally colluding and monopolizing the milk market was filed by more than a dozen smaller producers last year in Tennessee.

And there have been long-made allegations by some producers that DFA insiders milked the organization and the industry for their own financial benefit.

The most recent hubbub was sparked in part by the co-op's disclosure several weeks ago that its former CEO made a \$1 million - and still unexplained - payment to its former chairman in 2001.

At the same time, the co-op confirmed that the Commodity Futures Trading Commission is investigating the DFA amid allegations of manipulated cheese prices at the Chicago Mercantile Exchange. Those prices are used to set prices for raw milk.

"Earnest pleas from constituents from Maine to California about the repeated coercive actions by the DFA (and others) against fair marketing of farmers' milk have been ignored too long," the consortium headed by the National Family Farm Coalition wrote to Sen. Patrick Leahy, chairman of the Senate Judiciary Committee. "As welcome as the CFTC and DOJ investigations are, they do not capture the scope of the DFA's stranglehold on the dairy industry."

What the DFA does

The DFA, located in a nondescript, nine-story, glass-faced building off I-29 near Kansas City International Airport, represents dairy farmers in the lower 48 states - from 600 Amish dairy farmers in Lancaster, Pa., to those milking thousands of cows in factory-like settings in Colorado.

With the push by global dairy conglomerates beginning in the 1990s, including giants such as Parmalat of Italy, Fonterra of New Zealand and Campina in Europe, some in the dairy industry saw a need to band together to provide a national and international presence for members to sell and market milk.

And market it did.

Last year, the DFA marketed almost 62 billion pounds of milk and dairy

products with total sales of \$11.1 billion, up 46 percent from 2006. The DFA, however, reported a \$109 million loss in 2007 because of non-cash write-offs totaling \$144.8 million tied to underperforming and non-performing assets.

Members of the DFA, which has become the second-largest cooperative of any type in the U.S., provide about 20 percent of the milk supply in the U.S. But through joint ventures with other entities and co-ops, the DFA markets about 30 percent of all dairy products produced in the U.S.

The DFA's export sales, mostly in the form of hard cheeses and powdered milk, totaled \$211.4 million in 2007, up 75 percent from \$120.8 million in 2006. Joe Horner, a dairy and beef economist at the University of Missouri, says that with the cheap U.S. dollar, exports have been gaining traction. And unlike years past when the vast majority of exports were powdered milk, they are moving more towards higher-priced items like cheese and butter.

Yet just because business is brisk, it doesn't mean it's good for the producer down on the farm.

"Yes, they're finding a market for their product as demand is staying strong even with higher prices, but margins in recent times are getting really squeezed as input costs soar," Horner said.

In fact, this is a crucial time for milk producers. While consumers have been paying high prices for milk since last year, the producer's take has been greatly diminished by significantly higher feed and energy costs.

All segments of agriculture are under tremendous pressure, but maybe none more so than dairy, said Dave Drennan, executive director of the Missouri Dairy Association. About 90 percent of the organization's 600 members belong to the DFA.

"Energy is a big deal to us - each individual dairy uses a lot for milking equipment, the bulk tank to keep the milk cold, and the other thing is hauling," Drennan said. "The state law in Missouri is that milk has to be picked up every 48 hours. That means someone is in the lane every other day to pick up the milk, and all those are diesel-powered.

"Throw in that dairy is the most regulated in agriculture, and that dairy producers are price takers, not price makers, and it's tough."

Smith concurred.

"Dairy farmers are getting at or near record prices, but they have to because of their input costs," Smith said. "In the second half of 2007 they had good margins, and those carried over into the first quarter, but I would say today many producers have negative margins again."

Along with tougher economics, in May the DFA hit the news when Smith

sent a letter to members revealing that in 2001 the then chief executive officer, Gary Hanman, made an unauthorized, under-the-table \$1 million payment to the then chairman, Herman Brubaker, reportedly now living in a nursing home.

Hanman, who lives in Platte City, didn't return calls. But Smith said the money has been repaid with interest. The co-op has hired outside legal counsel to investigate Hanman's payment, and to look for others, and has given the Department of Justice a heads up about the situation.

Smith said the co-op still doesn't know what the payment was for.

"The whole thing is very sad, and it was a bad act," Smith said. "We've recovered the money, but it's more that it was a breach of trust."

As for the seemingly continuous string of antitrust litigation and allegations of collusion and monopolization, Smith says he doesn't think it's unusual for an organization with the size and scope of the DFA to come under such scrutiny.

In a lawsuit filed last year, 16 smaller milk producers in the Southeast alleged that the DFA and other entities, including Dean Foods of Dallas, the largest single milk bottler in the U.S., conspired to monopolize the market in that region. The three entities together, the lawsuit says, own 33 of 51 processed milk bottling plants in the Southeast, representing 77 percent of capacity in the region.

"Depending on your viewpoint, there are some who feel we're too concentrated," Smith said.

He continued: "Yes, it's true the DFA has 50, 60 percent in the Southeast and with two or three others might have 80 percent of the raw milk. Getting farmer co-ops working together - frankly we feel like that's what we should do."

Smith says the DFA is cooperating with the Department of Justice, as it has with the CFTC, which he said is investigating cheese purchases made by the DFA in 2004 at the Chicago Mercantile Exchange in the cheddar cheese pit, where spot prices serve as a benchmark for setting prices for raw milk.

That inquiry is tied back to Hanman, who, according to a December 2004 story by the Chicago Tribune, boasted to DFA members in an October 2004 meeting in New York that through trading actions of the DFA at the CME from that spring through September, it was able to increase prices paid to members by \$1.3 billion.

"I don't believe we did anything wrong, but I guess I would say the CFTC isn't as certain of that as we are," Smith said.

The CFTC and the Department of Justice would neither confirm nor deny any investigation of the DFA.

Then there are allegations of self-dealing, one of the most often-cited

examples involving a joint venture in the Northeast.

In that instance, Smith said the DFA joined with an industry veteran, Bob Allen, in a joint venture. In the end, the DFA and Allen, who invested about \$1 million of his own money, sold the dairy operation, and each partner pocketed almost \$22 million.

"That was a success, but because of the money involved, the story makes for good fodder for some people," Smith said, "but frankly I would hope I could find more deals like that that were successful."

Conflicting views

Jerry King has been in the dairy farming business for more than 50 years. During most of that time, he said, he's been a member of a co-op of some sort.

King and his brother-in-law, Ed Steele, sold the Steele King Dairy outside of Butler, Mo., last December, but both still help out the couple who bought it, Robert and Theresa Shine.

"I guess the good thing about (co-ops) is I never had to worry about having someplace to sell my milk," King said. "You could be selling to a private company, and one day they could just up and tell you they didn't want your milk anymore."

As for the prices he received from the DFA, King said he was pretty satisfied.

"It was pretty competitive, but probably never as much as we wanted," King said. "But I guess we always want more, don't we?"

But others are frustrated that in some instances the DFA is their only option.

Take Tony Whitehead, who has a dairy operation in southern Missouri, where unfortunately, he said, Dairy Marketing Services - a joint venture of the DFA and Dairylea of Syracuse, N.Y., where Smith got his start - is his only option.

"I was selling to another smaller co-op down here, but they got bought up by DFA, too," Whitehead said.

Then there's Freddie Martin of Humansville, Mo., who now sells to DMS, but back when he did his own bottling, the DFA refused to buy his surplus.

"Now I don't have anything against them, but they don't like us little boys," Martin said. "I was in competition with them, so they didn't want to buy from me."

Martin said he was one of the producers who over the years had been contacted by the Department of Justice, asking questions about the DFA.

One who has long criticized the DFA is Pete Hardin, publisher and editor of a dairy industry weekly newspaper, The Milkweed, based in Brooklyn, Wis.

Of the uncovering of the recent \$1 million covert payment, Hardin thinks it's just the beginning of an unraveling.

Hardin has also been critical of the DFA's financial performance, including last year's loss.

Hardin also noted that some smaller co-ops return a much higher portion of sales to farmer members, including the Scenic Central Milk Producers in Wisconsin. That co-op, with 300 members and \$62 million in sales last year, returned about 90 percent of revenues to members, compared with less than 70 percent at the DFA.

But he's willing to give Smith some benefit of the doubt to see if he can clean up the organization and its reputation.

"At this point I can't tell, but I'm sure he's at least trying," Hardin said. "But it's hard to turn the ship around when it's been going in the same direction for such a long time."

Who's got milk?

Industrywide, more than a third of the milk produced in the U.S. goes into drinking milk. A little over 40 percent goes into butter, powdered milk and cheeses like those used by pizza makers. Twenty percent goes into what the industry calls "soft" products - ice cream, cottage cheese, sour cream and yogurt.

Hard products - butter, cheese and powder - can be stored and shipped internationally. About 10 percent of milk produced in the U.S. ends up in products that are exported around the world, mostly hard cheeses and powdered milk.

At the same time, about 6 percent of the dairy products consumed in the U.S. are imported, much of it high-end soft-ripened cheeses such as Brie and Roquefort, although the higher prices for these make the value of dairy exports and imports about equal.

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