A CENTURY OF COOPERATION

Dairylea Cooperative Inc.

Received CFTC Records Section 6/16/09

DFA Dairy Farmers of America

09-4

16

2009 JUN 16 PM 3 20

C.F.T.C. OFFICE OF THE SECRETARIAT

June 16, 2009

Mr. David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW.
Washington, DC 20581

COMMENT

Re: Whether to Eliminate the Bona Fide Hedge Exemption from Speculative Position Limits

Dear Secretary Stawick:

Dairylea Cooperative Inc. (Dairylea) and Dairy Farmers of America (DFA) collectively request that the Commodity Futures Trade Commission (CFTC) change its policy relative to swap dealers being eligible for the bona fide hedge exemption and, instead, place limits on their speculative trading activity. We also request that speculative limits be placed on the non-commercial customers of swap dealers.

Dairylea and DFA are cooperatives exclusively owned by dairy farmers that operate family businesses. Our farmer members face financial harm by unchecked speculative activity when it increases commodity prices regardless of underlying market fundamentals – this increased volatility impacts dairy farmers' cash cost of operating. Although the comments below are specific to dairy farmers, unchecked market speculation harms everyone who consumes these commodities

Livestock feed is the life-blood of dairy farms. Without it, cows do not have the fuel necessary to produce milk. Although many of our dairy farmer members grow the preponderance of their feed, most purchase a significant amount in the form of pre-mixed feed concentrate, shelled corn, soybean meal and other commodities directly impacted by feed commodity futures prices. As an operating expense, purchased feed is the single largest component – representing about one-third, but up to 50% or more of production costs. Cash feed commodity prices, FOB the farm, change day-to-day and month-to-month, because of changes in futures prices which is the benchmark used in pricing these inputs.

In 2008, when corn futures prices escalated, physical commodity prices escalated as well. Speculative investment decisions by participants in hedge funds and other entities result in commodity price appreciation not supported by factors one would associate with impacting the supply and demand for the underlying physical commodity. When this occurs, commodity

PO Box 4844
Syracuse, NY 13221-4844

futures prices increase and push cash prices up. This non-fundamental increase drives up dairy farmers' cost of production and negatively impacts their financial position.

Your request for comments on the proposed change in regulation of swap dealers comes at a time when dairy farmers are suffering financial losses that may be the worst ever. U.S. dairy farmers are losing an estimated $74 per cow per month, on average – although farms that purchase a larger than average proportion of their feed may be losing significantly more[1]. For the average size farm of about 163 cows, this would be more than a $140,000 loss on an annualized basis. For dairy farms of 1,000 cows – which farms of this size and larger produce slightly more than 45 percent of the milk in the U.S. – the annualized loss is a staggering $1 million or more. Dairy farmers net margins have deteriorated due to price issues impacted by the loss of export markets and the worldwide financial crisis, and due to higher production costs largely showing up in feed prices. Since the expansion of federally supported ethanol production, the average cost of the purchased feed component of production costs has increased 68 percent[2]. A large factor in this increase is due to greater demand for feedstuffs generated by the ethanol marketing channel. Due to the feed price inflation caused by ethanol, dairy farmers can ill-afford additional price inflation caused by unchecked speculative investments.

Recently, July 2009 corn futures prices have increased from $3.59 ½ per bushel in March to $4.18 per bushel, today, a 16 percent increase. Along with increased prices in the soybean complex, this has driven cash operating costs on dairy farms up significantly at a time that milk prices remain at levels that is estimated to average 29 percent less than production costs during the first six months of this year[3].

Allowing unfettered speculation in feedstuffs to provide the opportunity of financial gain to some of the wealthiest Americans and its institutions, at the risk of financial harm to dairy farmers and at the risk of food inflation to all Americans, is unconscionable. Although we do not have evidence to offer as to the impact this has on economic activity, it seems evident that the prudent decision would be to take initiatives to limit the opportunities for speculative activities that potentially can significantly harm commerce and the pocketbooks of the majority of Americans not able to partake in the gains of the speculative activities.

Lynn Stout, the Paul Hastings Professor of Corporate Securities Law at UCLA, in her testimony to the Senate Committee on Agriculture, Forestry and Nutrition on June 4, 2009, stated when commenting about derivatives speculation that: "These speculative trading gains are purely private benefits, however, that come at other investors' expense. Meanwhile, unrestrained derivatives speculation has historically been linked to a host of very serious economic ills, including price bubbles, increased risk, reduced real economic growth, and increased fraud and manipulation."

---

[1] Dairylea has projected the average loss at $74 per cow per month. Information from others suggests that losses exceeding $100 per cow per day have been occurring on farms that purchase larger than average amounts of feed.
[2] As projected by Dairylea using USDA data for corn, soybeans and alfalfa and a utilization formula developed by Dairylea. The analysis indicates that purchased feed cost has risen from a 2002-2006 average of $3.72 per hundredweight of milk produced to $6.26 in 2009.
[3] As projected by Dairylea.

Michael Masters, Managing Member, Master Capital Management, LLC, in his testimony to the Senate Committee on Homeland Security and Governmental Affairs in May 20, 2008, stated when asked are institutional investors contributing to food and energy price inflation: "Institutional investors are one of, if not the primary, factors affecting commodities prices today."

The concern we present goes beyond the spot month prices. Dairy farmers forward contract their feed purchases – locking in feed prices months in advance of deliveries. Regulations allowing investors to speculate, beyond reasonable limits, in non spot months, can have a price distorting impact on dairy farmer feed prices. This can result in farmers locking into feed prices at levels much higher than the fundamentals would suggest. For some farms that milk large numbers of cows on a small land base, locking into a year's worth of feed prices in late summer/early fall, is customary. Since dairy feed is the lifeblood of the business, these farmers contract with neighboring farms, feed mills, or others on a yearly basis – to assure that they will have feed for their dairy farm. These feed purchase contracts are influenced by futures prices – beyond the spot month. Excessive speculative activity, beyond the spot month that results in rising prices, can contribute to higher feed costs for these dairy farms.

In response to the questions posed relative to the oversight of non-commercial activities of swap dealers, we provide the following comments.

1) Swap dealers that are not providing transactions for the legitimate hedge of underlying physical commodities should have speculative limits imposed and no longer be allowed to qualify for exemption under the existing bona fide hedge definition.

2) A limited risk-management exemption for swap dealers is appropriate on transactions hedging underlying physical commodities, provided the transactions for the client are legitimate physical hedges. For example, if the client is a grain elevator that uses the swap dealer as a means of hedging its natural price risk, but also uses the swap dealer to place bets on copper prices, the transactions relative to copper should not carry the exemption. We realize this can slide into a gray area very quickly. For instance, a milk company that uses a swap dealer to hedge corn and soybean prices, that are part of a milk contract whereby the plant is paying dairy cooperatives a milk price that is adjusted by changes in feed prices, should qualify for the exemption since the changes in corn and soybean prices directly impact the price the plant pays for its milk supply. We recommend administrative latitude on the part of the CFTC, combined with a system of appeals for reconsideration, to handle these "gray" areas.

3) Upon making the change, some time period should be allowed to bring swap dealers into compliance.

4) Speculation that can drive energy and metal prices higher have the same ill-effect as speculation on feed commodities – including negatively impacting dairy farmers cost of production and their financial performance. Corn futures for example are linked to

crude oil futures because of the relationship of ethanol to fuel prices. We believe the same speculative limits should apply for energy and metals, as well.

5) Transactions for swap dealers' clients that are hedging price risk of the underlying physical commodity should still be considered bona fide hedgers. Guidance should be given to what constitutes a commercial, however, administrative discretion should be left to the CFTC or the self-regulatory organization, to appropriately adjust as necessary to the continued maturation of the derivative marketplace hedging physical commodity price risk.

6) Swap dealers should self certify whether clients are commercial, report information to identify such and be periodically audited. Annual reports should be filed along with monthly reporting of new clients or changes in existing client's activity (i.e., change from commercial to non-commercial activities).

7) More information is always better than less information, to the extent that it does not create a large financial burden for a small benefit. Transparency will be improved by creating subcategories as presented in the request for public comment.

8) No comment at this time.

9) It would be important to look through to the intermediaries to review their transactions and apply speculative limits to the initial counter-party, if applicable., For example, if a swap dealer transacted with a hedge fund, the CFTC or its representative should look through the transaction and apply applicable position limits to the hedge fund to assure the hedge fund did not work through another swap dealer, gaining additional speculative exposure and possibly circumventing the position limits.

10-15) No comments at this time.

Dairylea and DFA request that the CFTC change its policy and place limits on the speculative trading activity of large swap dealers. Doing so, will limit the speculative impact on feed and other commodity prices faced by dairy farmers and may lead to reduced volatility in commodity markets. This requested action may help limit the appreciation in operating costs on US dairy farms.

Dairylea is a farmer owned agriculture marketing and service organization with more than 2,200 members. It is the largest milk marketing organization in the Northeastern US, selling more than 5.5 billion pounds of raw milk annually through an extensive milk marketing network. Dairylea's goal is to maximize net returns at the farm by preserving and enhancing milk markets and milk marketing relationships, and by providing services and programs that create real value to our members.

DFA is a leading dairy marketing cooperative that serves and is owned by nearly 18,000 dairy farmers in 48 states. Through programs and services designed to help make businesses more profitable, DFA brings added value in the form of farm lending options, health insurance, sustainability resources, risk management tools, member retirement plans and on-farm field and lab services. Through its Gold Standard Dairy Program, DFA member farms meet high standards in areas including animal well-being, environmental stewardship, employee training and milk safety and quality. In addition to marketing milk, DFA is one of the country's most diversified manufacturers of dairy products, food components and ingredients, and is a leader in formulating and packaging shelf-stable dairy products.

Thank you for allowing Dairylea and DFA to comment on this important issue to the thousands of family business owners that own our cooperatives.

Sincerely,

Edward W. Gallagher

Edward W. Gallagher
Vice President
Economics and Risk Management
Dairylea Cooperative Inc.
Dairy Farmers of America, Farm Services Division
1-800-654-8838