

MEMORANDUM

January 28, 1997

TO: Assembly Republican Legislators and Staff
FROM: John Liethen, ARC
RE: National Cheese Exchange and Dairy Prices

The following is a brief summary on the factors which impact milk prices, the controversy surrounding the National Cheese Exchange, and proposed legislative action.

Wisconsin Milk Prices and Recent Events

Background: The Basic Formula Price

The price of cheese traded on the wholesale market, the selling price of milk paid at dairy product processing plants, and, to a lesser extent, the federal dairy price support impact the price of milk paid to farmers in Wisconsin and the Upper Midwest. The US Department of Agriculture determines the Basic Formula Price (BFP) which is the minimum price a wholesale milk buyer must pay producers under the federal milk marketing orders for manufacturing grade milk, i.e., milk used for butter, cheese, and ice cream production. The BFP formula includes prices paid by dairy processing plants in Minnesota and Wisconsin and the trading price of manufactured dairy products, such as cheese and butter.

In turn, the National Cheese Exchange (NCE) impacts the price offered by cheese processing plants. Located in Green Bay, the NCE is the only wholesale market for bulk cheese in the nation. Much like other commodity markets, traders buy and sell bulk quantities of cheese. As a result of the trading at the NCE, the price of bulk cheese is determined for each week and is used by processing plants as a mechanism to determine the value of their product and what they are willing to pay for milk which is used in production. Again, this average price is reflected in the BFP.

The final factor which has a marginal impact on milk prices is the federal dairy price support system. The price support prevents the BFP from falling below a certain minimum price. Currently, the price support is at \$10.20 per hundred weight (cwt) and is funded by an 11.25 cents/cwt assessment paid by farmers to the federal government. With passage of the 1995 Farm Bill, the dairy price support system will be phased out by the year 2000 and the assessment will be eliminated by 1997.

Two things must be noted regarding the BFP. First, the BFP is only the *minimum price* a milk buyer must pay to farmers. In Wisconsin, the price farmers actually receive for milk is often higher than the BFP. Cooperatives negotiate higher prices for their members. Also, Wisconsin dairy processing plants have argued the need to maintain a reliable flow of quality, raw milk and thus pay higher prices. The average "mailbox" price farmers received in 1996 was \$14.60/cwt, \$1.21 higher than the BFP. Second, the average BFP in 1996 was a historical record of \$13.39/cwt. This average was \$1.56 higher than 1995.

Focus on The National Cheese Exchange

As stated above, the NCE is run much like a commodity market in that bulk quantities of a commodity, in this case cheese, are bought and sold. However, there are unique differences between the commodity trading in Chicago or New York and the NCE in Green Bay. First, there are no safeguards preventing dramatic fluctuation in trading prices at the NCE. All other commodity markets are regulated by the Commodity Futures Trading Commission (CFTC). Second, the NCE is a cash-market where less than one-half of one percent of all cheese in the US is traded. Commodity markets operate on trading futures and options of a given commodity with broad representation by the respective industry's players. From 1988-1993, four companies accounted for 88 percent of all cheese sales at the NCE, not a representation of actual market conditions.

In March 1996, University of Wisconsin - College of Agricultural and Life Sciences and Department of Agriculture Trade and Consumer Protection researchers completed a four year investigation of the trading practices at the NCE. Volatile trading during the early 1990s prompted the investigation. Perhaps the most significant finding of the investigation was that companies who prior to 1988 were buyers of cheese both on and off the Exchange and companies who were sellers of cheese both on and off the Exchange reversed roles. This change in trading behavior allowed companies to "trade against their interest." A company which primarily sells on the Exchange yet primarily buys off the exchange could force the price of cheese down by selling at an artificially low price in order to lower its cost of buying off the Exchange.

Milk Price Drop and The Governor's Task Force

Due to the correlation between milk prices and trading at the NCE, the high milk prices of the previous months dropped as cheese prices fell from \$1.75 to \$1.30 per pound in November. A drop in cheese prices of one cent per pound results in approximately a ten cent drop in milk prices per hundred weight. The BFP dropped to a low of \$11.34/cwt. Although 1996 was a record year for milk prices, production inputs, such as feed costs, and equipment prices have been rising resulting in lower profits.

Agricultural economists and dairy market observers explain the drop in cheese prices and the subsequent drop in milk prices on increased cheese production during the summer months of 1996 which resulted in higher cheese inventories, not because of anti-competitive behavior by NCE participants. For instance, California dairy producers, who sell their milk for dry milk production, increased their cheese production by 30% between January and October of 1996 due to such a high BFP. Cheese inventory levels nationwide were 16% higher in October 1996 than they were the previous year. High cheese inventories coupled with buyers observing milk availability for future cheese production led to lower bids at the NCE. While cheese and milk prices are currently rising, national cheese inventories at the end of 1996 were still 24% higher than last year.

As a result of the UW-CALS/DATCP investigation, Governor Thompson appointed a Task Force on Cheese Pricing in the spring of 1996. The suggestions from the Task Force will be delivered to the Board of the NCE, to the USDA and to Congress in early February. The Task Force agreed to the following recommendations:

1. The US Department of Agriculture should not use the NCE price to determine the basic formula price;
2. The price of milk used for the federal milk marketing orders should be based on supply and demand;
3. A limit on cheese price movement in trading at the NCE;
4. The Coffee, Sugar, and Cocoa Exchange and/or the Chicago Mercantile Exchange establish a cash market for cheese;
5. The CFTC and the Federal Trade Commission re-evaluate their authority to regulate the NCE; and
6. The NCE include a public member on its board.

Legislative Action

ASSEMBLY JOINT RESOLUTION 5

Authored by Rep. Ott, AJR 5 requests that USDA to stop using the NCE as a mechanism to determine the BFP and that a new formula be created to more accurately reflect supply of and demand for milk.

ASSEMBLY JOINT RESOLUTION 14

Also authored by Rep. Ott, AJR 14 requests the CFTC and the FTC to re-evaluate their regulatory authority over the NCE.

Both of these proposals will enhance the Governor's argument for dairy price reform during his trip to Washington, D.C.

SENATE BILL 2

Authored by Senator Clausen, SB 2 requires the DATCP to regulate the NCE and creates penalties for certain non-competitive behavior. The following are major provisions of SB 2:

1. The DATCP is required to monitor and supervise the trading activity of the NCE;
2. Traders on the NCE are prohibited from trading against interest and from any other type of price manipulation as identified by DATCP rule. Trading against interest is defined as a seller primarily on the NCE acting primarily as a buyer off the exchange and vice versa;
3. The DATCP can issue an order refusing trading privileges to a member of the NCE who has traded against interest or acted to manipulate price;
4. Members of the NCE are required to report to the DATCP all of their trading activity both on and off the NCE during their participation at the Exchange; and
5. The DATCP can seek both criminal and civil penalties for violations of the provisions of the bill. Individuals are not provided the opportunity to seek civil damages from violators of the provisions of the bill.

Senate Bill 2 requires DATCP to draft emergency rules to implement the law within 60 days of enactment of the law.

On January 21, 1997, the Senate Committee on Agriculture and the Environment held a public hearing on SB 2. The Committee recommended passage of SB 2, as amended by a substitute amendment described above, on a 5-0 vote. On January 28, 1997, Sen. Welch raised a point of order that SB 2 was not properly before the Senate because it has a fiscal note of \$411,400 and had not had a hearing before the Joint Committee on Finance (JFC). The Senate referred SB 2 to the JFC.

Rep. Springer (D) authored a companion bill to SB 2 in the Assembly. Rep. Springer's bill (LRB 1611/2) has not been officially introduced.

Major Arguments Against State Regulation of the NCE

- Regulation of the NCE does not guarantee increased farm income. A regulatory action and eventual court case may be needed before the actions of the traders change their behavior. In any event, completely legal activity on the NCE does not guarantee that cheese prices will rise.
- The key to improving milk prices is for the USDA to stop using the NCE cheese prices in their BFP formula. The USDA has already indicated that it will find an alternative to the NCE in its milk price formula within the next few months.
- Trading which raises cheese prices and therefore milk prices is also a violation of the bill if the trader is *primarily* a buyer off the NCE and *primarily* a seller on the NCE. Such regulation could put farm cooperatives in legal jeopardy for simply trying to get better prices for their members, even if the cooperative is *unsuccessful* at raising prices.
- Because of the impact the NCE has on the price of cheese and milk nationwide, the federal government, not the state DATCP, should regulate the trading activity of the NCE. Federal regulators have the expertise in commodity trading oversight that the DATCP does not have.
- This legislation merely panders to legitimate farmer frustrations over milk pricing policy at the federal level.
- The NCE is the only cash market for cheese in which cooperatives, processors, and marketers can trade to create a reference point for future price negotiations.
- Passage of the bill will only chase the NCE out of Wisconsin – America's Dairyland. The Board of Directors of the NCE have made it clear that the regulation proposed in this legislation will hinder the ability of members to trade freely without fear of criminal prosecution. While the NCE has welcomed oversight by the CFTC, they have stated their intent to move if the state begins regulation.
- Requiring members of the NCE to know the price of cheese off the Exchange prior to trading on the Exchange to prevent them from trading against interest would be technically near impossible since the NCE is the only price discovery mechanism for cheese.
- State legislators should focus their energy on substantive legislation which can improve Wisconsin farm income, such as reducing property taxes and eliminating burdensome regulation.

Major Arguments Made in Favor of State Regulation of the NCE

- The anti-competitive actions of large traders, such as Kraft, have forced milk prices down causing individual farm income to drop as much as 25 percent. The state must do something to protect farm family income.
- With less than 0.2 percent of total cheese volume in the U.S. being traded at the NCE, the least the state can do is protect the dairy industry from price fluctuations influenced by a less than perfect representation of the nation's cheese market.
- Wisconsin dairy farmers cannot wait for federal action to resolve the decline in milk prices. The state must act now.
- Regulation of the NCE is not in violation of the Constitution's commerce clause. The state is regulating a private market within its borders.
- Members of the NCE should have nothing to fear as long as they do not participate in unfair trading activity or price manipulation.
- If the NCE does leave the state because of these new regulations, Wisconsin's dairy industry loses little. The state will be sending a strong signal that it will not tolerate unfair trading behavior which reduces family farm income.

Analysis

The problems associated with the decline in Wisconsin dairy prices are not new. Increased competition by Southwestern and California dairy farmers and the continuation of an unfair federal milk marketing system which depends on inaccurate assessments of milk value continue to plague Wisconsin dairy farmers and their ability to become profitable. The Governor's trip to Washington, D.C. should help pressure the federal government to resolve some of the problems associated with the influence the NCE has on milk prices. Nevertheless, until Congress eliminates or the USDA reforms the federal milk marketing system, dairy farmers' paychecks will remain dependent on the price of cheese determined at the NCE or an alternative commodity market.

Throughout the coming months, milk prices are predicted to rise again. Some agricultural economists believe that the BFP average for 1997 will be well above \$13/cwt. With changes in federal milk marketing orders expected and transition into a more market based dairy economy, farmers and legislators will have to cope with greater fluctuations in milk prices for the near future. This will be trying for most.

Unfortunately, state legislators will never be able to increase milk prices. State legislators should focus on keeping pressure on the federal government and Wisconsin's congressional delegation for dairy policy reform. Legislative attempts to influence milk prices through state legislation are mostly political. One answer at the state level is for legislators to maintain and improve an economic climate which provides farmers an opportunity to succeed through common sense regulation, lower property taxes, and access to quality health care.

If you have any questions on this or any other agriculture issue, please feel free to contact me.

Summary of the Bill

National Cheese Exchange Oversight and Improvement Act of 1997

* Amends the Commodity Exchange Act, to require the Commodity Futures Trading Commission (CFTC) to regulate the National Cheese Exchange (NCE), in consultation with USDA, until such time as the NCE is no longer used as a reference price for the majority of commercial cheese sales off the exchange.

* Require the NCE (or any other cash market regulated by the CFTC as a result of this bill) to submit to the CFTC for approval a set of rules and regulations of operation, and to enforce those rules and regulations.

* Further, the bill would give the CFTC authority to regulate other cash markets, if the conditions similar to the those on the NCE were to occur on another cash market. Specifically, CFTC would be required to regulate a cash market when the following conditions coincide:

- trading is geographically centralized
- the cash market is very thinly traded or highly illiquid
- the price established by the market or exchange acts as a reference price for a majority of commercial transactions off the market
- the market is substantially unregulated by any other regulatory structure (including state regulation or regulation by the market itself)
- manipulation on the cash market is a deterrent to the use of the futures market for the same commodity.

105th Congress
1st Session

S. _____

IN THE SENATE OF THE UNITED STATES

Mr. Kohl (for himself and Mr. Feingold) introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To amend the Commodity Exchange Act to require the Commodity Futures Trading Commission to regulate the National Cheese Exchange and certain cash markets until the Commission determines that the Exchange or markets do not establish reference points for other transactions, and for other purposes.

1 *Be it enacted by the Senate and House of Representatives of the United*
2 *States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE**

4 This Act may be cited as the "National Cheese Exchange Oversight and
5 Improvement Act of 1997".

6 **SEC. 2. FINDINGS.**

7 Congress finds that the operation of the National Cheese Exchange is of
8 national concern, and in need of Federal oversight, because---

9 (1) a 3-year, federally funded investigation into the activities of the
10 National Cheese Exchange in Green Bay, Wisconsin, determined that the
11 National Cheese Exchange is very thinly traded, highly concentrated,

1 “(2) a cash market for a commodity if---

2 “(A) the cash market is geographically centralized in the form
3 of a market or exchange;

4 “(B) the cash market is determined by the Commission to be
5 very thinly traded or highly illiquid;

6 “(C) the price established by the cash market functions as a
7 reference price for a majority of commercial transactions off the cash
8 market for the commodity being traded;

9 “(D) Trading the cash market is concentrated among relatively
10 few buyers and sellers;

11 “(E) the cash market is substantially unregulated by any other
12 regulatory structure (including State regulation or self-regulation);

13 “(F) a futures market regulated under this Act also exists for the
14 commodity that is being traded on the cash market; and

15 “(G) the Commission determines that the instability, illiquidity,
16 and/or potential for manipulation for on the cash market could be a
17 deterrent to the use of the futures market for that commodity.

18 “(b) GENERAL RULE.--- In consultation with the Secretary of Agriculture,
19 the Commission shall regulate a cash market under this Act until the Commission
20 determines that the cash market is not functioning as a reference price for a
21 majority of commercial transactions off the cash market for the commodity being
22 traded.

23 “(c) RULES AND REGULATIONS.--- The Commission shall require a
24 cash market that is subject to this section to---

25 “(1) submit to the Commission for approval a set of rules and
26 regulations for operation of the cash market; and

1 completely unregulated, and subject to manipulation;

2 (2) while less than 1 percent of the cheese produced in the United
3 States is sold on the National Cheese Exchange, the price determined by the
4 National Cheese Exchange acts as a reference price for as much 95 percent
5 of the commercial cheese transactions conducted in the United States;

6 (4) the Coffee, Sugar, and Cocoa Exchange in New York, an
7 exchange regulated by the Commodity Futures Trading Commission, trades
8 futures contracts for cheese;

9 (5) low-volume trading of cheese futures contracts on the Coffee,
10 Sugar, and Cocoa Exchange is partially related to concerns about the lack of
11 viability, and potential for manipulation, in the dominant cash market for
12 cheese, the National Cheese Exchange;

13 (6) the National Cheese Exchange is completely unregulated by any
14 Federal or State agency; and

15 (7) the Commodity Futures Trading Commission claims a lack of
16 authority to regulate or oversee cash markets, such as the National Cheese
17 Exchange.

18 **SEC. 3. CFTC REGULATION OF NATIONAL CHEESE EXCHANGE AND**
19 **CERTAIN CASH MARKETS**

20 The Commodity Exchange Act (7 U.S.C. 1 et seq.) is amended by adding at
21 the end the following;

22 **“SEC. 23. COMMISSION REGULATION OF NATIONAL CHEESE**
23 **EXCHANGE AND CERTAIN CASH MARKETS.**

24 **“(a) DEFINITION OF CASH MARKET.**---- In this section, the term ‘cash
25 market’ means---

26 **“(1) the National Cheese Exchange; and**

NEWS

UNITED STATES DEPARTMENT OF AGRICULTURE
Office of Communications News Room 460-A
Washington, DC 20250-1300
Internet: News@usda.gov Phone: 202-720-9035
World Wide Web Home Page: <http://www.usda.gov>

Release No. 0019.97

Jim Petterson (202) 720-4623
Connie Crunkleton (202) 720-8998

USDA SEEKS COMMENT ON USE OF NATIONAL CHEESE EXCHANGE DATA IN DETERMINATION OF MILK PRICES

WASHINGTON, Jan. 29, 1997--Agriculture Secretary Dan Glickman today announced he is taking steps to address concerns raised by dairy producers about how milk prices are calculated.

Glickman is seeking public comment on whether National Cheese Exchange (NCE) price data should be used in the determination of the Basic Formula Price (BFP) used in federal milk marketing orders. This action is in addition to the process currently underway in the Department to consolidate and reform federal milk marketing orders by April 1999, as mandated by the 1996 Farm Bill.

The BFP is determined by USDA each month based on a formula that uses the previous month's producer price paid by unregulated manufacturing plants in Minnesota and Wisconsin, adjusted for changes in dairy product prices between the previous and current month. The price of cheese on the NCE is used in this adjustment.

The BFP serves as the price that handlers must pay dairy farmers for milk used to manufacture Class III products (i.e., butter, nonfat dry milk powder, cheese) under the federal milk marketing order program. It also is used to arrive at the price that processors must pay dairy farmers for milk consumed as fluid milk and soft products usage of milk (i.e., yogurt, ice cream).

"Many dairy producers and producer organizations, as well as Senators Kohl and Feingold and Congressman Obey, have indicated their concern with using NCE prices to establish the BFP," Glickman said. "There are concerns that NCE prices may not be reflective of market conditions for cheese nationally, because only a very small share of total U.S. cheese is traded on the NCE, and NCE prices have been subject to abnormally high volatility."

"We must address these concerns now so that dairy producers have confidence that the prices they receive reflect market conditions," Glickman said. "We cannot wait until April 1999 to address this issue. Based on the comments we receive, we will determine whether we should proceed with a national hearing on replacing NCE prices in establishing the BFP."

In response to concerns about the accuracy of reported prices, this month, USDA's National Agricultural Statistics Service (NASS) will begin conducting a national survey of cheddar cheese prices. "We must have broad participation in the survey if it is to be useful to the dairy industry and to be considered as a possible substitute for NCE prices," Glickman said.

The Department will continue to review the BFP as part of Congress' mandate in the 1996 Farm Bill to reform and consolidate federal milk marketing orders. During the next several weeks, in preparation for meeting the April 1999 deadline, USDA will release several studies addressing options for milk order reform, including the role of the BFP and other longer-term pricing issues.

Interested parties wishing to comment on the use of NCE prices in the determination of the BFP may send their comments to: Dairy Division, AMS, USDA; ATTN: BFP Evaluation; Room 2968-S; PO Box 96456; Washington, DC 20090-6456. Comments should be postmarked not later than March 31, 1997.

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NOTE: USDA news releases and media advisories are available on the Internet. Access the USDA Home Page on the World Wide Web at <http://www.usda.gov>

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Beginning Jan 1, 1998, there shall be ~~no~~ cash auction market for Cheese conducted in the state unless it is subject to regulation by ~~the~~ the federal govt.

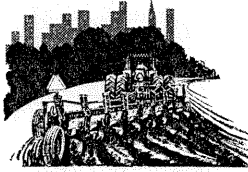
a) No cash auction market for cheese may exist ~~at~~ in this state, after January 1 1988, unless such cash auction market is subject to regulatory oversight by an appropriate federal agency (such as the Commodity Futures Trading Commission)
[need definition of cash auction market]

b) No person may engage in an attempt to engage in any activity intended to manipulate art. finally the market price of cheese traded on a cash auction market.

Substitute Amendment to Senate Bill 2 (passed Senate Ag Comm 5-0)

1. Gives DATCP authority to monitor and supervise trading on NCE
2. Gives DATCP authority to investigate trading against interests and price manipulation that may occur on NCE
3. Requires anyone who trades on NCE to report certain data to DATCP
4. DATCP must promulgate rules related to trading against interest and any other behavior which would constitute price manipulation
5. If DATCP finds a violation of the rules related to trading against interests or price manipulation, the Department can refuse the violator's trading privileges on the NCE
6. Gives DATCP the ability to file an injunction, in addition to taking a company to court. If a company violates the injunction, they can be fined a civil forfeiture (in addition to any civil forfeiture they may be fined if they are found guilty in court).
7. The sub took out the ability for individuals (farmers, groups of farmers) to file suit against a company for trading against interests or price manipulation on the NCE
8. If the bill is signed into law, any emergency rules needed to administer the provisions of the bill must be completed within 60 days of the enactment of the bill and permanent rules must be completed by October 1st after enactment of the bill

Chairman:
Agriculture Committee



Member:
Environment & Utilities
Government Operations
Natural Resources
Rural Affairs

Al Ott

State Representative • 3rd Assembly District

FAX COVER SHEET

TO: Lou Gentine FAX NUMBER: 414-892-7900

FROM: *State Representative Al Ott*

DATE: 2/6/97

Number of pages attached including cover sheet _____

****If all pages are not received or are illegible, please call (608) 266-5831**

Message: Lou - The following letter was distributed regarding
the letter that you e-mailed to all Assembly offices. If my
memory serves me correct, I thought you indicated that
Sargento does not trade on the NCE. If this is true, I
don't think it has been pointed out, and from Sen. Clausings
letter it would appear that Sargento does trade on the NCE.
A follow-up letter may be appropriate - please feel free
to contact me to discuss.

Rep. Al Ott



WISCONSIN LEGISLATIVE COUNCIL STAFF MEMORANDUM

One East Main Street, Suite 401; P.O. Box 2536; Madison, WI 53701-2536
Telephone (608) 266-1304
Fax (608) 266-3830

DATE: February 3, 1997
TO: SENATOR ALICE CLAUSING
FROM: Dave Stute, Director
SUBJECT: Comments on Letter From Louis P. Gentine

This memorandum, prepared at your request, comments on a statement in a January 29, 1997 letter captioned "Dear Representative" from Louis P. Gentine, Chairman and CEO of Sargento Foods, Inc., a marketer of cheese products headquartered in Plymouth, Wisconsin.

In his letter, Mr. Gentine made the following statement:

Elimination of trading on the National Cheese Exchange would severely impair the cheese industry, since thousands of daily transactions and existing marketing contracts are pegged to the price reflected on the Exchange. Senate Bill 2 would essentially freeze prices at the last price reflected on the Exchange prior to the Bill's implementation, rather than allow supply and demand to move the price when appropriate. Effectively eliminating the Exchange would also have major consequences for non-cheese companies, since the National Cheese Exchange prices are the primary component for setting the Basic Formula Price under Federal Milk Marketing Orders as well as the California State Milk Pricing Order.

Mr. Gentine's statement appears to imply that the enactment of Senate Bill 2 into law would result in the permanent cessation of all trading on the National Cheese Exchange. While that is certainly possible (no one is compelled to trade on the Exchange; the decision to participate is made by each individual member-trader), that result appears highly improbable.

Effective upon the enactment of Senate Bill 2 in its current form (as shown by Senate Substitute Amendment 1), the following actions would become illegal:

1. Engaging in a systematic pattern or practice of "trading against interest," either directly or through a broker, for the purpose, or with the effect, of affecting milk or cheese prices off the National Cheese Exchange. (The Bill specifically describes those actions which constitute "trading against interest.")

2. Engaging in any individual action or participating in any collective plan or action related to the purchase or sale of cheese on or off the National Cheese Exchange with the intent to manipulate artificially the market price of milk or cheese.

Presumably, Mr. Gentine's prediction would be true if all trading currently done on the Exchange would be violative of the new law; that is, it constitutes engaging in a systematic pattern of trading against interest for the purpose, or with the effect, of affecting milk or cheese prices off the Exchange or to artificially manipulate the market price of milk or cheese. Presumably, however, that is not the case. Further, testimony submitted to both the Governor's Task Force on Cheese Pricing and the Senate Committee on Agriculture and Environmental Resources, which you chair, has vigorously defended the Exchange and the role which Exchange trading plays in the process of price discovery.

Trading done on the Exchange in the course of conducting a trader's business **does** "allow supply and demand to move the price when appropriate," in Mr. Gentine's words. Such trading is not prohibited by Senate Bill 2. While it is possible that traders may decide to not trade on the Exchange out of fear that they would violate the new law, that fear would appear to be unfounded unless their trading: (1) constitutes a "systematic pattern or practice, 'done' for the purpose, or with the effect of, affecting milk or cheese prices off the National Cheese Exchange"; or (2) is done with an "intent to manipulate artificially the market price of milk or cheese."

To reiterate, Senate Bill 2 is not directed at discouraging trading on the Exchange. It is directed against trading on the Exchange done for the purpose of affecting prices, rather than against trading done in the usual course of the trader's cheese business, which will also permit the market forces of supply and demand to reveal the appropriate current price for cheese.

Please contact me at the Legislative Council Staff offices if you wish further comment on this matter.

DJS;jt;kja



29 January 1997

Dear Representative:

I am writing to voice opposition to Wisconsin Senate Bill 2. Elimination of trading on the National Cheese Exchange would severely impair the cheese industry, since thousands of daily transactions and existing marketing contracts are pegged to the price reflected on the Exchange. Senate Bill 2 would essentially freeze prices at the last price reflected on the Exchange prior to the Bill's implementation, rather than allow supply and demand to move the price when appropriate. Effectively eliminating the Exchange would also have major consequences for non-cheese companies, since the National Cheese Exchange prices are the primary component for setting the Basic Formula Price under Federal Milk Marketing Orders as well as the California State Milk Pricing Order.

While we agree that improvements can be made, there are better alternatives for improving the system than premature elimination of trading on the National Cheese Exchange. Options include: oversight of trading on the National Cheese Exchange by a federal agency; anonymous electronic trading; establishment of more frequent and longer periods of time for trading on the Exchange; and combining cash and futures on one exchange.

The National Cheese Institute is currently working with the National Cheese Exchange to develop alternatives and evaluate their merits. They are exploring the affiliation of the National Cheese Exchange with an existing commodity exchanges outside of the state of Wisconsin, and requesting proposals from the Chicago Mercantile Exchange, the Coffee, Sugar & Cocoa Exchange, and the Chicago Board of Trade for their advice on the best way to establish an affiliation, as well as other means of assuring a cash market for cheese.

Please be prudent and allow for a better alternative to be brought forth before taking premature action on elimination of trading on the National Cheese Exchange. Vote against Senate Bill 2! I would appreciate learning your position on this important issue.

Sargento Foods Inc. is a national leading marketer of retail and foodservice cheese, snacks, appetizers and ingredients products. Sargento is headquartered in Plymouth Wisconsin, with facilities in Elkhart Lake, Hilbert, Fond du Lac and Kiel, Wisconsin, with employment of 960.

Cordially,
Louis P. Gentine
Chairman and CEO

*** ACTIVITY REPORT ***

TRANSMISSION OK

TX/RX NO.	9186
CONNECTION TEL	84148927900
CONNECTION ID	
START TIME	02/06 13:21
USAGE TIME	01'47
PAGES	4
RESULT	OK

Chairman:
Agriculture Committee



Member:
Environment & Utilities
Government Operations
Natural Resources
Rural Affairs

Al Ott

State Representative • 3rd Assembly District

Phone
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Jan-28-97 02:44P

P.08

GRANDE[®] CHEESE COMPANY

DAIRY ROAD, BROWNSVILLE, WISCONSIN 53006-0067 • TELEPHONE: 414/269-7200

January 28, 1997

Alvin R. Ott
Wisconsin State Capitol
P.O. Box 8953
Madison, WI 53708

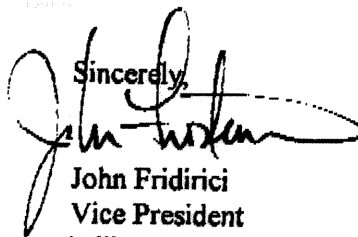
Dear Representative Ott:

Grande Cheese opposes Wisconsin Senate Bill 2. We fully appreciate the concern for Wisconsin; as a company we have six locations employing more than 500 Associates and buy milk from nearly 1000 of Wisconsin's very best producer dairies.

We view attempts to regulate the National Cheese Exchange by the state as counterproductive to the success of the industry. We do support the various industry initiatives being pursued to deal with the perceived shortcomings of the marketplace.

We appreciate and share the concern expressed in the efforts putting forth Senate Bill 2. The objectives are appropriate, but the proposed regulation detrimental. Should Senate Bill 2 be voted into law, we ask you to make the effective date December 31, 1997, giving industry time to develop a viable cash market alternative.

Sincerely,



John Fridirici
Vice President
Milk Marketing and Procurement

JIF/slr

SENATE BILL 2

**DAIRY INDUSTRY STATEMENT ON PROPOSED WISCONSIN LEGISLATION
REGARDING NATIONAL CHEESE EXCHANGE TRADING PRACTICES**

A viable cash market for cheese is crucial to the cheese industry. The existing National Cheese Exchange is currently the only viable cash market for the sale and purchase of cheese. Having such a market is absolutely necessary for any commodity. The National Cheese Exchange also accurately reflects competitive supply and demand conditions nationally. Elimination or restriction of trade on such an exchange would have a major negative impact on the cheese industry. Legislation proposed in the Wisconsin State Legislature would severely restrict trading activity on the existing National Cheese Exchange, effectively eliminating the trading opportunities that exist. Moreover, without an available cash market, producers will be harmed rather than helped.

The cheese industry is initiating a thorough review of existing cash and futures markets for cheese as well as other possible alternatives to address concerns being raised about existing markets. The cheese industry is taking action immediately; however, it is extremely important that no action be taken on this legislation which would impede a cash market while this process goes forward.

We support the initiatives being undertaken by the dairy industry to continue to refine and enhance trading techniques at the National Cheese Exchange and to examine alternative cash market options. We are committed to a viable cash market and to the development of additional risk management tools to deal with the volatility of an increasingly dynamic and market oriented dairy industry.

National Cheese Institute
National Milk Producers Federation
Wisconsin Cheese Makers Association
Wisconsin Dairy Products Association
Wisconsin Federation of Cooperatives

Alto Dairy Cooperative
Associated Milk Producers, Inc.
Beatrice Cheese, Inc.
Borden, Inc.
Darigold, Inc.
Foremost Farms USA, Cooperative
Grande Cheese Company
Great Lakes Cheese
Hilmar Cheese Co.
Kraft Foods, Inc.
Land O'Lakes, Inc.
Leprino Foods Company
Marathon Cheese
Masters Gallery Foods
Mid America Dairymen, Inc.
Sartori Foods
Schreiber Foods, Inc.
Weyauwega Milk Products, Inc.



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

January 29, 1997

TO: Senator Brian Burke, Senate Chair
Joint Committee on Finance
Room LL1, 119 Martin Luther King Blvd.

FROM: Bob Lang, Director

SUBJECT: Supplemental Fiscal Estimate on Senate Bill 2

Pursuant to your request under Joint Rule 41(3)(a), I have prepared a supplemental fiscal estimate on 1997 Senate Bill 2.

A copy of that estimate is attached.

BL/sas

Attachment

cc: Don Schneider, Senate Chief Clerk
Peter Dykman, Legislative Reference Bureau

LRB or Bill No./Admin. Rule No.
SB 2

Amendment No. if Applicable

FISCAL ESTIMATE

DOA-2048 N(R10/94)

ORIGINAL UPDATED
 CORRECTED SUPPLEMENTAL

Subject

Regulation of National Cheese Exchange

Fiscal Effect

State: No State Fiscal Effect

Check columns below only if bill makes a direct appropriation or affects a sum sufficient appropriation.

- Increase Existing Appropriation Increase Existing Revenues
 Decrease Existing Appropriation Decrease Existing Revenues
 Create New Appropriation

Increase Costs - May be possible to Absorb Within Agency's Budget Yes No

Decrease Costs
See Text

Local: No local government costs

1. Increase Costs
 Permissive Mandatory
2. Decrease Costs
 Permissive Mandatory

3. Increase Revenues
 Permissive Mandatory
4. Decrease Revenues
 Permissive Mandatory

5. Types of Local Governmental Units Affected:
 Towns Villages Cities
 Counties Others _____
 School Districts WTCS Districts

Fund Sources Affected

GPR FED PRO PRS SEG SEG-S

Affected Ch. 20 Appropriations

20.115(1)(a)

Assumptions Used in Arriving at Fiscal Estimate

Summary of Bill

Senate Bill 2 (SB 2) would regulate certain trading practices on the National Cheese Exchange (a cash auction market for bulk cheese that is operated by National Cheese Exchange, Inc.). The bill would prohibit certain trading practices related to the pricing of cheese on the National Cheese Exchange that would be enforced under the state's unfair trade practices statutes, currently administered by DATCP.

Specifically, the bill would prohibit persons from engaging in individual actions or participating in any collective plan or action related to the purchase or sale of cheese on or off the National Cheese Exchange, with the intent to artificially manipulate the market price of cheese or milk.

The bill would also prohibit a practice identified as "trading against interest" defined as engaging in a systematic pattern or practice of doing the following for the purpose, or with the effect, of affecting milk or cheese prices off the National Cheese Exchange:

- 1) either by buying or selling on the Exchange at an unfavorable price compared to what could be obtained off the Exchange; or
- 2) acting primarily as a seller on the Exchange and a buyer off the Exchange, or vice versa.

Violations of the trading practices regulated under the bill would be considered an unfair method of competition or unfair trade practice and would be subject to the same court injunctions, civil forfeitures, and criminal penalties as violations under the state's general trade practice statutes and DATCP rules.

The bill would take effect on the first day of the first month after publication.

- see attached pages -

Long-Range Fiscal Implications

Agency/Prepared by: (Name & Phone No.)

Al Runde
Daryl Hinz
Legislative Fiscal Bureau 266-3847

Authorized Signature/Telephone No.

Bob Lang
Robert Wm. Lang 266-3847

Date

January 29, 1997

Fiscal Effect of Bill

In March, 1996, DATCP determined that it had authority under its general unfair methods of competition and trade practice authority (s 100.20) to promulgate a rule that would essentially prohibit the same conduct as SB 2 (the rule and bill are substantively identical). DATCP's fiscal note to draft rule ATCP 107 states that \$2,700 PR and .06 PR position would be needed to implement the proposed rule (the source of program revenues would be fees paid by processors of dairy products). The Department indicates that approximately 48 hours of staff time per year would be necessary to periodically monitor trading activities on the Exchange and to respond to complaints concerning alleged violations of the rule.

Although SB 2 is substantively identical to draft rule ATCP 107, in its fiscal note to SB 2 dated January 27, 1997, the Department indicates that \$411,400 GPR and 7.0 GPR positions annually would be needed (additionally, \$18,200 GPR in one-time office equipment costs are identified). The note indicates staffing would be necessary to monitor all trading activities and transactions on and off the Exchange, to conduct investigations of alleged violations, to undertake formal administrative actions against violators, for court enforcement of violations, and other administrative duties. The Department indicates that its current estimate differs from the fiscal estimate on its proposed rule because: (a) the staffing estimates for the bill were developed, in part, by reviewing the staffing requirements necessary to conduct the three and one-half-year National Cheese Exchange study in conjunction with the University of Wisconsin; and (b) it was determined that the program would no longer be a complaint based program with periodic monitoring of the Exchange but rather a more proactive program that is constantly monitoring activities and trading records on and off the Exchange, conducting investigations and proceeding with enforcement actions.

Specifically, the Department states that the following staff would be needed to enforce the provisions of SB 2: (1) two trade practice analysts would be required to observe weekly trading activity on the Exchange (the Exchange meets for approximately one-half hour each week), review trader's reports, compile summaries of trading activities on the Exchange and on futures and spot markets for cheese, butter and other dairy products; (2) three agriculture auditors to coordinate activities with the trade practice analysts to compile company specific data and conduct investigations, including financial and statistical analyses, detailed audits of transactions and summary reports with recommendations for further legal action; (3) one senior attorney to conduct legal actions against violators and prepare cases sufficient to meet the standards of proof for antitrust proceedings; and (4) one program assistant to perform various administrative duties.

The bill makes no appropriation. Essentially, the bill codifies the existing authority of DATCP to regulate in this area, as evidenced by draft rule ATCP 107. Therefore, it could be argued that, consistent with the fiscal note submitted with the proposed rule, the level of workload associated with the bill would be similar to much of DATCP's trade and consumer protection responsibilities, and would largely be determined by the priority given to it by the Department relative to its other trade practices regulation. That is, for some unfair trade practice activities (for example, minimum markup and other discriminatory pricing activities), the Department makes use of state statutes and administrative rules to establish a level playing field in the marketplace, educates the industry on those rules or statutes, and then reacts primarily to formal complaints of alleged violations. Conversely, other trade practices programs such as the dairy and grain plant security programs involve a substantial level of proactive enforcement in that staff are statutorily required to annually review the financial records and determine the financial viability of every business contracting for dairy and grain products.

In the absence of a listing of duties, appropriated funding or other specific detail, the implementation effort of a statute is largely at the discretion of the administering agency. While the work required to implement SB 2 would largely be left to the discretion of DATCP under the bill, the \$2,700 identified by the agency in March 1996 clearly contemplates a limited enforcement effort. If a more proactive enforcement stance is desired some level of staffing would be appropriate.

In some instances the Legislature has provided DATCP with additional responsibilities in regulating trade and pricing practices and has provided no additional staff or funding (for example, leaf tobacco buying and selling practices and brewers trade practices). In other instances, the Legislature has provided staff to DATCP to conduct specific statutory responsibilities. A recent example is 1993 Act 16, which provided 1.0 auditor position to enforce the statutory prohibition against unfair discrimination in drug pricing.

In order to provide a more proactive role than DATCP contemplated in ATCP 107, this estimate is based upon the provision of one position and related salary, fringe benefits and supply costs. Providing 1.0 agricultural auditor position would require \$9,900 (including one-time costs) for two months of funding in 1996-97 and have an annual cost of \$43,500.

Further, it should be noted that in many instances of consumer protection and trade regulation activities in new or evolving areas there may be an initial increase in workload in order to uncover unfair practices and determine ground rules (either through the administrative rule or formal court processes). After a period of time, this workload may be reduced (although occasional flare-ups may occur). Further, some have argued that regulation solely by Wisconsin could result in the Exchange leaving Green Bay for another state where regulation could, at least temporarily, be avoided (or could result in fewer traders on the Exchange).

Summary of SSA 1 to SB 2

Senate Substitute Amendment 1 (SSA 1) to SB 2 adds specific requirements that could impact the costs of implementing the bill. SSA 1 would make the following changes to SB 2: (1) require DATCP to monitor all trading activity on the Exchange; (2) require the Department to promulgate rules defining specific conduct that would constitute market manipulation (DATCP would be directed to promulgate emergency rules within 60 days of the effective date of the act and a permanent rule by October 1, 1997); (3) require those persons trading on the Exchange to submit a quarterly report to DATCP listing the date, type of transaction, quantity traded and price for all transactions made on and off the Exchange; (4) provide the Department with specific enforcement authority, including authority to refuse trading privileges of persons found in violation; (5) establish civil forfeitures of not less than \$1,000 or more than \$10,000 for each violation; (6) provide the Department of Justice with authority to commence court actions to recover a forfeiture; and (7) establish an effective date of the first day after the first month beginning after publication or on July 1, 1997, whichever is later.

While SSA 1 adds specific regulatory and enforcement provisions, DATCP determined, when it proposed ATCP 107, that it had similar authority to regulate and enforce National Cheese Exchange trading activities under its general trade practices statutory authority (for example civil forfeitures under existing statutes for unfair trade practices are not less than \$100 nor more than \$10,000 per violation).

Other provisions of SSA 1 may require additional effort by DATCP. Promulgating the emergency and permanent rules defining illegal conduct would increase workload on a temporary basis. However, it could be argued that once a rule is promulgated the enforcement burden should be eased by having prohibited conduct clearly identified. Further, the substitute amendment requires DATCP to monitor all activity on the Exchange, while SB 2 would leave the level of monitoring up to the Department (the Exchange meets for approximately one-half hour each week). Quarterly reports on trading on and off the exchange would be reviewed at some level by DATCP (however, under SB 2 or the proposed rule, DATCP, in certain instances, may have to obtain such information on its own initiative or through legal action in order to conduct an investigation).

The substitute amendment makes no appropriation (under SSA 1 any enforcement costs would be delayed until the 1997-99 biennium). Therefore, while it would appear that SSA 1 would result in an increased workload for DATCP, the overall level of monitoring and enforcement activity conducted by the agency would be largely dependent on the resources available and the priority placed on these activities by DATCP. If it is found that the position and funding identified in this estimate is insufficient to implement the requirements of SSA1, additional resources could be sought through the biennial budget process, separate legislation or the Joint Committee on Finance, after the required rules have been promulgated.

FISCAL ESTIMATE WORKSHEET

1997 Session

Detailed Estimate of Annual Fiscal Effect DOA-2047(R10/94)	<input type="checkbox"/> ORIGINAL <input type="checkbox"/> CORRECTED	<input type="checkbox"/> UPDATED <input checked="" type="checkbox"/> SUPPLEMENTAL	LRB or Bill No./Adm. Rule No. SB 2	Amendment No.
Subject Regulation of National Cheese Exchange				

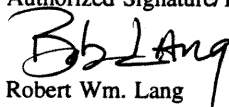
I. One-time Costs or Revenue Impacts for State and/or Local Government (do not include in annualized fiscal effect):

\$2,600 for office equipment

II. Annualized Costs:	Annualized Fiscal impact on State funds from:	
	Increased Costs	Decreased Costs
A. State Costs by Category		
State Operations - Salaries and Fringes	\$36,300	\$ -
(FTE Position Changes)	(0 FTE)	(- FTE)
State Operations - Other Costs	\$7,200	-
Local Assistance		-
Aids to Individuals or Organizations		-
TOTAL State Costs by Category	\$43,500	\$ -
B. State Costs by Source of Funds	Increased Costs	Decreased Costs
GPR	\$43,500	\$ -
FED		-
PRO/PRS		-
SEG/SEG-S		-
III. State Revenues- Complete this only when proposal will increase or decrease state revenues (e.g., tax increase, decrease in license fee, etc.)	Increased Rev.	Decreased Rev.
GPR Taxes	\$	\$ -
GPR Earned		-
FED		-
PRO/PRS		-
SEG/SEG-S		-
TOTAL State Revenues	\$	\$ -

NET ANNUALIZED FISCAL IMPACT

	<u>STATE</u>	<u>LOCAL</u>
NET CHANGE IN COSTS	\$ 43,500	\$ _____
NET CHANGE IN REVENUES	\$ _____	\$ _____

Agency/Prepared by: (Name & Phone No.) Al Runde Daryl Hinz Legislative Fiscal Bureau 266-3847	Authorized Signature/Telephone No.  Robert Wm. Lang 266-3847	Date January 29, 1997
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FISCAL ESTIMATE WORKSHEET

1997 SESSION

Detailed Estimate of Annual
Fiscal Effect
DOA-2047 (R10/94)

ORIGINAL UPDATED
 CORRECTED SUPPLEMENTAL

LRB or Bill No/Adm.Rule No.
SB2

Amendment No.

Subject

Proposed Act to regulate the trading practices on the National Cheese Exchange and to grant rule-making authority.

I. One-time Cost or Revenue Impacts for State and/or Local Government (do not include in annualized fiscal effect):

\$18,200 computers, office equipment

II. Annualized Cost:

Annualized Fiscal Impact on State funds from:

A. State Costs by Category	Increased Costs	Decreased Costs
State Operations - Salaries and Fringes	\$ 335,100	\$ -
(FTE Position Changes)	(7 FTE)	(- FTE)
State Operations - Other Costs	76,300	-
Local Assistance		-
Aids to Individuals or Organizations		-
TOTAL State Costs by Category	\$ 411,400	\$ -
B. State Costs by Source of Funds	Increased Costs	Decreased Costs
GPR	\$ 411,400	\$ -
FED		-
PRO/PRS		-
SEG/SEG-S		-
III. State Revenues -	Increased Costs	Decreased Costs
<small>Complete this only when proposal will increase or decrease state revenues (e.g., tax increase, decrease in license fee, etc.)</small>		
GPR Taxes	\$	\$ -
GPR Earned		-
FED		-
PRO/PRS		-
SEG/SEG-S		-
TOTAL State Revenues	\$ -	\$ -

NET ANNUALIZED FISCAL IMPACT

	<u>STATE</u>	<u>LOCAL</u>
NET CHANGE IN COSTS	\$ 411,400	\$ _____
NET CHANGE IN REVENUES	\$ _____	\$ _____

Agency Prepared by: (Name & Phone No.) DATCP Paul Dingee (608) 224-4925	Authorized Signature/Telephone No. <i>Barbara Knapp</i> Barbara Knapp (608) 224-4746	Date 1/24/97
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Testimony
Wisconsin Federation of Cooperatives
Senate Bill 2
Public Hearing Before the Senate Committee on Agriculture and Environmental Resources
January 21, 1997

I am Will Hughes, Director of Dairy Policy and Business Development, Wisconsin Federation of Cooperatives. WFC is opposed to Senate Bill 2 as written. While we appreciate your efforts to respond to concerns related to the National Cheese Exchange, this bill is not the vehicle to address these issues.

The dairy members of Wisconsin Federation of Cooperatives believe that passage of Senate Bill 2 will put the interests of Wisconsin dairy cooperatives and their members at financial risk because this bill will jeopardize the workings of the current cash market for cheese at a time when no viable alternative exists. A cash market is needed to operate cooperatives' cheese businesses.

The bill will have the effect of restricting trading activity by dairy cooperatives who are generally manufacturers and sellers of cheese, yet routinely buy as well as sell on the National Cheese Exchange. The bill language would restrict common business practices as well as the "trading against interest" that the Legislature is trying to prevent.

If trading of cooperatives is restricted or if the National Cheese Exchange ceases to exist before improvements can be made to it, or before an alternative cash market is created, dairy cooperatives will be left without a cash market reference price on which to base their selling prices in contract and negotiated sales. A cooperative's ability to effectively bargain and negotiate fair prices will be lessened in that event, and chaos in the marketplace could result. There needs to be provision for an orderly transition from the current cash market to an alternative or an improved cash market.

There are several deliberate efforts underway that will either lessen the impact of the National Cheese Exchange on farm milk prices, improve the public confidence in the National Cheese Exchange or move toward development of an alternative cash market for cheese. WFC dairy cooperatives support these efforts.

1) USDA has indicated that it will not use the National Cheese Exchange as a component of any milk price formula for use in federal milk marketing order pricing when it reforms federal milk pricing rules unless and until public confidence in the market is no longer subject to question.

2) Efforts are underway for federal oversight of the National Cheese Exchange or any cash market alternative. Federal regulation by the Commodity Futures Trading Commission is preferable.

Wisconsin Federation of Cooperatives Testimony on SB 2

3) The dairy industry is committed to either improve or replace the National Cheese Exchange in an effort to improve public confidence in the cash market for cheese. Alternative cash markets are being explored by the Coffee, Sugar, and Cocoa Exchange. The Chicago Mercantile Exchange will be considered as an alternative market as well.

The Wisconsin Federation of Cooperatives supports prompt and effective action by the dairy industry to implement these efforts as soon as possible. WFC served on the Governor's Task Force on Cheese Pricing and supports its basic recommendations.

Finally, we support the efforts of the Wisconsin Legislature and this Committee to work toward resolution of finding and maintaining a viable cash market for cheese in which there is a high degree of public confidence.

Thank you.