

The Milkweed

Dairy's best marketing info and insights



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CFTC Probing CME Cheese Cash Market Activities

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The parties involved won't, or can't acknowledge. But the Commodities Futures Trading Commission (CFTC) is actively investigating alleged irregularities in cash Cheddar markets at the Chicago Mercantile Exchange (CME).

CFTC's specific angle is alleged manipulation of cash Cheddar markets that may have influenced settlement of futures and options contracts.

Sources in the cheese industry tell *The Milkweed* that CFTC has been actively investigating CME cash market activities for Cheddar for the past two to three months.

When questioned, a media spokeswoman at CME that she could not comment on an investigation, if there was one or not. She advised contacting CFTC directly.

CFTC was equally informative. "The Commission does not comment on what it is or is not investigating," an employee stated in response to a question from *The Milkweed*.

Midwest cheese industry sources have been more helpful—confirming visits from CFTC investigators out of the Commission's regional office in Kansas City, Missouri.

Beyond such helpful comments from CME and CFTC, *The Milkweed* has learned that an active CFTC probe of cash Cheddar markets and related settlement of futures/options has been ongoing for the past 60 to 90 days. A number of cheese industry participants have been interviewed by CFTC investigators. It's important to note that CFTC's investigatory powers extend only to matters involving manipulations of cash markets to influence resolution of futures/options.

One key target: DFA

A major focus of CFTC's investigation centers on Cheddar cash market activities by Dairy Farmers of America—the nation's largest dairy farmers' cooperative. From summer 2000 until sometime in spring 2005, when DFA's cash flow constricted ... DFA had been the predominant purchaser of Cheddar in cash market trading at CME.

DFA's involvement CME Cheddar cash market "oddities" has occurred several times in the past five-plus years.

*In August-September 2000, DFA drove up the Cheddar cash markets by over 25 cents per pound through purchases of hundreds of carloads of Cheddar cheese (both 40-lb. blocks and 500-lb. barrels). Trouble was: DFA violated CME rules by failing to pay for these mega-purchases on a timely basis. *The Milkweed's* editor filed a formal complaint with CFTC shortly thereafter, providing investigators with an September 18, 2000 audio tape of DFA CEO/President Gary Hanman bragging about DFA's strategy to drive up farm milk prices by driving up CME Cheddar purchases through large purchases. CFTC took no action against DFA, although a person at the Commission acknowledged it was unusual for a complaining party to provide an audio tape detailing alleged misdeeds.

*In 2003 and 2004, various sharp run-ups in CME cash Cheddar markets caused Class III milk prices in the federal milk order program to eclipse Class I (fluid) milk prices—resulting in a so-called "price-inversion". DFA and its marketing affiliates then "depooled" the Class III milk for April-May 2004—pirating tens of millions of dollars in what should have been revenue destined for dairy producers.

*Two other strange "interventions" by DFA in the CME cash Cheddar markets occurred. In May-June 2004, for weeks DFA maintained a flat-line price of \$1.80/lb. for block Cheddar. And then, in late summer/early fall 2004, DFA's purchases held block Cheddar constantly at \$1.60/lb., as the co-op was negotiating a complex, major financial restructuring with insurance companies.

More than DFA, however ...

Cheese industry sources state that CFTC's probe of CME Cheddar pricing antics may hook more than DFA. Sources cite strange price antics in November 2004 and January 2005, which saw one trader almost single-handedly drive up CME Cheddar prices to unduly high levels ... and then benefit on resolution of previously-contracted futures/options positions. These antics were closely covered by *The Milkweed* in its February 2005

issue, in an article titled "CME Price Yo-Yo: Futures-Based Manipulation?"

Specifically, a trader from Minnesota is reportedly gaining CFTC's focus for these trading antics. He netted millions in settling futures positions, after driving up the cash Cheddar markets.

CFTC probe just the start

There is, an active CFTC investigation, let's hope CFTC staffers get it right. Manipulating dairy's most important pricing mechanism—CME Cheddar cash markets—is wrong, whatever the manipulators' motives may be.

The complexity of dairy pricing...and the ability of certain parties to manipulate the system for venal gain...merits thorough investigation far beyond CFTC's limited mandate.