



March 28, 2014

Memo to Shareowners of Dean Foods (ticker: DF)

Rationale for a *Vote In Favor* on Shareholder Proposal #7: “Water Stewardship in the Agricultural Supply Chain”

Mercy Investment Services seeks to share the basis for the shareholder proposal submitted to Dean Foods (DF) requesting a corporate commitment to engage with dairy suppliers on water use and impacts associated with dairy operations. We invite our fellow active shareowners and proxy advisory firms to consider this rationale and vote or recommend a vote in Favor of this resolution.

Dean Foods is a Dallas, Texas-based dairy products company with plants and distributors throughout the United States. Dairy operations and processing are supported by local resources relying heavily on water in sufficient quantity and quality—water that is also needed to support other local business and communities. As such, we expect companies like Dean Foods to extend water management practices to their supply chain in order to address water quality and quantity risks and opportunities more systematically.

The resolved clause included in the Dean Foods proxy statement states:

Shareholders request that the Board of Directors of Dean Foods (the Company) adopt a comprehensive policy to require the Company’s key dairy farmer suppliers to report regularly on their performance and progress on: water use (including, where relevant, in feed production); manure management; in addition to energy use and greenhouse gases—and include a summary of this information as part of the Company’s annual sustainability report to shareholders (prepared at reasonable cost and excluding proprietary information.)

Below, we outline summary points to supplement investor knowledge on the physical effects from climate change on water supplies and impacts on agriculture, along with key data points that bolster the business case for our proposal. The Dean Foods preliminary [proxy filing and statement](#) of opposition to Mercy’s proposal (#7) is found on page 28.

The Business Case: Dean Foods and Water Stewardship

- **Dean Foods is among the largest processors and distributors of fluid milk in the U.S. and can thus demonstrate leadership and positively influence its dairy suppliers.** Dean Foods, following a sale and a spinoff in 2013, evolved from a company with three distinct business platforms into an enterprise focused solely on the fluid dairy business. Dean Foods operates approximately 70 manufacturing facilities. Its largest purchase is raw, unprocessed milk and totals more than \$5 billion annually. Dean Foods sources milk directly from co-ops representing more than 10,000 dairy farmers, 700 independent farms, and 600 organic family farms across the U.S. In comparison, large milk producers and competitors such as Nestlé and

Unilever have adopted comprehensive and effective sustainable agriculture and dairy policies even as they have wider reaching supply chains.

- **Dean Foods measures and discloses management of water within its production facilities, but has not extended its water management strategy (stewardship) to its supply chain, where most water use and impacts occur.** Dean Foods has not determined what proportion of its milk production, or core suppliers, whether cooperatives or direct dairy farmer suppliers, are located in regions of high water stress, areas exposed to long-term drought, or areas of elevated pollution in water. Without this information, the company may be overlooking serious near-, mid- and long-term risks to its supply chain. A recent study on environmental impacts and tools for suppliers to assess their environmental footprint by the Innovation Center for U.S. Dairy (of which Dean Foods is a founding member) stated that its “motivation for publication is to share these lessons learned and provide a catalyst to inspire the dairy industry to create more sustainability initiatives. Further, the tools generated from the study will help empower the industry to realize these goals.”ⁱ
- **Reporting standards such as CDP Water expect companies dependent on water to engage with suppliers.** Dean Foods has received the CDP Water questionnaire for two consecutive years and remains in the non-responder category. CDP Water, now backed by investors with \$57 trillion in combined assets, states that “since agricultural water use within the [consumer staples] sector accounts for the largest consumptive use of water, it is recommended that respondents engage more actively with their suppliers.” CDP Water consumer staples sector respondents have reported “a greater level of exposure to supply chain risks than any other sector.”
- **Oversight of best practices in local water management at the supplier level can help to secure future access to clean water supplies as well as help to prevent runoff that can affect human health.** A Natural Resources Defense Council report states that manure from dairy cows is thought to have contributed to the disastrous 1993 contamination of Milwaukee's drinking water, which killed more than 100 people, sickened approximately 400,000 and resulted in \$37 million in lost wages and productivity. In California, which is undergoing a prolonged drought, state officials identify agriculture (including cows) as the major source of nitrate pollution in more than 100,000 square miles of polluted groundwater.ⁱⁱ
- **Taking a leading role over time in focusing on supplier sustainability and water performance will help Dean Foods better define the scope of its environmental impact and align with its 2020 Environmental Sustainability Goals.** Dean Foods states in its website that it is “concerned about the future and economic well-being of the entire U.S. dairy industry,”ⁱⁱⁱ and states in its CDP Supply Chain response (GHG emissions only) that “if harvests for key ingredients in dairy feed are reduced due to climate temperatures, our farms and the farmers we procure raw milk from will experience higher costs for acquiring feed and nutritional products for the cows.” Undertaking efforts to assess agricultural supply chain water risks exposure and adopting a supplier policy is a *forward-thinking* strategy for Dean Foods.

Agriculture, Water, and Climate Change Impacts

- **Nearly one-third of the total water footprint of agriculture in the world is related to the production of animal products, including dairy.**^{iv} With global demand for dairy rising with population growth, it is essential to improve the long-term sustainability of dairy production through water stewardship practices that embrace efficient water use in the growing of dairy feed such as alfalfa and corn, and that minimize pollution of freshwater from animal manure and chemical fertilizers. This not only protects the company from reputational risks associated with under-regulated suppliers, but safeguards local communities from water pollution risks.

- **The 2014 Global Risks Perception Survey by the World Economic Forum placed ‘water crises’ third among the top ten global risks of highest concern.**^v Furthermore, the Palmer Drought Severity Index, which measures how moisture conditions depart from normal, projects ‘extreme’ drought as the normal climatological state by the end of the 21st century under the high emission scenarios in many mid-latitude locations, including the southwestern U.S. Projected drought and extreme weather conditions will likely have financial and reputational risks to Dean Foods’ dairy business; their thousands of suppliers must properly hedge water risks (quantity and quality) in the face of changing climate conditions.
- **“The impacts of climate change will be experienced more profoundly in terms of the frequency, intensity or duration of extreme events (e.g., heat waves, droughts, extreme rainfall events).”**^{vi} The IPCC (Intergovernmental Panel on Climate Change) 5th Assessment Report (AR5) [Physical Science] indicates that, based on climate model projections, in addition to uncertain changes in soil moisture, there are escalating risks of severe agricultural drought.^{vii} The supplemental IPCC report, [Impacts, Adaptation and Vulnerability], will reveal more of the threats climate change poses to agriculture and food security.
- **In January 2014, the U.S. Department of Agriculture (USDA) designated areas in 11 states, including 27 counties in California, as primary natural disaster areas due to drought.**^{viii} Dean Foods operates in at least five California-based locations. Additionally, according to a report by the National Drought Forum, drought affected more than 65 percent of the U.S. in 2012. The report notes that costs associated with the 2012 drought could be greater than losses from Superstorm Sandy, which makes the 2012 drought one of the top three costliest natural disasters since 1980.^{ix}
- **Changing climate conditions and new extremes in droughts and flooding threaten the long-term viability of farming, which Dean Foods relies on for its business.** As early as 2009 the U.S. Department of Agriculture (USDA) reported that climate change affects average temperatures and temperature extremes; timing and geographical patterns of precipitation; snowmelt, runoff, evaporation, and soil moisture; the frequency of disturbances, such as drought, insect and disease outbreaks, severe storms, and forest fires; atmospheric composition and air quality; and patterns of human settlement and land use change, which directly impact crop yields [including dairy feed] and meat production.^x Therefore, the management and disclosure of suppliers’ water practices is essential to ensure long-term productivity of Dean Foods’ business operations and will ensure oversight of high-risk resources (water).

Shareholder Proposal Text

Water Stewardship in the Agricultural Supply Chain

Resolved: Shareholders request that the Board of Directors of Dean Foods (the Company) adopt a comprehensive policy to require the Company’s key dairy farmer suppliers to report regularly on their performance and progress on: water use (including, where relevant, in feed production); manure management; in addition to energy use and greenhouse gases—and include a summary of this information as part of the Company’s annual sustainability report to shareholders (prepared at reasonable cost and excluding proprietary information.)

Whereas: Global estimates from the Food and Agriculture Organization indicate that agriculture accounts for roughly 70% of all water withdrawals. According to the Environmental Protection Agency, in the U.S., water pollution from agriculture is the number one cause for impaired waterways. In groundwater, pathogens and nitrates from manure from dairy farms can impact human health via drinking water. Good agricultural stewardship practices often result in less pollution and reduced greenhouse gas emissions, more fertile soil, and increased biodiversity in the surrounding ecosystem(s).

With global demand for dairy rising with population growth, it is essential to improve the long-term sustainability of dairy production. Dean Foods is the largest processor and distributor of fluid milk in the U.S., operating approximately 70 manufacturing facilities. Its largest purchase, raw, unprocessed milk, totals more than \$5 billion annually. Dean Foods sources milk directly from co-ops representing more than 10,000 dairy farmers, 700 independent farms, and 600 organic family farms across the U.S. We commend the company's procurement team's alignment with the Institute for Supply Management's principles, which "champion social responsibility and sustainability practices in supply management," but believe the company can increase its leadership and positively influence its dairy producers.

A 2011 study by the Innovation Center for U.S. Dairy, of which Dean Foods is a founding member, analyzes water impacts from domestic dairy production including water use, water stress, and eutrophication in the dairy supply chain. The study finds "these impacts are regional and location-dependent, but also extend into the entire watershed in which the dairy is located." The research indicates about "35 percent of feed is grown on the farm by dairy farmers and the rest is purchased from other farmers." Thus dairy operations can extend, where appropriate, best practices to their feed production.

Dean Foods states it is "concerned about the future and economic well-being of the entire U.S. dairy industry." Taking a leading role in focusing on supplier sustainability and water performance will help Dean Foods better define the scope of its environmental impact and align with its 2020 Environmental Sustainability Goals.

We recommend the Company use the "Stewardship and Sustainability Guide for U.S. Dairy" as a framework to communicate progress. We encourage Dean Foods' key suppliers to pilot Farm Smart, a new "smart tool" that seeks to help dairy producers "evaluate their production techniques, assess economic and environmental consequences of potential improvements in management practices, and share the contributions that their farm businesses have made to neighbors, community groups and consumers."

Thank you for considering a "YES" vote in Favor of a defined sustainability strategy that protects our company's long-term success and social and environmental health.

Please contact Marcela Pinilla with any questions you may have regarding this shareholder proposal: 646.692.3289 | 617.301.0029 (m) | mpinilla@sistersofmercy.org

ⁱ <http://www.sciencedirect.com/science/article/pii/S0958694613000137>

ⁱⁱ <http://www.nrdc.org/water/pollution/ffarms.asp>

ⁱⁱⁱ <http://responsibility.deanfoods.com/social-responsibility/corporate-policies-positions/>

^{iv} <http://www.waterfootprint.org/Reports/Mekonnen-Hoekstra-2012-WaterFootprintFarmAnimalProducts.pdf>

^v http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2014.pdf

^{vi} http://www.climatechange2013.org/images/report/WG1AR5_ALL_FINAL.pdf

^{vii} [Ibid.](#)

^{viii} <http://www.doi.gov/news/pressreleases/joint-statement-from-secretaries-jewell-pritzker-and-vilsack-on-the-drought-declaration-in-california.cfm>

^{ix} http://www.usgs.gov/blogs/features/usgs_top_story/drought-the-stealth-disaster/

^x <http://www.usda.gov/img/content/EffectsofClimateChangeonUSEcosystem.pdf>