

2016 MAY 16 PM 2: 03

RECEIVED



May 16, 2016

Office of the Hearing Clerk  
United States Department of Agriculture  
1400 Independence Ave., SW  
Stop 9203, Room 1031, South Building  
Washington, DC 20250-9203

**Re: Milk in California: [AO] Docket No. 15-0071**

Milk Producers Council (MPC), representing dairy families throughout California, respectfully submits this reply brief in support of the Cooperative's Proposal Number 1 for a California Federal Milk Marketing Order. MPC appeared and participated in this USDA hearing on behalf of the approximately 120 dairies we represent, accounting for about 10 percent of the State's milking herd. Our members are made up of both producer-cooperative owners and independent producers, and our positions in this hearing were approved by a unanimous vote of our Board of Directors, made up exclusively of California dairy farmers.

We would first like to echo the comments included in the Cooperatives' post-hearing brief that, "The California milk marketing system is deteriorating, and without intervention, the future of California producers is in peril" (page 7 of the Cooperative's brief). As a non-profit trade association whose sole responsibility is to work with and represent the interests of California dairy families, we've seen first-hand the devastating financial impact on our State's producers of operating outside the Federal Milk Marketing Order system.

While it is true that California operates within a State Milk Marketing Order – one which MPC has been actively involved in throughout its history – that State Order has proven incapable of fostering orderly milk marketing. This hearing record includes ample testimony and evidence demonstrating this fact, largely driven by the significant discounts in the State's monthly regulated milk prices relative to the Federal Milk Marketing Order's monthly regulated milk prices, which apply to a vast majority of the U.S. milk-producing regions outside of California. Direct testimony from California producers during the hearing amplified the impact this has had on their ability to compete in a national market for milk (referenced on pages 12-13 of the Cooperatives' brief). Further, testimony during the hearing highlighted the State Milk Marketing Order's inability to apply minimum pricing regulations on milk imported into California, threatening the viability of a system where extensive geographic exploitations are available and used due solely to the existence of a state line.

MPC and its members support the Cooperatives' Proposal Number 1 as it would appropriately place our producers on an even playing field with those producers we compete with around the country. It is important to note that the regulated prices established under Proposal Number 1 would be *equal* to the regulated prices announced in each of the existing Federal Milk Marketing Orders. This fact was often lost throughout the hearing in testimony by California dairy manufacturers who provided unsupported claims of doom-and-gloom if Proposal Number 1 were adopted. These manufacturers have enjoyed the benefit of a California Discount in the monthly regulated milk prices for many years, and understandably are fighting hard to defend that competitive advantage. But we urge USDA to consider those arguments in the context of the reality that Proposal Number 1 does not propose regulated milk prices above those already in place in the existing ten FMMOs, but exactly equal to them.

In addition, MPC believes that the hearing record includes significant evidence that Proposal Number 1 would not only establish orderly marketing conditions in California, but also enhance the orderly nature of milk marketing throughout the United States. With approximately 20 percent of the nation's milk production, the current significant discount in California's regulated milk prices compared to the Federal Order regulated milk prices has a negative impact on the orderly marketing of milk and finished dairy products that may be difficult to calculate with specificity, but is certainly real. Putting California producers and processors on a more even playing field with the rest of the U.S. industry is a move towards more orderly milk marketing nationwide.

#### **Acknowledging Unique and Important Considerations in California**

While Proposal Number 1 would bring California into the national milk regulatory program, it does so in a way that also recognizes some of the unique characteristics of California's market dynamics. MPC testified in detail as to these items aimed at addressing California-specific issues, and we briefly reiterate those items here:

1. **California's Quota program.** Through the 1996 and 2014 Farm Bills, Congress approved and the President signed Federal law stating, "The order covering California shall have the right to reblend and distribute order receipts to recognize quota value." MPC strongly supports the inclusion of the provisions in Proposal Number 1 that allow for the California Department of Food and Agriculture (CDFA) to continue operating the 100% producer-funded quota program under a memorandum of understanding with USDA. This provision is a significant priority of our members.
2. **Strong pooling provisions.** MPC recognizes that other Federal Milk Marketing Orders have varying requirements for handlers to be classified as pool plants, and we support the rights of the producers in those orders to vote in favor of that language. MPC believes that the goal of orderly milk marketing in California is best served by a system of stable participation in the pool. Voluntary depooling on a month-to-month basis as is being proposed in Proposal Number 2 by the Dairy Institute of California is potentially destabilizing and threatens the comprehensive approach towards orderly marketing taken by the cooperatives in Proposal Number 1.

3. **Uniform blend prices.** We recognize that other Federal Milk Marketing Orders have elected to establish producer location differentials, which aid in facilitating the movement of milk to deficit areas through higher differentials. However, as noted in the next item on this list, Proposal Number 1 takes a much more direct approach in facilitating that movement of milk, in the form of a focused, producer-funded transportation subsidy program. In the interest of orderly milk marketing, MPC believes that is a much more efficient policy for a California Federal Milk Marketing Order.
4. **Transportation subsidies to facilitate movement of milk into California's deficit markets.** MPC has supported a pool-funded direct subsidy to producers and cooperatives who serve the qualifying California Class 1, 2 and 3 plants in milk deficit areas as a focused and efficient method of facilitating the orderly movement of milk, and we agree with the cooperatives' decision to include a very similar system in Proposal Number 1 for a California Federal Milk Marketing Order.
5. **California's enhanced standards for fluid milk products.** California's enhanced standards for the fluid milk products sold in the State were established by the California Legislature and are protected by Section 144 of the 1996 Farm Bill (7 USC 7254). While the issue of California's authority to maintain these separate standards is outside the scope of this hearing, it is still a very relevant topic as the current State Marketing Order – as well as both the cooperatives' Proposal Number 1 and the Dairy Institute of California's Proposal Number 2 – include a "fortification credit" in the calculation of a fluid milk handler's pool obligation, providing a partial offset for the cost of purchasing the condensed skim or nonfat dry milk needed to meet the enhanced standard. MPC supports the inclusion of this credit in a California Federal Milk Marketing Order.

In summarizing MPC's support for Proposal Number 1, I believe the five points above are a glimpse at what MPC would describe as a sound comprehensive approach for a California Federal Milk Marketing Order. The items do not stand on their own, but rather represent various interrelated pieces of an overall approach to achieve specific policy objectives. In the case of MPC, our policy objectives include (in no particular order):

- Integrity of the California marketwide pool;
- A level playing field for producers – minimum milk prices that are aligned with national prices for comparable milk;
- A level playing field for processors – equal raw product costs within classes, nationally competitive minimum prices, and support for producer-funded initiatives to assist processors in securing an adequate milk supply; and
- Protection of California's historical quota program.

### **Additional Consideration for USDA Regarding Transportation Subsidy Proposals**

Finally, MPC would like to use this opportunity to highlight an issue that was identified through cross-examination during the hearing, but does not appear to be addressed in the post-hearing briefs. During testimony on November 11, 2015 by Rob Blaufuss of Dean Foods, MPC had the opportunity to cross-examine Mr. Blaufuss on the issue of the transportation subsidy program included in Proposal Number 2. Mr. Blaufuss was the primary witness put forth by the Dairy Institute of California to testify with regard to this proposed transportation subsidy program. Before going into that exchange, there are several facts to lay out as background:

- There are significant similarities in the overall intent of the “transportation allowance” program in Proposal Number 2 and the “transportation credit” program in Proposal Number 1 (Section 1051.55 in the respective proposals).
- The concept of these subsidy programs are that handlers are eligible for a credit against their pool obligation for bulk milk delivered directly from a farm to a pool plant in defined deficit milk regions of California purchasing at least 50% of their milk for Class I or II utilization.
- This type of program, one of which is currently in place in the California State Milk Marketing Order, is intended to offset the difference for a producer in the decision between a lower-cost local haul to a Class III or IV plant and a higher-cost haul to a Class I or II plant in a milk deficit area.
- This is a necessary consideration since *virtually all California milk is transported from ranch-to-plant at the exclusive expense of the producer.*
- The “offset” in the producer’s additional hauling costs in the form of a “transportation credit” or “transportation allowance” makes it possible for a Class I or II plant in a milk deficit area to compete on a level playing field for a milk supply with manufacturing plants much closer to the dairy farms.
- Further, as these subsidies are accounted for as a credit against the pool obligation of the handler, they are essentially funded from the producer-settlement fund at no additional cost to the handler.

Under the current California State Milk Marketing Order, the value of the transportation allowances are paid to the producer, as a recognition that it is the producer paying the actual hauling costs associated with delivering bulk milk to the plants. However, through cross-examination of Mr. Blaufuss, it was discovered that no provision exists in Proposal Number 2 (nor in Proposal Number 1, given their similarities in this particular area) to ensure that the transportation allowance (Proposal Number 2) or transportation credit (Proposal Number 1) is ultimately paid to the producer. Instead, the handler is given this “allowance” or “credit”, with **absolutely no obligation** to pass that along to the producer who has incurred the actual cost of serving that deficit market.

That full cross examination can be read on pages 7148-7153 of the hearing transcript. An excerpt from that cross-examination is included here:

**Robert Vandenheuvel, Milk Producers Council (RV):** ...In general, in your experience, who pays the hauling costs of transporting milk from the farm to the plant, in this case, a Class 1 plant that would be eligible for these transportation allowances or credits?

**Rob Blaufuss, Dean Foods (RB):** Sometimes that transaction is picked up by the plant, most of the times it is picked up, borne onto the cost of the producer, as I understand it.

**RV:** As you understand it. The language of Proposal 2, Section 1055, or 1051.55(b) is, contains the provisions related to the Transportation Allowance Program, just making sure I'm looking at the right place, correct?

**RB:** Yeah, (b) would be the allowances.

**RV:** So if I'm looking here, it appears that (b) starts, "each handler operating an eligible pool plant and the handler that transfers or diverts bulk milk from a pool plant to an eligible pool plant, and each handler described in 1051.9(c) or 1051.9(d) that delivers producer –

**Judge Jill Clifton:** Just to be clear, Mr. Vandenheuvel, 1051.9(c)?

**RV:** Yes.

**Judge Clifton:** Or 1051.9(d)?

**RV:** Yes. I'm sorry, shorthand there. So I guess my point, rather than reading Federal Register language into the record, my point is that this allowance applies to a handler that's either purchasing milk or responsible for delivering milk to a, to a pooled handler that meets the definitions of this section, that would be who gets California, that milk is, or that those dollars are sent to the producer?

**RB:** Yes.

**RV:** Okay. I don't see in this section where that is, so is there in another section where there's an obligation from the, an obligation for the pool plant to pass along those transportation allowance dollars to their direct shipper, in order to mirror what's currently going on in California? Maybe it is another section.

**RB:** Sorry, I'm just trying to read to see here.

**RV:** Okay.

**Judge Clifton:** And for the record, this discussion has been on Exhibit 1, page 47230, the third column.

**RB:** *I don't see where that language is included, but it would be my understanding that that would be a change that we would be willing to make to be reflective of what's in current regulations.*

**RV:** *Okay. So it is the Dairy Institute's position, as you understand it, that these transportation allowances in the case where a Cooperative is not involved in the transaction, that that money would, in fact, be directly, it would be passed through the handler of the pool plant to its direct shipper?*

**RB:** *That's my understanding how the California system works today, and that's how we would intend that to be in our proposal.*

**RV:** *All right. With that understanding, I can't say I see that in the proposal, and so perhaps another witness, since, you know, your availability is limited, could provide additional testimony at some point, because it doesn't, at this point I don't see it, and it's -- it's difficult to assess whether I'm done with this issue unless it is very clear in the language. So with that caveat, I don't have anymore questions at this time.*

Additional discussion of this issue occurred moments later in cross-examination of Mr. Blaufuss by Bill Richmond of the U.S. Department of Agriculture. That full cross-examination can be found on pages 7153-7156 of the hearing transcript. An excerpt is also shown here:

**Bill Richmond, USDA (BR):** *Okay. And I think what triggered the break was – was from Mr. Vandenheuvel's questions about figuring out where in your proposal there are provisions for milk coming directly from farms to plants, and how that credit scheme could work. So it would really help us if maybe you could help us understand the intent the Dairy Institute a little better?*

**RB:** *With respect to Mr. Vandenheuvel's question, you know, I think it would just take a little clean up, a sentence or two addition, or just a couple words. It's part (b) that he talked through, to make sure that it's clear that if it is direct ship, it is functioning as it is today. And I don't know what the exact language would be, but it would be our intent to maintain what occurs today would occur under our proposal, so that that money is being passed along, it's not being collected and saved and not distributed as it is today.*

**BR:** *Okay. I appreciate that. That helps.*

MPC greatly appreciates this clarification by Mr. Blaufuss of the Dairy Institute of California's intent in how this transportation subsidy would operate. Taking this clarification into account, as well as the appropriate logic of a transportation subsidy being directed towards the individual(s) **actually paying** for the transportation of that milk, MPC respectfully requests that USDA consider additional provision(s) to accomplish this intent in its final California Federal Milk Marketing Order.

While MPC is open to any method by which this intent is achieved, we believe that this may be accomplished with an adjustment to the provisions of Section 1051.73(a), "Payments to Producers and

to Cooperative Associations,” to require the value of the transportation credit or allowance to be included as a reimbursement in the final payment to a producer. If necessary, MPC would be open to a certification system where the Market Administrator could receive confirmation that the producer is, in fact, responsible for paying the costs associated with transporting the bulk milk from ranch-to-plant, and therefore should be the ultimate recipient of the transportation credit or allowance value.

Given the potential complexities associated with even minor adjustments to proposed Order language, rather than proposing specific language modifications, we would ask that USDA engage its legal experts to draft language aimed at achieving this clarified and appropriate intent.

This transportation subsidy system represents a significant amount of money (the current transportation allowance program in California accounts for approximately \$3 million in pooled revenues per month), and that amount will only grow over time. As California’s milk production profile continues to change in the years to come, with even more milk production capacity moving away from the milk deficit regions, the potential dollar amounts associated with this transportation subsidy program will continue to grow. It is important that the intent of this subsidy program – to offset the actual costs associated with transporting bulk milk – result in the dollars *actually flowing to the party responsible for paying those direct costs*. As this does not change the uniform prices announced under the Order, but rather represents a reimbursement of the additional transportation costs incurred by a producer using a defined calculation included in the Order language, we believe this modification can be written to remain consistent with the uniform pricing provisions under the AMAA.

Again, MPC thanks you for the opportunity to submit this reply brief. Please feel free to contact us with any questions or clarifications you may have.

Sincerely,



Robert Vandenheuvel  
General Manager  
Milk Producers Council