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UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE
SECRETARY OF AGRICULTURE

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In re:)
Milk in California) [AO]
) Docket No. 15-0071
)

REPLY BRIEF

on behalf of

THE MIDWEST DAIRY COALITION

submitted by

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On behalf of the dairy farmer-owned cooperatives of the Midwest Dairy Coalition (MDC), I am submitting this reply brief with regard to the consideration of the establishment of a California federal milk marketing order (CA FMMO).

This reply brief primarily addresses the mandatory pooling aspects of Proposal #1 submitted by California Dairies Inc. (CDI), Land O'Lakes Inc. (LOL) and Dairy Farmers of America Inc. (DFA), and makes references to arguments made in the related post-hearing brief filed by these cooperatives ("the Proponents"). This MDC reply brief also make references to the post-hearing brief submitted by the Dairy Institute of California (DIC), hereinafter referred to as the "the Opponents."

The dairy cooperative members of the Midwest Dairy Coalition include:

Associated Milk Producers Inc.,
Bongards Creameries,
Ellsworth Cooperative Creamery,
First District Association, and
Lakeshore Federated Dairy Cooperative
(including FarmFirst Dairy Cooperative, Mid-West Dairymen's Co. and
Scenic Central Dairy Cooperative).

Collectively, the dairy cooperatives of the MDC represent about 8,700 dairy producers in eight states, which accounts for roughly 20 percent of the nation's dairy producers. All of these dairy producers are within the geographic boundaries of Federal Orders 30 or 32. The MDC cooperatives own and operate 20 dairy plants in six states, most of which produce manufactured dairy products such as cheese, butter and powder.

While the MDC cooperatives do not operate in California, the MDC has chosen to participate in the CA FMMO hearing through this reply brief because of the potential implications of these proceedings on the structures and procedures in the existing FMMO regions, particularly orders 30 or 32. Unlike other regional FMMO hearings, the CA FMMO hearing is a promulgation hearing, which increases the possibility that decisions made by USDA with regard to this hearing could set precedents for other regions.

1) The language of the 1996 Farm Bill, as amended by the 2014 Farm Bill, should not be read to grant authorities beyond the plain reading of the law.

The 1996 Farm Bill included language, which was reiterated and renewed by the 2014 Farm Bill, specifying the following:

"Upon the petition and approval of California dairy producers in the manner provided in section 8c of the Agricultural Adjustment Act (7 USC 608c), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, the Secretary shall designate the State of California as a separate Federal milk marketing order. The order covering California shall have the right to reblend and distribute order receipts to recognize quota value." 7 U.S.C. § 7253(a)(2).

Based on this provision of law, the Proponents have submitted a proposal that seeks to establish a FMMO for California. However, the Proponents read much boarder authorities into the farm bill language than actually exist from a plain reading of the statute.

Specifically, the Proponents in making their case for mandatory pooling of all milk within California (with a few minor exceptions), argue that such a requirement is integral to the Congressional intent in the words "... shall have the right to reblend and distribute order receipts to recognize quota value." To the contrary, there is nothing in the farm bill language that speaks to pooling requirements, and certainly nothing that grants special authorities for the CA FMMO to institute pooling procedures that violate the Agricultural Marketing Agreement Act of 1937 (AMAA) or that conflict with existing standards used in all of the ten existing FMMOs established under the AMAA.

2) Performance-based pooling is a critical part of the FMMO system, and long established under the AMAA.

The Proponents of Proposal #1 suggest that the AMAA requires "all" milk to be pooled. (94-95). Such a finding not only flies in the face of existing FMMO policy, but would undermine a critical tool used by dairy farmers and their cooperatives within the FMMO order system.

There are currently no other FMMOs that limit the ability to depool milk delivered to a non-pool plant. What is limited is the ability to repool milk after depooling, and Class I milk cannot be depooled.

The ability to depool manufacturing milk during certain market conditions is very important to the dairy farmer-owners of the MDC cooperatives. For example, during times when regulated Class III prices exceed Class I prices as a result of rising market prices and the lag in Class I pricing (i.e. during a period of price inversion), the ability of a cooperative cheese plant in Wisconsin or Minnesota to depool milk is clearly beneficial to the incomes of producer members of that cooperative.

The Proponents quote a list of California dairy producers arguing in favor of Proposal #1 as follows:

California producers do not want an advantage, just a level playing field with the nation's producers. The testimony is clear, the California producers simply want to be "in line with other producers throughout the federal system." (Lopes Tr. Vol. XXXIV, p. 6797 (Nov. 10, 2015).) According to Cornell Kasbergen, "being on a level playing field with the rest of the country is the answer." (Kasbergen Tr. Vol. V, p. 960 (Sept. 28, 2015).) No witness made the issue clearer than James Netto. Mr. Netto just wants a chance to compete: "I think every dairyman in California ought to be able to wake up in the morning and compete with everybody across the U.S We're not saying give us more money, we're saying, put us in the game, Coach, get us off the bench." (Netto Tr. Vol. XXXV, p. 7165 (Nov. 11,

2015).) The level playing field, as Michael Oosten testified, is "the foundation of what orderly marketing ... should be." (Oosten Tr. Vol. XXXVIII, p. 7775 (Nov. 16, 2015).) [12]

Yet in reality, the provisions of Proposal #1 that require mandatory pooling for all classes of milk (or "inclusive pooling" as it is euphemistically described by the Proponents) is distinctly NOT in line with, nor a level playing field with, the rest of the FMMO system.

This is further explained in the Opponents brief:

Even though all Class I distributing plants have always been treated as pool plants under FMMOs (whether under individual handler pools or market-wide pools), dairy farmers have always been able to voluntarily disassociate with the pool by not shipping to a Class I plant or other voluntarily pooled handler. *See County Line Cheese, supra*. This ability to choose whether or not to be pooled means that dairy farmers are not presently regulated in their capacities as "producers" as proscribed by the AMAA at 7 U.S.C. §608c(13)(B): "No order issued under this chapter shall be applicable to any producer in his capacity as a producer." Producers can and do opt-out under the ten FMMOs. But as with everything else in the Cooperative Order, the Cooperatives ignore this characteristic of the ten FMMOs. And it is an unlawful result. (77)

The Proponents argue that:

In regards to these proceedings, the two essential purposes of the AMAA are enhancement of producer income, and establishment and maintenance of orderly market conditions. (28)

In the Upper Midwest and Central orders (orders 30 and 32, respectively), the performance-based pooling requirements and the ability to depool manufacturing milk were established with a clear focus on producer income. During certain market conditions, such as a Class III/Class I price inversion, the ability of a cooperative dairy plant to depool milk on behalf of their dairy farmer-owners is clearly beneficial to the incomes of those producers. In the existing ten FMMOs, this has the benefit of enhancing producer income, one of the "essential purposes of the AMAA" according to the Proponents. In addition, such performance-based pooling standards have also been implemented in a way that does not undermine orderly marketing. Why wouldn't the ability to depool milk be of similar benefit for dairy product plants in California as well?

The Proponents argue that the AMAA does "not limit mandatory pooling to Class I milk." (94) However, nor does the AMAA require pooling of all milk. To justify mandatory pooling of all milk on the basis of AMAA language is to stretch the plain reading of the statute. If the proponents are arguing that the AMAA language envisions the mandatory pooling of "all" milk, are they also arguing that the existing ten FMMOs, which do not include mandatory pooling provisions for all classes, are in violation of the Act, contrary the Secretary's final rulings pertaining to each of those federal orders?

The Proponents argue further that:

Allowing depooling in the California FMMO will deny to California producers the very goal of their request for an FMMO: the ability to experience the minimum price values provided under the FMMO program to the rest of the country. If Class II, III and IV values generated in the California marketplace are not pooled in the California FMMO, the fruits of those values will be denied to California producers on a uniform basis. (97-98)

Yet, the existing FMMOs allow for depooling under provisions very closely scrutinized by the Secretary. Are the Proponents arguing that in the existing federal orders the producers in those regions being denied the “fruits of those values” on a “uniform basis”?

3. The concentrated nature of the California dairy industry has resulted, in part, from actions taken by the Proponents and, therefore, is an ironic justification for mandatory pooling.

The Proponents argue that the highly concentrated nature of California dairy processing is one of the factors that necessitate mandatory pooling. Yet the actions of the Proponents themselves have added to this problem, because they have either sold or significantly reduced production at their cooperative-owned plants.

On this same point, the Opponents argue:

Mandatory pooling also adversely affects available plant capacity. Ironic since DFA and LOL have sold off, closed or otherwise limited their cheese-making capacity, Ex. 98, at 11 (Testimony of Mr. de Jong). There have already been recent circumstances where milk could not be economically received at California plants because of mandatory pooling, even with the FMMO Premium. See Section VII. (75)

4. The Proponents themselves argue there are economic benefits of depooling milk.

The Proponents acknowledge that depooling has economic benefits for producers associated with the plant that is depooling:

The arithmetic on permissive California depooling is staggering. Not only would depooling by a large California entity have a significant negative impact on the pool and the producers' blend price, it would also give the depooling entity a significant advantage over its competitors. For example, if an entity with 30 percent of the pool had a \$1.00 incentive to depool, it would immediately reduce all its competitors' pay price by \$.30, while keeping \$1.00 for itself or its own producers. (102, footnote 38)

In other words, if the depooling entity were a producer cooperative, it would create a “significant advantage” for the producer-owners of that cooperative. This is in keeping with the argument made by the Proponents (28) that price enhancement for dairy

producers is one of the “essential purposes” of the AMAA. Yet Proposal #1 advocates for mandatory pooling, which would deny these economic benefits to producer-owned plants.

5. In contradiction to earlier arguments, the Proponents also erroneously argue that there is very little advantage to depooling of milk in other FMMOs.

The Proponents argue that there is no advantage of depooling to dairy product manufacturers in other orders because manufacturers in most other orders pay above the FMMO minimum prices:

Conversely, the Proponents of inclusive pooling demonstrated and documented in their rebuttal testimony that there is no material price advantage in other FMMO markets by having either the ability to be a non-pool plant, not bound by order minimum prices, or to depool at will. Both Mr. Hollon and Mr. Schad provided detailed information about the experience of their national cooperatives in marketing in FMMOs throughout the country. (Hollon Tr. Vol. XL, pp. 8074-91 (Nov. 18, 2015); Schad Tr. Vol. XXXVIII, pp. 7787-7815 (Nov. 16-, 2015) and Vol. XXXIX, pp. 7829-49, 7870-76 (Nov. 17, 2015); Exh. 185, pp. 2-6.) Their testimony, along with other data and testimony of record, established clearly that cheese manufacturers in the rest of the country pay in excess, and most far in excess, of minimum FMMO prices for milk used to produce cheese. (Christ Tr. Vol. XII, pp. 2458-66; Exh. 58, pp. 9-10; Exh. 60 (Oct. 7, 2015).) [107-108]

Appropriately, the Opponents rebut the argument that there is no real economic benefit of depooling in the existing FMMOs:

The Cooperatives protest too much when they claim that depooling does not advantage the market as a whole. Ex. 185, at 5-6 (Testimony of Mr. Schad). They ignore the fact that businesses regulated under FMMOs make individualized decisions that impact their bottom line with respect to pooling and depooling. Tr. 588: 20-589:3 (Testimony of Mr. Schaefer) ("Some plants choose to be non-pool plants, and that choice is predominantly in our market made based on the economics of pooling milk in a particular month ... Basically, it's based on the relationships of the prices, which lead to the producer price differential and the return that they would get from pooling.") And it is illogical to claim that depooling has little value when so much eligible milk is not pooled and so many in the industry fought extensively in multiple USDA proceedings over the existence of and necessity to deal with de-pooling. *See* USDA Pooling Decisions Discussed and Cited in Section VI, Part B, above. The ability to leverage eligible milk not pooled, or purchases of milk below class prices in the existing FMMOs, provides an important financial benefit to businesses operating with that system that must be extended to any California FMMO. Ex. 98: 15- 17 (Testimony of Mr. de Jong); Tr. 2529: 13-25 (Testimony of Mr. Christ). (72-73)

6. The voluntary nature of producer milk pooling within FMMOs is long established.

The pooling of milk used for manufactured dairy products has long been voluntary in the FMMO system, and has operated in a balanced way to address the needs of producers and consumers. On this point, the Opponents argue:

USDA has a consistent policy to distribute pool proceeds based on a voluntary election to participate in serving the Class I market.

USDA has always found it necessary to define the parameters for which dairy farmers obtain that valuable right to share in the uniform price — a showing by a dairy farmer that he is ready, willing and able to serve the fluid milk market. USDA restated its longstanding policy in the Final Decision for FMMO Reform:

The pooling provisions for the consolidated orders provide a reasonable balance between encouraging handlers to supply milk for fluid use and ensuring orderly marketing by providing a reasonable means for producers within a common marketing area to establish an association with the fluid market. *Milk in the New England and Other Marketing Areas*, 64 Fed. Reg. 16025, 16130 c.2-3 (April 2, 1999).

USDA has clearly determined that orderly marketing requires a "test" or pooling provision requirement in order to determine who is eligible to share in the uniform price because permitting any dairy farmer to participate without a pooling provision would also be disorderly. Performance-based pooling provisions are required to meet the Declared Policy of the AMAA:

"[p]ooling provisions of all orders ... are intended to define appropriate standards for prevailing market conditions in assuring that the marketing area would be supplied with a sufficient supply of milk for fluid use." *Milk in the Upper Midwest Marketing Area*, 68 Fed. Reg. 37674, 37678 c.2 (April 9, 2004); *Milk in the Northeast Marketing Area*, 70 Fed. Reg. 4932, 4943 (January 31, 2005). [61-62]

The MDC also concurs with the Opponents' further explanation of USDA's longstanding policy about performance-based pooling:

USDA's unvarying conclusion is that pooling standards are necessary to identify the dairy farmers who provide service in meeting the fluid milk market needs:

This is important because producers whose milk is pooled receive the market's blend price. If the pooling provisions do not reasonably accomplish these aims, the proceeds that accrue to the marketwide pool from fluid milk sales are not properly shared with the appropriate producers and can result in an unwarranted lowering of returns to those producers who actually incur the costs of supplying the fluid needs of the

market. 70 Fed. Reg. at 4943, c.2 (emphasis supplied); 69 Fed. Reg. at 18838 c.3 ("[i]t is the pooling standards of the order that identifies those producers who are relied upon to supply the Class I needs of the marketing area"). [63]

USDA has decisively and repeatedly declared that performance-based pooling standards are crucial and unavoidable: "Pooling standards that are performance based provide the only viable method for determining those eligible to share in the marketwide pool." Milk in the Central Marketing Area, 71 Fed. Reg. 54152, 54157 c.3 (September 13, 2006) and 68 Fed. Reg. 51640, 51645 c.1; Milk in the Mideast Marketing Area, 69 Fed. Reg. 19292, 19298 c.3 (April 2, 2004); 70 Fed. Reg. at 4943 c.1; and 68 Fed. Reg. at 37684 c.1 (rephrased as pooling standards are "the only viable basis for determining those eligible in the pool.").

The importance and prominence that performance-based pooling standards have in establishing and maintaining orderly marketing conditions is unequivocal and unyielding. These provisions are found in the "Pool plant," "Producer," and "Producer milk" provisions of each order and specify the requirements for a producer, the milk of a producer, or a plant that must be met in order to share in the benefits of the pool. *Id.* [63]

7. Conclusion

In conclusion, the Proponents of Proposal #1 seek to add California to the FMMO system as a way to "level the playing field" with other regions of the country. However, the Proposal also seeks to establish mandatory pooling provisions that are unprecedented within the FMMOs system, unsupported by the statutory language of the AMAA or the 2008 and 2014 Farm Bills, and have the potential to establish precedents that would undermine the beneficial pooling practices of dairy producer-owned cooperatives in other regions of the nation.

Therefore, the dairy cooperatives of the Midwest Dairy Coalition urge the Secretary to reject any effort to establish mandatory pooling standards as part of the consideration of the establishment of a CA FMMO.