UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In the Matter of:

MILK IN THE APPALACHIAN AND	)	DOCKET NOS. AO-388-A15 and
SOUTHEAST MARKETING AREAS	)	AO-366-A44; DA-03-11

BRIEF AND PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

SUBMITTED JOINTLY BY

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I. OVERALL INTRODUCTION

This Brief and Proposed Findings of Fact and Conclusions of Law is submitted on behalf of Prairie Farms Dairy, Inc. ("Prairie Farms") and Dean Foods Company ("Dean Foods"). Prairie Farms is a fully qualified Capper-Volstead dairy farmer owned cooperative. Both Prairie Farms and Dean Foods operate fluid milk plants, defined as handlers under federal milk marketing orders ("FMMO"). They acquire raw milk from dairy farmers known as producers. Federal orders require these handlers to pay uniform class prices for their milk, and through the producer-settlement fund, creates a "blend price" payable to all producers that is also uniform as to all producers. "The uniform pricing for producers must be combined with a pooling system for handlers in order *to avoid inequities.*" *United Dairymen of Arizona v. Veneman*, 279 F.3d 1160, 1162 (9th Cir. 2002). The underlying rulemaking proceeding herein is a two issue proceeding: Part One of this Brief discusses the proposed consolidation or reverse consolidation of two FMMOs; Part Two of this Brief discusses the exceedingly important issue of exempt producer-handlers that have the capacity to affect the market for milk in the Southeast and Appalachian marketing areas.

In Part One of this Brief, Prairie Farms and Dean Foods oppose further consolidation of orders (and instead strongly suggest that some reverse consolidation is fully justified – indeed further consolidation may violate the 1996 Farm Bill's requirement that there be at least 10 orders) on the grounds that further consolidation will simply move or exacerbate existing disorderly marketing conditions. In Part Two, Prairie Farms and Dean Foods support a size limitation on producer-handlers. Adoption of further consolidation and a refusal to limit the unhampered growth of unregulated entities will create the very inequities that the FMMO system is designed to prevent.

PART ONE

II. INTRODUCTION FOR CONSOLIDATION AND REVERSE CONSOLIDATION

Prairie Farms and Dean Foods oppose proposals to further consolidate federal milk marketing orders and instead favor proposals for a greater number of smaller federal orders. As demonstrated at the hearing, one of the fundamental purposes of the FMMO system is to provide fluid milk to fluid distributing plants based upon the higher price (Class I differential) such plants pay for raw milk. However, after Federal Milk Order Reform in 2000, which itself was the result of Congressional insistence that the Secretary consolidate orders to between 10 and 14 orders, the industry and the Secretary have discovered that there is a fundamental inconsistency in having few, large orders and the AMAA requirement that the Secretary maintain orderly marketing conditions. The chief issue for Part One of this proceeding was how the large size of federal orders actually discourages raw milk from moving to all fluid milk distributing plants. Fundamentally, this is because it is blend price differences between orders that in the first instance cause milk to move (and be pooled) to where it is needed and location adjustments within federal orders are not large enough to move milk within an order.

Moreover, after a scant four years of history after federal order reform and with the Secretary having expressly considered and rejected merger of the very orders that are now sought to be merged, proponents of such merger cannot demonstrate (as to this act of discretion) changed circumstances that override the Secretary's 1999 Decision. Unlike the issue of the exemption of producer-handlers, which proponents of limiting the exemption submit is NOT a subject of the Secretary's discretion (*see* Part Two below), the failure to establish such changes dooms the merger proposals. Indeed, the only "real" justification for the proposed merger is administrative convenience for the dominant dairy farmer cooperative or marketing agency. One searches in vain within the governing statutory authority for a proposition that such alleged "convenience" is remotely relevant. On the other hand, the 1996 Farm Bill clearly required the Secretary to consolidate orders to no fewer than 10 and no more than 14 orders. With the Western Order voluntarily voted out by the same national cooperative that is the major proponent of further consolidation here, there are presently only 10 federal milk marketing orders. The Secretary, as a threshold question, must first decide that the minimum number of 10 orders required by Congress in 1996 is somehow no longer applicable before she can consider the merger at all.[1]

The fallacy in merger proponents' reasoning was seen visually in the arbitrary plant distribution overlap circles drawn on Exhibit 48, Item 41. Visually, the overlap of milk supplies was obviously least acute along the Mississippi/Alabama/Tennessee borders suggesting the need to break the Southeastern order into two orders as suggested by Prairie Farms and Dean Foods. But most importantly, if one actually believes the theory of proponents, adoption of the merger proposal will simply move the administrative convenience and line-drawing problems to southern Ohio, Indiana, Illinois and Missouri. And if the overlap circles in Exhibit 48, Item 41 are to be believed, then why stop at those borders (the proponents did not show overlap from Texas, Oklahoma, central and northern Missouri, Illinois, central and northern Indiana, Ohio or West Virginia), why not simply adopt one national federal milk marketing order? Because that most certainly would not achieve the needed result of getting milk to where it is needed no more than adoption of the proposed merger.

[1] Final termination of the Western Order was implemented after the conclusion of this hearing. Prior to final termination, either the Secretary or the cooperative voting out the order could have come to a different conclusion. This issue was thus not ripe in February. But it is overly ripe now.

Finally, if anything, the history of post-federal order reform has taught the Secretary and the industry that a few, large orders actually contribute to disorderly marketing conditions. The termination of the Western Order earlier this year and Prairie Farms and Dean Foods alternative proposal, designed to address the significant problems revolving around the extremely large Central Order and the fact that milk is difficult to procure in the southeastern corner of that Order demonstrates beyond peradventure this problem. The Secretary must not, in order to cure private parties' administrative convenience, worsen disorderly marketing conditions in St. Louis. Moreover, the economic history of St. Louis demonstrates that a new even larger Southeastern order will most likely suffer the same consequences, making it difficult to procure raw milk supplies in the southeastern corner of that order.

The proposed merger should be rejected and, if any proposals are to be adopted, the deconsolidation proposals of Prairie Farms and Dean Foods (supported by other independent witnesses) should be adopted instead. Alternatively, while the merger should be rejected, the Secretary should convene, at her earliest convenience, a national hearing to discuss the very real need to have more, smaller federal milk marketing orders – all considered simultaneously so that the results of one proceeding will not cause harm in other regions.

III. SUMMARY OF CRITICAL FACTS AS TO MERGER OR DECONSOLIDATION

- The Secretary expressly considered and rejected the issue of this particular proposed merger during Federal Milk Order Reform.
- The market participant changes since 1999-2000 are insufficient to justify changed circumstances.
- The cooperative justification for administrative convenience is not relevant and ignores the very real fact that adoption of the merger proposals would merely move the problem to a different geographical area.
- St. Louis has experience, since federal order reform, difficulty obtaining a raw milk supply.
- Adoption of the merger proposals will exacerbate the problem in St. Louis.

- Blend price differences between orders provide a significantly greater economic incentive to move (or pool) milk to fluid milk distributing plants than the plant location adjustments within orders.
- The larger the milk order, the more difficult it is to economically justify moving milk to those distributing plants located deep within a federal order and especially those plants located closer to the next higher blend price order.

IV. <u>PROPOSED FINDINGS OF LAW</u>

Prairie Farms and Dean Foods respectfully request that the Secretary reach the following conclusions of law pursuant to 5 U.S.C. § 557(c):

A. <u>The Impact Of Federal Milk Order Reform</u>

Unlike the issue of producer-handlers,[2] the issue of FMMO merger and consolidation was a principal focus of Federal Milk Order Reform. Until after the fact, it was the only thing that Congress demanded that USDA accomplish. By definition then, the Secretary considered this issue to the fullest extent. Indeed in the Final Rule, the Secretary openly acknowledged considering the very option addressed in this hearing both before and after the Proposed Rule was issued in January 1998. 64 Fed. Reg. 16025, 16059, c.3 (April 2, 1999). In fact, many of the proponent cooperatives today made the identical proposal then and (incredibly) made the identical disorderly marketing pitch that they make today:

> The comment stated that this further [Southeast and Appalachian] consolidation would make milk utilization rates more similar across the order, would facilitate and encourage milk flow to deficit areas and minimize any negative price impacts on producers. According to Carolina-Virginia Milk Producers Association [now Maryland-Virginia Milk Producers Association and one of the members of proponents' coalition] *the existence of*

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[2] This issue is discussed more fully in Part Two, but the distinction is not academic. First, we argue that USDA actually lacks the legal authority to have a producer-handler as opposed to a purely *de minimis* exception. Second, we note that with respect to producer-handlers we are not arguing for a change in policy (regardless of the outcome as to the legal issue above); instead we are asking USDA to apply its dictum that it will regulate when producer-handlers have been shown to affect the market. We submit that at 3,000,000 pounds, such evidence now exists. Moreover, in federal order reform, USDA was directed to examine the proper geographic set-up and alignment of the federal orders. USDA decided <u>not</u> to change deliberately the regulatory status of any handler whether a producer-handler or otherwise. Therefore, the standard for whether or not the Secretary is now making a "different" decision is entirely different.

> *separate Southeast and Appalachian order areas could result in disorderly marketing conditions on the eastern side of the proposed Southeast area.*
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> . . .
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> A second DFA [another proponent coalition member today] comment recommended that the Southeast and Appalachian order areas be combined because the primary supplemental milk supply for both areas is the western states (Texas, New Mexico and Missouri). The comment stated that it is likely that these supplemental supplies would be likely associated with the Southeast order because of its greater proximity, and eastern Southeast milk would be "stair-stepped" across to the Appalachian order to reduce hauling costs. According to DFA, during the market's flush production month, the Appalachian order would not bear the burden of surplus milk since the distant surplus milk would be associated with the Southeast order in addition to the eastern Southeast milk supplies that also would be associated with the Southeast order to avoid inefficient milk movements, resulting in a disproportionate burden of surplus milk pooled on the Southeast order.

Id. at 16059 c.3 to 16060, c.1. The Secretary rejected these arguments, rationales and the proposed further consolidation.

An analysis of Exhibit 11, submitted by the Market Administrator (not a private party proponent herein) is quite instructive because the Secretary based part of his decision back in 1999 on the fact that less than 1% of the Appalachian's total supply came from New Mexico and other points west, while a full quarter of the Southeast's total supply came from that area. Today, as in early 2000 right after federal order reform's implementation, Order 5 produces approximately one-half of the milk utilized in Order 5. The percentage is down somewhat, but not significantly. Perhaps more importantly, for 2000 (right after federal order reform's implementation), The Southeast provided more pounds to Order 5 than did the Northeast (526,261,198 vs. 423,650,804 pounds). In 2002, the situation was mildly reversed with the Northeast providing 32.5 million more pounds than the Southeast. Meanwhile milk from the

Southwest to Order 5 had actually dropped, while Upper Midwest supplies to Order 5 had increased by 40 million pounds for the short months. By 2003, Order 5 was depending on 90 million more pounds from the Northeast than the Southeast and the Upper Midwest supplied 113 million pounds to Order 5. The Mideast Order provides almost a full 19% of the supply of raw milk for Order 5. And both this number and the percentage have more than doubled since federal order reform was implemented. The southwest number is larger again (80 million pounds), but when combined with the Southeast is still less than the total for these areas prior to federal order reform. The Southwest milk supply is only 1.3% of the total supply of Order 5 milk. Ex. 11.

In contrast, for Order 7 (Ex. 43), 19.2% of the Southeast Order milk comes from the Southwest (more than 15 times the percentage for Order 5 and 15 times the absolute number or pounds). The Central Order appears to have provided almost the same percentage and number of pounds to both Orders 5 and 7. Order 5 only provides 3.2% of Order 7's milk. Finally, all other orders (including presumably the Upper Midwest and the Mideast) combined provide Order 7 with only 6.5% of its milk in contrast with the 27% that those orders combined provide to Order 5.

The same rules used to reject the further consolidation in 1999 should apply today in deciding to reject the proposed merger. The numbers tell a story strikingly different than proponents of further merger. First, Order 5's reliance on Southwest milk supplies, while it has increased, has increased at a far, far smaller rate than its reliance on orders to the north. Second, Order 7's reliance on the Southwest has remained stable and is 15 times the reliance of Order 5 on that same area. If anything, Exhibits 11 and 43 indicate that there is a significantly greater and growing reliance for Order 5 on Order 33 milk supplies. Proponents' argument for further merger should suggest then that Order 5 should be merged with Order 33. Alternatively, the reliance on Order 1 supplies has also grown since federal order reform. But the reliance of Order 5 on Order 7 or Order 7 on Order 5 milk supplies has actually decreased. So the association of these two markets is actually going in the wrong direction to support "a change in circumstances" warranting further merger.

What the market administrator demonstrates is that stair-stepping milk (moving milk to where it is needed through blend price differences) is actually working. However, the stair-stepping is mostly west to east for Order 7 and north to south for Order 5. These two orders could hardly be more different in their reliance on reserve supplies from different geographic regions. And this is how it should be.

However, Federal Milk Order Reform may also require as a legal matter that the proposed merger be rejected. Although the legal issue now discussed is novel, the Secretary must address it if she is to prefer the merger option. But may she do so? There are presently precisely 10 federal milk marketing orders, the very number (at the minimum level) that Congress said *must* result from federal order reform. 7 U.S.C. § 7253 (1996). The Secretary, perhaps more wisely than the industry realized, made certain that there were 11 federal orders after the reform process was completed. This meant that had dairy farmers, as they did subsequently, voted "no" on one of the 11 consolidated orders, the Secretary was left with a safety valve of 10 remaining orders. But now, with dairy farmers, including the major cooperative proponent herein, having voted out the Western Order, the legitimate legal question is, "may the Secretary, by her own acts, reduce the number of orders below the threshold set by Congress in the 1996 Farm Bill?" Because it would now be the Secretary, not a voluntary vote of dairy farmers, that would cause the number of federal orders to fall below the minimum required by Congress in 1996. May she do so? This is a significant policy and legal question that must be answered *before* the Secretary even considers the proposed merger. Perhaps this novel legal issue should be fully briefed and decided prior to any decision on the merits.[3] If the legal basis is lacking, it would be truly unfortunate to discover that years down the road.

B. The Secretary's Discretion Based Upon Prior Decisions

In Part Two, we discuss the application of *Motor Vehicle Mfrs. Ass'n v. State Farm Mut.*, 463 U.S. 29 (1983) (striking down change in rule regarding passive restraints as being a change in discretionary policy not supported by evidence of changed circumstances). Recognizing the risk that one might accuse us of arguing out of both sides of our mouth,[4] a critical distinction can and must be made. With all due respect to the Secretary, the issue of the legal treatment of producer-handlers is just that, a legal issue, in which the discretion of the Secretary is not relevant. What is relevant is whether the Secretary has properly analyzed the law as applied to producer-handlers. Moreover, as discussed below, proponents are not really asking for a change in policy, but a recognition of the Secretary's established policy of market impact once a producer-handler reaches a certain size.

But the issue of the further consolidation of the orders is a matter that, subject to Congressional mandate as to the number of orders, is a matter of the Secretary's discretion. Having exercised that discretion during federal order reform so as to not further consolidate the Southeast and Appalachian orders, the Secretary is governed by *Motor Vehicle Mfrs. Ass'n* as to the proposed Southeast and Appalachian orders (note that splitting up the Southeast order was

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3 With only 10 federal orders presently, even if one allows one for California as was done in the 1996 Farm Bill, there is plenty of room for Prairie Farms and Dean Foods' proposal to deconsolidate the Southeast order.

4 The recent filings in the Arizona-Las Vegas and Pacific Northwest marketing area proceedings by one law firm on both sides of the issue being an extraordinary example.

not before the Secretary in the late 1990's).[5] The Secretary must, if she chooses to pursue the ill-advised proposed further consolidation, not only decide that federal order reform's minimum order number permits her to act, but also must establish, by a greater amount of evidence, that she was wrong back in 1999 when she used her discretion to deny the very proposal proposed today. Given the level of the evidence, this she cannot do.

C. Disorderly Marketing Conditions And The Larger Policy Issues

Proponents of the merger relied upon allegations of price misalignment along the eastern border of the Southeast Order and southern boundary of the Appalachian order as their principal justification for the merger. In addition to this being the precise problem alleged during the federal order reform, proponents were forced to concede (Tr. 300-302, 305 and 312 (Elvin Hollen)) that such price alignment issues routinely exist along federal order boundaries generally. Moreover, such price alignment issues already exist between St. Louis and these very orders. Tr. 549-554 (Gary Lee), Tr. 878-884 (Paul Christ), and Tr. 305 (Hollen).

Assuming that the Secretary concludes that the alleged price alignment issue along the Georgia, South Carolina and Tennessee borders is relevant and new, the Secretary should conclude as a matter of law that she cannot and should not simply move and also exacerbate a price alignment problem from one region to another. Such shifting of burdens does nothing to "create and maintain orderly marketing conditions." 7 U.S.C. § 602(1). Again note that according to Exhibits 11 and 43, Order 5 has much greater and growing reliance on milk supplies from the Mideast Order 33 and Order 7 has a much greater reliance on the Southwest. Why not, under proponents' logic, merge Order 5 with Order 33 and Order 7 with Order 126? Moreover,

[5] Perhaps more importantly, we do know, after the experience of federal order reform, that federal milk orders that are too large may lose producer support (Western Order) or simply prevent milk from being obtained in southeastern regions of an order (e.g., Central Order).

if the proponents complaint is to be believed and price differences between orders eliminated, the only logical conclusion (which we oppose) would be a single national order.

Moreover, the Secretary should conclude as an economic and legal matter that blend price differences between orders has a greater capacity to cause milk to move (or at least be pooled) on an Order than do the location adjustment differences within an order. Tr. 549-550 (Lee) and Tr. 880-881 (Christ). Indeed following federal order reform, there is significant evidence that large orders result in a difficulty in economically moving milk to the southeastern region of an order when that area borders a higher blend priced order to the south or east. Tr. 550-552 (Lee), Tr. 312 (Hollen) and Tr. 881 (Christ). Therefore, fewer and larger orders will result in a reduced economic incentive to move milk to where it is needed.

The Secretary should conclude that after the proposed merger, there will be a reduced incentive to move milk to Winston-Salem and other points in Order 5. Exhibit 67 introduced by proponents as opposition to the deconsolidation actually supports rejection of the proposed merger. The point of Exhibit 67 was to show that after deconsolidation it may become more economically difficult to serve plants in the eastern portion of the newly recreated Mississippi Valley order because the reduced Class I utilization would result in a lower amount of money available to pay for the haul of that milk. But upon examination of the sponsoring witness (Tr. 957-964 (Hollen)), one can create an identical chart showing the resulting economic disincentives in other regions should the proposed merger be adopted.[6] What is sauce for the goose is sauce for the gander. For instance, a close examination of Exhibit 67 also reveals the following:

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6 Proponents acknowledge that the impact of transportation credits are not studied in Ex. 67. Tr. 963-964 (Hollen). Those credits would, of course, work to the advantage of moving milk to the Southeast vis-à-vis St. Louis and make the impact spread even larger.

1. If Winston-Salem's Class I utilization is reduced by five percentage points (Ex. 27 introduced by the market administrator, holding all other things equal, shows that merging Orders 5 and 7 would cause such a drop for February 2002), the contribution of the blend price to the haul of the milk (as well as to the local dairy farmer struggling to produce milk) would be reduced by $0.155 (compare Ex. 67 – Lancaster to Winston Salem haul at 70% Class I ($0.567 haul loss) to 65% Class I ($0.722 haul loss)). Therefore, merger of Orders 5 and 7 will decrease the economic incentive to move milk to Winston Salem, lower pay prices to local farmers and, when the result causes even more milk to be needed from the north, further reduce pay prices payable to local farmers as even greater supplies are needed to be imported with an increased haul loss on that milk movement.

2. If deconsolidation were adopted, the haul loss on a movement of milk from Little Rock to Atlanta (based upon an assumed 5% increase in Class I utilization) would be reduced by $0.14 (compare Ex. 67 – Little Rock to Atlanta haul under 65% and 70% scenarios).

3. Further merger will adversely affect milk supplies vis-à-vis St. Louis and Order 7. If Class I utilization rises for Atlanta by October 2002's 3% (the number appears to range from 1 to 4% for various months), the reduced haul loss to Atlanta would be approximately $0.10 per cwt (using 3/5 of the 5% change from 65 to 70% shown in Exhibit 67). Of course this proceeding will not change Order 32's utilization, so St. Louis would remain the same while the haul to Atlanta now gains $0.10 on St. Louis meaning that the incentive to move even more milk past St. Louis to Atlanta will have grown by another dime.

4. Stair-stepping actually works. The very last set of theoretical milk movement on Exhibit 67 show a move from Kentwood, Louisiana to Atlanta. Presently, because those two cities are in the same order, there can be no blend price contribution to moving that milk.

Indeed, with a negative Class I differential difference from Kentwood to Atlanta, the move costs money regardless. But if deconsolidation were adopted, Exhibit 67 shows that for every 5 percentage point increase in the relative Class I differential difference between Atlanta and Kentwood, the haul would be compensated at $0.155. This would actually encourage (or reduce discouragement of) milk movements from Louisiana to Atlanta. This point illustrates Prairie Farms and Dean Foods' central thesis – that blend price differences can move milk and large orders without blend price differences within the order, reduce economic incentives to move milk to where it is needed.[7]

The Secretary cannot create or exacerbate disorderly marketing conditions in Ohio, Indiana, Illinois, Missouri, Oklahoma and Texas simply to "cure" an alleged condition (predicted by proponents in 1998 before Federal Order Reform) in a much smaller geographic area.

This hearing raises a larger philosophical and policy question which, proponents submit would be better, if not only, resolved through a national (or semi-national since perhaps Arizona-Las Vegas and the Pacific-Northwest marketing areas would most likely be unaffected) hearing. Did we as an industry and the Secretary actually establish the correct milk marketing orders during the federal order reform consolidation process? The proponents suggest that the answer is no as to the Southeast and Appalachian orders. But even if they are right, their solution implicates other orders dramatically. This is not an area that can be handled piecemeal because the answer for one order may not be the answer for another order. Moreover, without being able to consider fully the impact of these proposals on other orders, the Secretary actions are akin to

7 Prairie Farms and Dean Foods cannot and will not deny the undeniable – that deconsolidation will likely create the reverse economic incentives as discussed for deconsolidation for Atlanta or regarding the proposed merger and Winston Salem. However, at a minimum this analysis shows the flawed character of the proposed merger. At the other extreme, the Secretary can and should determine that modest disincentives for moving milk to the proposed Mississippi Valley order are outweighed by the overall benefit of creating benefits to move milk to Atlanta and the overall benefits of having smaller orders with stair-stepped blend price differences that would likely be smaller differences than would result from one massive order in the southeast. Such smaller differences ought to obviate the concerns of the proponents of further merger.

replacing the tires on a car when the shock absorbers are broken and the chassis is out of alignment. Neither activity will fix the underlying problem. And so, if the Secretary merges these two orders, how will that affect her ability to deal with similar issues in other orders? How will she repair the further damage to St. Louis? Will she, without considering the national picture, make a policy decision for another large order that flies in the face of the Central Order's dreadful experience with post-federal order reform or even the Western Order's demise as a direct result of consolidating two perfectly respectable and working orders (Great Basin and Southeastern Oregon-Southern Idaho) into one massive catastrophe?

Proponents of deconsolidation submit that the answer is obvious. The Secretary should deny the merger proposals and deconsolidate the Southeast. In the alternative, the Secretary should deny the merger proposals and immediately call a national hearing to resolve the outstanding issues of what should be the proper number of orders and their proper boundaries.

The final policy issue is also vitally important. When an alleged majority of dairy farmers request a change or oppose a change, does that make the supported change right and the opposed change wrong? Of course not. If all it took to make a change in the orders is a majority, we would not need formal rulemaking hearings. The majority is not always right. Moreover, the history of U.S. Constitutional and other legal analysis, not to mention the underlying principals of our Republic, support the notion that we protect the minority from the potential tyranny of the majority. Moreover, dairy farmers or their representatives, allegedly represented by some of the proponents, appeared in opposition to the merger proposals and in support of the deconsolidation proposal or its underlying concept. Tr. 364 (Bill Thomas) and 373 (Norman Jordan).

D. The Deconsolidation Proposal Language

There is nothing overly complicated about the proposal to deconsolidate the Southeast order. Visually, it is supported by the merger proponents' own analysis of handler competition. Ex. 48, Item 41. It is (or its concept was) supported by Prairie Farms (Tr. 549 *et seq.* (Lee)), Dean Foods (Tr. 878 *et seq.* (Christ)), and North Carolina and Georgia milk producers (Tr. 364 *et seq.* (Tom Thompson)). The proposal is not designed (subject to the producer-handler issue that is discussed separately below) to make any significant changes except to the extent plants will now be regulated on a new order. Moreover, in order to address a perceived objection of the proponents for merger, the Secretary can and should consider modifying the proposed Southeast and Mississippi Valley orders to permit supply plants within one order to provide balancing services to the other without causing disqualification of producer milk status. For this limited purpose the provisions regarding supply plants outside the Southeast marketing area, but within the Mississippi Valley marketing area, could still qualify producer milk.

Finally, as a result of an error on our part resulting from the Secretary's declining to hear another deconsolidation proposal at the same time, certain counties in Kentucky – Ballard, McCracken, Marshall, Graves, Calloway, Carlisle, Hickman and Fulton – should be in Order 7 if the Secretary denies Proposal 1 and adopts Proposal 5. Tr. 905 (Charles English and Paul Christ).

E. The Transportation Fund Does Not Justify Merge

The Secretary should not merge these orders based upon the transportation fund issue. Indeed, no change in the transportation fund or credit mechanism is warranted. One searches in vain within the history of the federal order program for the concept that merger or consolidation of orders should depend on the financial health of the transportation funds in these two orders.

The transportation funds in these orders are unique. They have nothing to do with consolidation criteria. Moreover, the discussion above concerning Order 5's reliance on milk supplies to the north and northwest and the Southeast's reliance on milk supplies to the west is more likely the cause of the discrepancy in these funds. There is no need to consider consolidation on this basis. Moreover, there is no reason to increase the rate of payout over what already exists. The fund was not designed to compensate fully for the haul of supplemental milk. The fund was not designed to grow such that the differences in Class I prices, including such transportation charges, would increase between and among the Southeast Orders on the one hand and Orders 1, 32, 33 and 126 on the other hand. The present Class I differential price surface was set by Congress itself at the end of federal order reform. Changing the transportation pay-in rate would effectively change the system of pricing without considering the impact on other market orders. The Secretary should not undertake this action.

V. <u>PROPOSED FINDINGS OF FACT</u>

Prairie Farms and Dean Foods respectfully request that the Secretary make the following findings of fact pursuant to 5 U.S.C. § 557(c):

A. <u>The Proponents Of Deconsolidation</u>

1. Prairie Farms is a Capper-Volstead cooperative. Through ownership and joint venture, Prairie Farms operates 31 plants that process and package fluid milk, soft cultured products, ice cream, ice cream mix, frozen novelties, butter and anhydrous milk fat. Twenty-four of these plants are regulated by a federal order – one plant on Order 30, fifteen on Order 32, three on Order 33, two on Order 5, and three on Order 7. Tr. 549 (Lee).

2. Dean Foods is a fluid milk processor operating multiple plants on, among other orders, Orders 5, 7 and 32. Ex. 48, Items 4 and 5.

B. The Secretary Expressly Considered And Rejected The Issue Of This Particular Proposed Merger During Federal Milk Order Reform

3. The Secretary should make a finding of fact that her predecessor expressly considered and rejected Proposal 1 during the federal milk order reform process. *See* Part One, Section IV.A., *infra*. The Secretary should further find that a number of the proponents of Proposal 1 submitted arguments concerning price alignment and pay price convenience during the federal order reform process. *Id.* The Secretary rejected these arguments at that time. *Id.*

4. The Secretary also rejected the notion that different utilization rates between the Southeast and Appalachian border areas would justify further consolidation. *Id.* Logically, there will always be such differences among orders and logically handlers will always want to be regulated in the higher blend priced area. *See, e.g.,* Tr. 420-421 (John Hitchell).

C. The Market Participant Changes Since 1999-2000 Are Insufficient To Justify Changed Circumstances

5. Unable to establish overlap of reserve milk supplies or a change in handler plant distribution, proponents of further merger resort to an assertion that producer and handler consolidation and plant ownership changes justify the merger by representing changed circumstances. However, the consolidation criteria do not mention this criterion. Moreover, Exhibit 48's list of changed plant ownerships date back to January 1996 (before Congress even passed the 1996 Farm Bill giving rise to order consolidation). Changes represented on that list could well and did occur prior to the Secretary's final consideration for the Final Rule.

6. The most obvious example of this non-change is that Exhibit 48, item 8 lists the constituent parts of Dairy Farmers of America as existing in 1996 and Dairy Farmers of America as not existing. The parties are led to believe that the formation of DFA is one of the changed circumstances that the Secretary should consider. But the Secretary in denying further

consolidation on April 1, 1999 referenced a post 1998 Proposed Rule comment submitted in favor of further consolidation made by Dairy Farmers of America. 64 Fed. Reg. at 16059, c.3 - 16060, c.1. The Secretary could hardly have been unaware of this "changed" circumstance.

7. Exhibit 48, Item 4 lists as a change Holland Dairies to Hoosier Dairies owned by Prairie Farms. However, the Final Rule list of plants shows that identical change. 64 Fed. Reg. at 16084. Land O'Sun operations were by 1999 already part of a larger company which acquired Dean Foods. Thus, those plants did not actually change ownership. Similarly, Barber Dairies, Fleming Company and Purity Dairies had already been acquired by Dean Foods by 1999. Some plants, such as Coleman Dairies now owned by Turner Dairies, changed status within this time period, but proponents did not disclose, or did not know, when within the seven year period their ownership changed. Three plants listed as Southern Foods Group or "self" were all part of Southern Foods Group and were acquired by Suiza (now Dean Foods by successor) on January 1, 2000, the same date that federal order reform became effective.

8. The change in cooperative status, brought on by the major proponent itself and having occurred prior to announcement of the Final Rule in federal order reform, together with the proprietary plant changes known to have occurred prior the Final Rule, can hardly constitute the changed circumstances required to permit a change now.

D. Cooperative Justification For Administrative Convenience Is Not Relevant And Ignores The Very Real Fact That Adoption Of The Merger Proposals Would Merely Move The Problem To A Different Geographical Area

9. Unable to establish overlap of reserve milk supplies or a change in handler plant distribution, proponents of further merger assert that their administrative convenience justifies the merger. Again, one searches in vain in the federal order reform consolidation criteria for mention of this criterion. 64 Fed. Reg. at 16044-16051.

10. The Secretary should find that even if this factor is relevant, it would equally be true regarding the geographic areas where Order 5 has a greater association than Order 7 (Orders 1 and 33) and where Order 7 has a greater association than Order 5 (Order 126).

11. The Secretary should find that even if this factor is relevant, it is wholly under the control of the voluntary marketing associations and as such, if a factor for consolidation, would place solely in the hands of private parties the Secretary's discretion of where, when and how to consolidate or deconsolidate milk marketing orders.

E. St. Louis Has, Since Federal Order Reform, Difficulty Obtaining A Raw Milk supply

12. Order reform left a dead zone in Illinois and Missouri around St. Louis. The state of Illinois and the area of Missouri around St. Louis regulated by Order 32 are deficit milk production areas at least 50 weeks per year. Handlers there rely on supplemental supplies from other areas, primarily the Upper Midwest. Tr. 550 (Lee). These supplies overlap with Order 5. Ex. 11. Central Order milk is pulled in almost equal quantities into Orders 5 and 7. Exs. 11 and 43.

13. Exhibit 58 shows per capita milk production in the United States. It shows Illinois to be a deficit production area even to cover fluid milk consumption. Per capita fluid milk consumption was estimated to be 188.6 pounds in 2002. Illinois has per capita milk production of 160 pounds in 2003. Tr. 550-551 (Lee).

14. There is already (before any further consolidation) enough money to attract milk from parts of the Order 32 area to the Order 5 and 7 areas. Ex. 11 and 43. Exhibit 58 shows the statistical uniform prices for the base zones of Order 30 and Order 32 and Order 5 zoned to Evansville, Indiana and Order 7 zoned to Murray, Kentucky since January 2000. These plants

are closest to Order 32. The Order 32 price difference by itself will not cover the cost of transportation from Wisconsin or Minnesota to St. Louis and downstate Illinois. Tr. 551 (Lee).

15. These additional costs are generally covered by over order premiums, give-up charges, loose pooling standards and other payments. At the same time, much of Illinois and Missouri are located near or adjacent to Order 5 or Order 7. Dairy farmers located in those areas can ship to Order 5 or Order 7 plants and potentially receive a higher price with little or no additional hauling cost. Tr. 551-552 (Lee).

16. On October 31, 2001, representatives of Dairy Farmers of America (proponent of further merger) met with representatives of Prairie Farms. At that meeting, DFA informed Prairie Farms that DFA could no longer provide Prairie Farms' Order 32 plants with supplemental milk beginning January 1, 2002. DFA said that the returns did not cover the expense of bringing milk from outside the immediate Illinois and St. Louis areas. DFA said that they could ship milk from downstate Illinois and St. Louis areas to market in Order 5 or Order 7 and get a better return. Tr. 552 (Lee).

17. Prairie Farms has been able to withstand this financial pressure, but at the expense of other market participants. *Id.*

18. The Central Order has an abundance of milk pooled on it and a low Class I utilization percentage. Fluid processors in the St. Louis/Southern Illinois portion of the marketing area have great difficulty attracting adequate supplies of milk for Class I use. The difference in blend prices between the fringe areas where much of the milk is pooled and St. Louis is too small to cover the additional cost of transporting milk to St. Louis. Tr. 881-882 (Christ).

F. Adoption Of The Merger Proposals Will Exacerbate The Problem In St. Louis While Adoption Of Proposal 5 Would Provide Some Relief To The Current Situation

19. Adoption of the merger proposals will worsen this situation. Tr.549-550 (Lee). The financial difficulty in getting milk to St. Louis can only get worse vis-à-vis Order 7 plants if merger results, as participants anticipate, in higher Class I utilization and thus higher blend prices in Order 7. *See* Ex. 27. Nor is it an answer that Exhibit 27 suggests that Order 5 utilization will go down. The incentive to move milk to Order 5 already exists. The new larger order will attract even more supplies from around St. Louis. The Secretary should not adopt further consolidation proposals in isolation. The Secretary cannot reasonably respond to alleged disorderly marketing conditions in Georgia by exacerbating disorderly marketing conditions in St. Louis.

20. The current situation in the Southeast complicates the problems of St. Louis and Southern Illinois handlers in attracting milk for Class I use. While there is not enough incentive to attract milk to the area from other Central order sources, the Western Kentucky and Western Tennessee portions of the Southeast Marketing Order Area provide much better incentives to attract milk for Class I use. Tr. 882 (Christ). For example, the difference in location value between St. Louis ($2.00 zone) and Western Kentucky ($2.20 zone) is small ($0.20, but the difference in blend prices during 2003 was $0.81 (Ex. 44)). This means that milk flowing from north to south has an incentive to bypass the deficit location of St. Louis to be delivered to a less deficit area of Western Kentucky or Western Tennessee. Tr. 882 (Christ). Mr. Christ had first hand experience in servicing the St. Louis market and first hand experience after federal order reform in dealing with this deficit market. Tr. 890-891 (Christ).

21. Once the milk from the north finds an outlet under the Southeast order, there is little further incentive to find another outlet further east and south. Tr. 882 (Christ). This point is further bolstered by the analysis in Exhibit 67, above.

22. Splitting Order 7 into two orders would reduce the blend price difference between St. Louis and the new Mississippi Valley order, reducing the incentive to bypass St. Louis. Tr. 883 (Christ) and analysis of Exhibit 67, above.

23. Splitting the Southeast Order area into two would also increase the blend price difference between the western portion of the present Order and the eastern portion of the Order. This would increase the incentive to move milk further east and south to the more deficit portion of the current marketing area. This change of circumstances (future) would improve the functioning of all three orders; the Central Order, the new Southeast Order, and the new Mississippi Valley Order.[8] Tr. 883 (Christ) and analysis of Ex. 67, above.

24. Keeping a separate order to regulate the Appalachian marketing area will provide separate and distinct incentives to ship milk to pool distributing plants under both orders, encouraging milk to go to the more favorably priced area, which has the greater need for milk. Tr. 883 (Christ).

25. Similarly, establishing a separate order to regulate the Mississippi Valley marketing area would provide separate and distinct incentives to ship milk to pool distributing plants under what is now the eastern part of the Southeast marketing area and what is now the western part of the Southeast marketing area. Milk would be encouraged to flow to the area that that had the greatest need for milk, as exhibited by the higher blend price. Tr. 883-884 (Christ).

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[8] The one changed circumstance that does exist, for this portion of the Brief, was created by federal order reform itself – the inability of St. Louis to obtain a raw milk supply.

26. In reality, there is less of an overlap of handler distribution between Order 5 and 7 then proponents assert. Moreover, Exhibit 48, Item 41, submitted by proponents of further merger, supports the deconsolidation proposal (Proposal 5). An examination of that exhibit establishes that there is less handler overlap along the Alabama-Mississippi-Tennessee border than in other areas illustrated on that exhibit; the visual reduction in concentration is overwhelming. Handler distribution overlap actually *is* one of the criteria for consolidation consideration. In fact, it is one of the "primary criteria" and the first listed during federal order reform. 64 Fed. Reg. at 16059, c.2. However, the overlap of handler distribution is actually significantly and visually noticeably less than along the Southeast/Appalachian border area (or had proponents shown it along the Ohio-Kentucky border). Logically, breaking up the existing Southeast Order into two orders and along that line is fully and amply supported by Exhibit 48, Item 41. Having left out of this exhibit the overlap from handlers distributing from Orders 1, 33, 32 and 126, proponents, who created exhibit 48, are estopped from arguing that overlap from those areas is less than along the Alabama-Mississippi-Tennessee border. In fact, given the concerns regarding St. Louis procurement, *passim*, the overlap along those areas is clearly greater. Deconsolidation is the only answer to solve all of these problems. It is fully supported by the record, especially Exhibit 48, Item 41.

G. Blend Price Differences Between Orders Provide A Significantly Greater Economic Incentive To Move (Or Pool) Milk To Fluid Milk Distributing Plants Than The Plant Location Adjustments Within Orders

27. Adoption of Proposal 5 would result in a uniform price in areas to the south and east of Order 32 that would still be higher than Order 32, but not as high as the current level and not as high as would result from adoption of the merger proposals. Adoption of Proposal 5 will not raise the price in St. Louis and downstate Illinois, but may reduce the tendency to lure milk from those areas. Tr. 550 (Lee) and analysis of Ex. 67, above.

28. It is clear that the primary force driving where milk is shipped and pooled is blend price, and in particular, relative blend prices among potential destinations. Tr. 880 (Christ).

29. Any modification of the existing orders that will facilitate flexibility in the blend price within an order, and greater variation of blend prices between locations will encourage shifts in milk shipments away from areas with a relative abundance of milk to areas with a relative shortage of milk.

H. The Larger The Milk Order, The More Difficult It Is To Economically Justify Moving Milk To Those Distributing Plants Located Deep Within A Federal Order And Especially Those Plants Located Closer To The Next Higher Blend Price Order

30. The concept of ever larger milk marketing orders being a detriment, and not a benefit, to the FMMO system and to the dairy farmers was supported directly by non-cooperative aligned dairy farmer organizations from North Carolina (Ex. 51, Norman Jordan) and Georgia (Exs. 49A, Dr. Bill Thomas and 49B, Tom Thompson). In fact, these representatives pointedly recognized that "the common practice for USDA to enlarge a market order area and lower the average utilization in some areas" has been a detriment to them.

31. The "St. Louis phenomenon" is a result of the Central Order's being too large. Tr. 549 *et seq.* (Lee) and Tr. 881 (Christ).

32. It is now the case for the large Southeast Order that much of the milk pooled in that area originates from the west (and some from the northwest) of the marketing area. Since the Southeast Order produces an attractive blend price, there exists an incentive to ship milk to pool distributing plants under the Order. Tr. 880-882 (Christ).

33. However, the greatest incentive is to ship milk to the closest pool distributing plant, which would likely be located on the fringe of the marketing area. Tr. 881 (Christ). Logically, the larger the marketing area, the farther from the fringe will be the plants that need

milk the most and end up with the least incentive to which to ship milk. This is because there is less of an incentive to ship milk to a more distant pool distributing plant within the marketing area, even though it has a greater need for milk. The disincentive of increased transportation costs increases faster than the incentive of the greater location value of the blend price. *Id.*

I. Another Reason For Splitting Order 7 Is That It Would Improve The Functioning Of The Transportation Credit Program

34. The rate of payment for movements of supplemental milk from the west (Texas and New Mexico) is greater than the rate of payment for movements of supplemental milk from the northeast (Pennsylvania, Virginia and Maryland) because the Class price differences are smaller. Tr. 884 (Christ). The distances that the supplemental milk has to travel to Order 5 are also smaller. Ex. 67. It is likely, according to Mr. Christ with years of experience marketing milk, that the new, smaller Southeastern order transportation credit pool could operate at a lower average cost than if it must absorb the higher transportation credit payments for supplemental milk from the west. Tr. 884-885 (Christ).

35. The result of Proposal 5 would be to enhance the performance of local federal milk marketing orders in fulfilling their legal mandate of "assuring and adequate supply of milk for fluid use." Tr. 885 (Christ).

PART II

VI. INTRODUCTION FOR PRODUCER-HANDLER ISSUE

The proper treatment of producer-handlers is the single most important issue facing the federal order system today as it reaches to the very heart of the system –whether and how to assure uniformity by regulating some, or all, producer-handlers as handlers under the FMMO system. As will be conclusively demonstrated, the producer-handler regulatory exemption has no basis in the underlying statute and can and should exist, if at all, pursuant to historic administrative convenience justifications only. As such, proposals considered at the rulemaking hearing to restore equality and uniformity to the federal order system can and should be adopted immediately.

Under present federal milk order provisions, producer-handlers escape the uniform regulation required by the FMMO system. Today, separately or together, producer-handlers are significant competitors in some parts of the country. They can and do sell to major wholesale and retail outlets as price leaders. They can and do substantially affect the market for fluid milk products. They can and do have market sales removed from the regulated industry resulting in unequal treatment of the remaining players. They can and do negatively impact the prices paid to remaining dairy farmers. They can and do use other regulated or unregulated markets to "dispose" of their surplus in ways, heretofore unknown in the federal order program, such that surplus disposal is not only *not* a problem, but is actually an additional benefit. They thus benefit on both sides of the regulatory equation – not paying the same uniform class prices imposed on regulated handlers and not receiving the same uniform prices paid to producers. This undermines the regulatory system entirely. This is counter to the purposes of the Agricultural Marketing Agreements Act ("AMAA").

To be sure, as opponents repeatedly pointed out in this proceeding, there are no present significant producer-handlers in the Southeastern United States. They thus argue, ingeniously since in another proceeding they argued that it was too late to regulate producer-handlers, that it is too early to regulate (or to limit the exemption of) producer-handlers in the Southeastern United States. This argument cannot survive the Secretary's legal command to "create and maintain orderly marketing conditions" especially since "potential threats to order objectives may form a basis for regulation to maintain orderly conditions." *In re: Independent Milk Producer-Distributors' Ass'n*, 20 A.D. 1, 25 (1961).

Moreover, the historic justification for USDA not regulating producer-handlers simply does not apply given the size and scope of many of these operations in other parts of the country. And it is not as if the regulatory program in question were brand new or subject to a lack.of clarity as to what is demanded by the statute. "Uniform" prices paid by all handlers to all producers has long been mandated. *U.S. v. Rock Royal Co-*op, 307 U.S. 533 (1939). Yet uniformity has been and is defeated completely by the present system that permits a certain "faction" to avoid full regulation while all others may not. Such lack of uniformity is not justified by the enabling legislation or the U.S. Constitution. It is precisely the kind of "faction" condemned by James Madison in the *Federalist Papers* [1787], no. 10 ("faction . . . adverse to the rights of other citizens, or to the permanent and aggregate interests of the community"):

> To secure the public good, and private rights, against the danger of . . . faction, and at the same time to preserve the spirit and form of popular government, is then the great object to which our inquiries are directed.

Id.

In reality, the Secretary of the United States Department of Agriculture ("Secretary") in recognizing the importance of this issue, could and should retrace her steps[9] and, looking to the future (*American Airlines, Inc. v. Civil Aeronautics Board,* 192 F.2d 147 (D.C. Cir. 1951)) maintain orderly marketing through the elimination of the statutorily unjustified producer-handler exemption entirely. Notwithstanding clear statutory instruction, proponents of uniform

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[9] Equal and exact justice to all men, of whatever state or persuasion, religious or political; peace, commerce, and honest friendship with all nations, entangling alliances to none. . . They should be the creed of our political faith, the text of civil instruction, the touchstone by which to try the services of those we trust; and should we wander from them in moments of error or alarm, *let us hasten to retrace our steps and to regain the road* which alone leads to peace, liberty, and safety. Thomas Jefferson, *First Inaugural Address* [March 4, 1801] (emphasis supplied).

treatment are nonetheless prepared to recognize that administrative efficiency may still play a role in the Secretary's decision-making (i.e., that a genuine *de minimis* rule may be permissible). As such, proponents offered and support an alternative that would fully regulate producer-handlers, just like all other handlers when a specified volume (e.g., 3,000,000 pounds per month) is surpassed. This bright line test would maintain or restore order in most circumstances (there would still be regulatory disruption as the result of not regulating smaller operations) and maintain or restore handler confidence in a system that depends not only on actual uniform treatment, but the perception of uniform treatment of the regulated industry.

Failing that, regulated handlers, when inevitably large producer-handlers develop as a result of the Secretary's refusal to act, will be faced with the following choices: continuing to comply with the regulatory program while others do not; joining the ranks of the favored few; or looking to enforce their equal protection and statutory uniform treatment rights as they may separately determine. The enormous question before the Secretary then is nothing short than a matter of survival for the FMMO system. The industry is watching and waiting (somewhat) with great anxiety. Will the Secretary have the will and desire to retrace her steps and fix the problem, or will the Secretary and industry through a failure of determination, lack of political will or misapplied legal analysis fail to fix this unjustified and extralegal regulatory loophole?

VII. SUMMARY OF CRITICAL FACTS AS TO PRODUCER-HANDLERS

- Producer-Handlers at 3 million can have substantial impact on the market.
- Producer-Handlers selling to major retail customers that set the market price can have substantial impact on the market.
- Large producer-handlers are few and can be regulated with administrative efficiency.
- Provisions regarding sales of the same or similar product to the same customer are not adequate to regulate large scale producer-handlers selling to large scale retail customers when, for instance, the Secretary's designees determine that each store is a retail customer rather than the integrated retail customer.

- Adoption of Proposal 8 (opposed) is counter intuitive and would make it easier for producer-handlers to grow and have significant market impact.

VIII. PROPOSED FINDINGS OF LAW – THE LEGAL FRAMEWORK AND REGULATORY HISTORY

Prairie Farms and Dean Foods respectfully request that the Secretary reach the following conclusions of law pursuant to 5 U.S.C. § 557(c):

A. The Agricultural Marketing Agreement Act Of 1937

1. "Uniform" class payments by handlers (including handlers that are also producers) to producers.

The only place to begin this analysis and discussion of producer-handlers is the enabling legislation. At the outset, the unassailable legal fact is that there is no provision within the Agricultural Marketing Agreement Act of 1937 (7 U.S.C. § 601 *et seq.*) for any exemption whatsoever for any handler. In fact, just the opposite is true. Prices shall be "uniform" as to "all handlers." 7 U.S.C. 608c(5)(A). Congress did not say that prices "may" be uniform or " shall be similar." Congress did not say that such prices shall apply only to "some" handlers. Instead from adoption of this provision, Congress dictated that: "[s]uch prices shall be uniform as to all handlers" subject to an express list of limited "adjustments." *Id.*

Commonly accepted rules of statutory construction require the plain meaning be applied to these words. *Texas Food Indus. Ass'n v. United States Dept. of Agric.*, 81 F.3d 578, 582 (5th Cir. 1996) (elementary rules of statutory construction require that "the words of a statute will be given their plain meaning absent ambiguity."). Black's Law Dictionary defines uniform as "[c]onforming to one rule, mode, pattern, or unvarying standard; not different at different times or places; applicable to all places or divisions of a country." Black's Law Dictionary 1530 (6th ed. 1990). What is striking about this definition is that the term "uniform as to handlers" ought to mean the same thing as "uniform as to all handlers." The fact that Congress went out of its way to say "all handlers" after the word "uniform" leaves no room for doubt whatsoever under the statutory construction doctrine that all words in statute are to be given effect and meaning. *United States v. Menasche,* 348 U.S. 528, 538-539 (1955); *Coyne & Delaney Co. v. Blue Cross and Blue Shield,* 102 F.3d 712, 715 (4th Cir. 1996) ("Absent clear congressional intent to the contrary, we will assume the legislature did not intend to pass vain or meaningless legislation."). But Congress went a step further providing an express list of exceptions to the "uniform as to all handlers" rule. Congress provided a list of "adjustments." Note again that the existence of the word "adjustment" as opposed to "exceptions" means that the initial calculation shall be uniform and then that uniform calculation is adjusted. The Black's Law Dictionary definition for adjust is "[t]o determine and apportion an amount due." Black's Law Dictionary 43 (6th ed. 1990). For instance, two handlers with identical uses of milk and all other things being equal, except that if one handler's plant is in Atlanta, Georgia, and the other plant is in Little Rock, Arkansas, will pay a uniform class price adjusted for the difference between the locations of the two plants (i.e., 30 cents per cwt – the difference between $3.10 and $2.80). Congress did not use the term "exception" anywhere in the statute. Moreover, Congress did not use the term "producer-handler" anywhere in the statute.

Using standard rules of statutory construction (*Reiter v. Sonotone Corp.,* 442 U.S. 330, 338-339 (1979) (strained construction cannot rob words of their ordinary meaning or convert nouns into adjectives), the fact that Congress expressly defined a list of adjustments (rather than exceptions) and no where included an exemption or even a reference to producer-handlers, leads to the conclusion that no such exemption was contemplated. This doctrine "expressio unius est exclusio alterius" is defined as follows:

> A maxim of statutory interpretation meaning that the expression of one thing is the exclusion of another. Mention of one thing implies

> exclusion of another. . . . Under this maxim, if statute specifies one exception to a general rule or assumes to specify the effects of a certain provision, other exceptions or effects are excluded.

Black's Law Dictionary 581 (6^{th} ed. 1990) (internal citations omitted). This leads to the conclusion that producer-handlers were never exempted by Congress from full regulation. But just to be certain, Congress added yet another term in another paragraph of 7 U.S.C. § 608(c)(5):

> (C) In order to accomplish the purposes set forth in paragraphs (A) and (B) of this subsection (5), providing a method for making adjustments in payments, as among handlers (including producers who are also handlers), to the end that the total sums paid by each handler shall equal the value of the milk, purchased by him at the prices fixed in accordance with paragraph (A) hereof.

Leaving to the next section in this Brief the definition of the term "purchased by him," Congress' inclusion in the minimum price setting (and pool creation) of "producers who are also handlers" reinforces the only conclusion that producer-handlers will be subject to the same regulation as handlers who are not producers. Else the language in the parenthetical must be read out of the statute. And, again, under standard, uncomplicated rules of statutory construction, every word is to be given effect and meaning. *Menasche, supra.*

2. The Secretary's administrative convenience exemption of producer-handlers.

So just where does the producer-handler definition come from since it is clearly not authorized by statute? The simple answer is that it has evolved from the rule "*de minimis non curat lex*" – literally "[t]he law does not care for, or take notice of, very small and trifling matters." Black's Law Dictionary 431 (6^{th} ed. 1990). It was to the advantage of the Secretary and even the regulated industry not to bother with those processors who were *de minimis*. And that is precisely what happened in the beginning of the federal order program. The USDA publication *Early Development of Milk Marketing Plans*, Marketing Research Report No. 14 (May 1952) (an official publication of the Secretary and hardly produced for this proceeding more than 50 years later), makes abundantly clear that administrative difficulties in the early years prevented USDA from pursuing small processors (who at that time were almost all also producers). Three hundred and thirty five producer-distributors (the alternative term for producer-handlers) represented 50% of the Greater Kansas City sales area. *Id.* Imagine without computers and all of our other technology that has developed since then how impossible this made any enforcement of the program. Even then, legal critics (within the Department itself) recognized that the exemption was unfair to the other dairy farmers and **discriminated** against those distributors who were subject to the order. *Id.* p.39.

Thus, the USDA created "exemption" has no statutory basis and must be understood in the context of the *de minimis* rule. And the Secretary knows (or should know) that this is the real rule since her predecessor enunciated it in 1965:

> The need for regulating producer-handlers in this [Puget-Sound] market has been considered at a public hearing on previous occasions. At those times, it was not found necessary to pool and price the milk of such persons to achieve the purposes of the statute authorizing Federal orders. *It should be made clear at this point, however, that the Secretary is empowered by the Act to impose through an order regulation of producer-handlers in their capacity as handlers, if justified by prevailing market conditions.*

30 Fed. Reg. 15152, 15154, c.2-3 (December 9, 1965) (emphasis supplied). Without using the phrase, the Secretary applied a *de minimis* exception to the general rule for uniform pricing. Moreover, the legislative history (since the clear statutory language leaves no room for doubt resort to such history is unnecessary, but perhaps instructive) corroborates this analysis. Handlers who were also producers were expected to pay just like any other handler: (1) if they had an impact on the market (1933 Agricultural Adjustment Act ("AAA")); or (2) as a hard and fast rule (1935 and 1937 AMAA).

But the opponents of regulation point to oft repeated Congressional statements in a number of AMAA amendments: "The legal status of producer-handlers under . . . the [AMAA] shall be the same after the amendments made by this title take effect as it was before the effective date of such amendments." So what? Leaving aside the fact that the language has not been included in the last two Farm Bills (such that if the language did mean something that meaning has been reversed), the language is nothing more than a statement that the AMAA is not amended as to producer-handlers. Since the original AMAA clearly contemplated regulation of producer-handlers just as all handlers, the statement has no legal bearing on today's proceeding.[10] If anything it reinforces the statement of Chester R. Davis (the original Administrator of the AAA from 1933): "If the volume is large enough to be an important factor in the market, then they would be expected to come under the market plan." Hearings on H.R. 5585, 74th Cong. 1st Sess. At 14. "If . . . he became a large enough commercial operator he would have to be subject to the same regulation." *Id.* at 44.

3. "Sale of milk" as meaning "acquired for marketing" - *Rock Royal Co-Operative* and its progeny.

The next complaint of the opponents and at least one of their experts is that producer-handlers cannot be said to "purchase" milk from themselves. This comment runs counter to the legislative history in which it was made abundantly clear on the floor that producers who were also handlers would have to participate just as any other handler. However, we need not rely merely on legislative history for this conclusion. Decades of case law reaches the same

[10] The actual words of Congress do not constitute a recognition of the exemption and are merely a restatement that their status is "unchanged." Unchanged from what? Unchanged by the statute from the fact that uniform pricing applies to all handlers. The provision merely is an expression that nothing in that particular enactment affects producer-handlers. But it does not create an exemption either. In this respect, and with all due respect to the Secretary, the statement in Federal Order Reform that gives this statement more credence is also wrong. *See* 63 Fed. Reg. 16025, 16135, c.3 (1999). Regardless, even if Congress was somehow blessing the "exemption"- the only exemption that could be blessed was *de minimis non curat lex.*

conclusion. The opponents' assertion and the incredible assertion by an otherwise respected dairy economist flies in the face of all of this legislative history and case law.

Opponents would thus have the Secretary ignore 50 years of case law. This they cannot do. In the early days of the federal milk order program, cooperatives that acted merely as their members agents, and did not take title to milk (as with almost all cooperatives today) in the sale of their members' milk, asserted that they did not "purchase" milk under § 608c(5)(A) and (C). Thus, they concluded they were not required to pay minimum prices or account to any federal order equalization fund. But in language heretofore unknown apparently to opponents' expert, the U.S. Supreme Court disposed of this argument: "[a]s here [§ 608c(5)(A)] used the word 'purchased' means 'acquired for marketing.'" *United States v. Rock Royal Co-Operative, Inc.*, 307 U.S. 533, 580 (1936). The cooperative was thus required to account to the equalization fund putting it on an equal footing with other regulated handlers.

Not surprisingly earlier renditions of producers who were also processors took umbrage at being regulated as handlers. However, the enabling statute also makes clear (beyond § 608c(5)(C)) that these persons are handlers. Section 608c(1) defines "handlers" as being "processors, associations of producers, *and others engaged in the handling of any agricultural commodity* or product specified in subsection (2) of this section." (Emphasis supplied). Thus, when a U.S. District Court in California was confronted with this issue it concluded that a brewer who consumed all of the hops which it grew in the brewing of its beer was a handler. *Acme Breweries v. Brannan*, 109 F. Supp. 116 (N.D. Cal. 1952) (the specific exemptions for producers and retailers "indicates that it was intended that . . . regulation should fall upon those who do something with . . . hops other than to grow them or to sell them at retail.").

The final piece of the overwhelming legal evidence supporting regulation remains Congress' inclusion in § 608(c)(5)(C) of the special parenthetical "(including producers who are also handlers)." As interpreted correctly by both the Third and Fifth Circuits over 40 years ago, "[t]he more reasonable construction [of the section] is that the parenthetical phrase was meant to reach a producer-handler who handles or distributed milk which he himself produces." *Ideal Farms, Inc. v. Benson*, 228 F.2d 608, 615 (3d Cir. 1961), *cert. denied*, 372 U.S. 965 (1963); *accord Freeman v. Vance,* 319 F.2d 841 (5th Cir. 1963), *cert. denied*, 377 U.S. 930 (1964).

Congress has known for 40-50 years that USDA's interpretation (and the Court's) was that producer-handlers could (and in many cases should) be regulated. Given Congress' interest in the overall subject of the dairy industry and given the insertion of language regarding producer-handlers, if this interpretation were incorrect or the Court's conclusion wrong, Congress has had plenty of opportunity to fix it. It hasn't, and thus the Court's construction must stand. *Burlington Indus. v. Ellerth*, 524 U.S. 742, 763-4 (1998) (Congress' failure to alter legislation interpreted by earlier judicial decision, binds court to follow such previous judicial interpretation); *Neal v. United States*, 516 U.S. 284, 295 (1996) (". . . we give great weight to *stare decisis* in the area of statutory construction [because] 'Congress is free to change this Court's interpretation of its legislation.'"), *citing*, *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977).

B. The U.S. Constitution's Due Process And Equal Protection Clauses As Applied In *In re: Kraftco*, Require Immediate Action

Thirty years ago, the Secretary was faced with a similar uniform price problem. Processors who purchased from a cooperative obtained "free" quality control work for raw milk while Kraftco, purchasing milk from independent farmers, paid the minimum price for milk, but then deducted a charge for the quality control work that it performed. The financial impact on the handlers was the same, and Kraftco argued that the financial impact on the producers was likewise the same. However, the market administrator filed underpayment notices against Kraftco, but served none on the processors receiving the milk from the cooperative together with the "free" quality control services. Kraftco responded by filing a 15-A proceeding asserting, *inter alia,* that the imposition on it of minimum prices resulted in non-uniform prices since its competitors received the same service for free. Thus, Kraftco argued the Secretary was improperly ignoring the statutory mandate to impose uniform prices in derogation of both the AMAA and the U.S. Constitution.

After Kraftco prevailed before the Administrative Law Judge, the Secretary appealed. The Judicial Officer (who at various times described himself as the *alter ego* of the Secretary), in the only recorded instance of its kind in the history of the much litigated federal order program, issued a Tentative Decision and Order vacating the underpayment notices and remanding the proceeding back to the Administrative Law Judge. *In re: Kraftco Corp.* AMA Docket No. M 4-15 (January 7, 1974). The case then settled largely, if not entirely, on Kraftco's terms. The question is why? Because the Judicial Officer recognized that the uniform pricing and payment provisions were not being uniformly enforced. Even though the general rule is that Kraftco could not defend on the grounds of others' failure to abide by the law, the Judicial Officer recognized the fundamental unfairness of the situation and in striking language applicable to today's situation concluded:

> However, if through a mistaken interpretation of the Order, or otherwise, the Market Administrator enforced the Order properly only against one handler, or a small number of handlers, and failed to enforce the Order properly against most of the handlers subject to regulation, a serious question would arise under the Due Process Clause of the Fifth Amendment to the Constitution and under the uniformity provisions of the Agricultural Marketing Agreement Act of 1937.

> To use an extreme illustration, if the uniform minimum Order price required to be paid for the month of January 1970 was determined by the Market Administrator to be $5, but all handlers paid producers only $4.98; and the Market Administrator sent an underpayment notice only to one handler in the market; that would raise a serious question under the Due Process Clause and under the uniformity provisions of the Act.

Id. at 100. The Judicial Officer concluded, as a matter of law, that a difference of 2 cents per cwt or 0.4% of the total price not being paid by all handlers was *an extreme* illustration of a non-uniform price. This 2 cents per cwt as an "extreme example" compares favorably to Mr. Paul Christ's discussion (addressed more fully below) that a one cent per cwt impact on the pool is significant.

But the Judicial Officer, in this decision, went even farther. The Secretary (through the Market Administrator) had argued that there was nothing wrong with the producers performing the quality control work themselves or hiring someone on their behalf to perform those services. As applied to this proceeding the Judicial Officer's rebuke to the Secretary (his *alter ego*) is a knock-out punch to the opponents herein:

> If the Market Administrator were correct . . . then producers could themselves perform any other handler function, or hire someone else to perform any other handler function without violating the Order's minimum price requirements. Carrying that view to its *ultimate extreme, the producers could completely run a handler's milk plant*, substituting themselves for the handler's employees engaged in processing or distributing milk; or the producers could hire someone else to perform all of such handler's functions, without violating the Order's minimum price requirements.
>
> Such a construction of the Act and Order would completely destroy the uniformity of pricing required by the Act. The Agricultural Marketing Agreement Act expressly requires that all handlers be treated uniformly under a milk Order. The Act requires all Orders to fix 'minimum prices for such use classification which all handlers shall pay * * *. Such prices shall be uniform as to all handlers' (7 U.S.C. 608c(5)(A)). The Act also

> provides for the 'payment to all producers and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered' (7 U.S.C. 608c(5)(B)(ii).
>
> 'The Congressional policy of uniformity of pricing as expressed in sections 8c(5)(A), (B) and (C) of the act is applicable to all handlers subject thereto unless expressly exempted by the provisions of the act. A handler is not to be allowed to gain a competitive advantage by virtue of a disregard of the minimum uniform pricing provisions of an order.' *In re Bay State Ice Cream Company,* 23 Agric. Dec. 1043, 1055 (1964).

Id. at 95-96 (italic emphasis supplied). And yet, producer-handlers are permitted to substitute for the handler's functions and have been allowed to gain a competitive advantage by virtue of a disregard of the minimum pricing provisions of the order. The Secretary's Judicial Officer's decision 30 years ago was right then and, if applied now, cries out for implementation immediately of a realistic limitation on producer-handlers.

Therefore, the failure of the Secretary to ensure orderly marketing conditions by implementing in advance and enforcing when the time comes the uniform pricing provisions would violate the AMAA and the due process and equal protection clauses of the United States Constitution. The failure of the Secretary to act, especially given the Judicial Officer's decision in *Independent Milk Producers, supra, at 25*, would also sound disturbingly like *Krafico* in light of the obvious discrimination arguments.[11] Nonetheless, the Secretary's failure to act after this hearing would demonstrate that there is no intention to implement and enforce minimum pricing provisions against proponents' future competitors. There is nothing in the AMAA that permits this result.

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[11] For instance, like Krafico, proponents are prepared, absent evidence to the contrary, to assert that they believe that the Secretary has acted or failed to act regarding producer-handlers under the mistaken belief that minimum payments to and by producer-handlers can be treated differently (or not regulated fully) than minimum payments by Prairie Farms and Dean Foods to their dairy farmers. Therefore, they conclude that the Secretary as in *Krafico* has acted and is acting without actual malice. Discrimination in this legal setting does not necessarily equal actual malice, but it is nonetheless pernicious and proscribed.

The uniformity requirements of the Agricultural Marketing Agreements Act would be rendered null, void and meaningless if the Secretary (or a Market Administrator) is permitted by mistake, or otherwise, to enforce one provision or another against only one handler or as against only a group of handlers. *Kraftco* at 100. Ultimately, the federal order system stands for uniformity, and a lack of uniformity caused by the very officers sworn to implement and enforce it would render the program meaningless.

The constitutional arguments are no less formidable to the opponents' position. As early as 1886, the United States Supreme Court has consistently and repeatedly held that the government cannot be permitted to enforce its laws with an unequal hand so as to discriminate between persons in similar positions to their detriment. In *Yick Wo. v. Hopkins*, 118 U.S. 356 (1886), an unanimous Supreme Court struck down enforcement against Chinese operators of wooden laundries of a San Francisco ordinance which made it unlawful to operate a laundry without the consent of the board of supervisors except in a brick or stone building. Not surprisingly given that era and the discrimination against Chinese, the only facilities against whom the ordinance was ever enforced were Chinese. All but ten of the 320 facilities in San Francisco were wood. Only the 240 Chinese owned wooden facilities were subject to enforcement actions of the city while the 70 other wooden laundries were left undisturbed. The court first easily disposed of the spurious argument that aliens (like corporations) were less protected. "The rights of the petitioners. . . are not less because they are aliens and subjects of the emperor of China." *Id.* at 368.

The Court next disposed of the enforcement against one class of persons only:

> In the present cases, we are not obliged to . . . pass upon the validity of the ordinances complained of, as tried merely by the opportunities of their terms afford, of unequal and unjust discrimination in their administration; for the cases present the

> ordinances in actual operation, and the facts shown establish an administration directed so exclusively against a particular class of persons as to warrant and require the conclusion that, whatever may have been the intent of the ordinances, as adopted, they are applied by the public authorities charged with their administration, and thus representing the state itself, with a mind so unequal and oppressive as to amount to a practical denial of that equal protection of the laws which is secured to the petitioners. . . Though the law itself be fair, yet, if it is applied and administered by public authority with . . . an unequal hand, so as practically to make unjust and illegal discriminations between persons in similar circumstances, material to their rights, the denial of equal justice is still within the prohibition of the constitution.

Id. at 373-374.

Proponents are persons entitled to U.S. Constitutional protection with respect to these equal protection and due process arguments. *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (state may not lawfully impose greater tax burden on out-of-state corporation as opposed to in-state corporation). Just as Metropolitan Life could not be taxed by Alabama as a non-resident corporation differently from a resident corporation, the Secretary may not continue to cause proponents to pay minimum prices or contribute to the federal order equalization fund when their competitor does not face the same obligations merely because the competitor is both a producer and a handler. In fact, other processors with farms (and those presently without farms, but who purchase farms to become producer-handlers) could merely reorganize if this were so and acquire its milk from the producer side and then avoid obligations. The statutory analysis above, however, demonstrates that there is no legal basis for the producer-handler exemption, thus thrusting the equal protection and due process claims to the fore.

Since the AMAA requires all handlers, including producers who are handlers, to make payments to the equalization fund, the opponents are incapable of making any kind of showing regarding a rational basis for discrimination against Prairie Farms, Dean, Kroger, and other processors. *See Lehnhausen v. Lake Shore Auto Parts Co.,* 410 U.S. 356, 359-360; *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 526-527 (1959). Based upon the underlying legislation and discussion about the statutory authority above, the dual treatment of handlers and producers who are also handlers cannot be sustained by the underlying legislation or the U.S. Constitution. *Western & Southern Life Ins. Co. v. State Board of Equalization of California,* 451 U.S. 648, 674 (1981).

C. "Uniform" Application Or Treatment Under Other Federal Regulatory Programs

It comes as no surprise that other regulatory programs involving price or rate setting with similar statutory mandates regarding uniform pricing have reached litigation results that bolster the arguments made above. This is important because the dairy industry can think of itself in isolation from the remainder of the legal world. It is not. The same principles apply in American jurisprudence generally. The most striking example is the Federal Energy Regulatory Commission ("FERC") which is charged with rate setting for electrical and gas companies delivering service through common or company owned lines or pipelines. In its rate setting, FERC is mandated to require that customers be treated uniformly. So for instance, when a power company attempted to charge new customers for the cost of expansion of service, the D.C. Circuit affirmed a FERC order that allocated the costs of expansion across all pipeline capacity so that the unequal treatment would not inure to the benefit solely based upon how long customers had been receiving gas. *Battle Creek Gas Co. v. Federal Power Comm'n*, 281 F.2d 42 (D.C. Cir. 1960).

Similarly the FERC rejected a gas company's method for service interruption which would have only interrupted direct, not indirect customers. The direct customers had brought a claim of discrimination before FERC and the Commission agreed. *See Sebring Utilities Comm'n* *v. Federal Energy Regulatory Comm'n*, 591 F.2d 1003 (5th Cir. 1979). A notable exception in differential treatment under FERC rules is actually supportive here. In *Newark, New Castle & Seaford v. Federal Energy Regulatory Comm'n*, 763 F.2d 533 (3d Cir. 1985), differential treatment of cooperative and municipal customers was found permissible on the grounds that the differential treatment was temporary and there was no evidence of competitive harm. But the producer-handler exemption has been hardly temporary and as discussed in the Findings of Fact cannot be shown to have "no competitive harm." Note that under FERC rules the burden appears to have been on FERC and the supplier to establish that there was no competitive harm since uniform treatment is the rule and the exception must be justified. While the court in *Newark* does not expressly so hold, it would appear that the justification in this instance is merely a restatement of *de minimis non curat lex*.

In at least one other regulatory setting involving an extreme example, the equal protection doctrine has been applied. *Bannum, Inc. v. Louisville,* 958 F.2d 1354 (6th Cir. 1992) (holding that it was unconstitutional to require landowner to obtain special use permit to operate a landfill employing felons, where other landfills were not required to obtain such a special use permit). *See also Massachusetts v. Daley,* 170 F.3d 23 (1st Cir. 1999) (holding that federal state-by-state quota system for limiting amount of fish caught unlawfully discriminated (no mention of equal protection), noting that no scientific data supported state-by-state quota and that quota actually harmed state that was intended to be benefited). Here the producer-handler exemption as presently set forth in current order provisions, despite the plain statutory requirement for uniform treatment of all handlers and producers, harms Prairie Farms and Dean Foods, as well as other similarly situated handlers, all of whom are intended beneficiaries of the program. Under *Daley*, the present exemption is unlawful.

Nothing in this discussion can change the plain meaning of the AMAA; however, the Secretary and the industry need to recognize that uniform treatment of all regulated industry players is a central and prevalent theme in American jurisprudence. It is long past time to treat producer-handlers, at least those with significant retail customers, uniformly as required by statute.

D. <u>Disorderly Marketing Conditions</u>

The Secretary is obligated to maintain orderly marketing conditions. 7 U.S.C. § 602(1). At its most fundamental core, there is no more of a disorderly marketing condition than non-uniform prices among handlers. This is nothing more than a statement that handlers who affect the market must be regulated in order to meet both the uniform pricing and orderly marketing conditions goal.

Nor do we have to reach far back in the history of federal orders to find the Secretary agreeing with this concept. Most recently as to an unique regulatory provision that existed in the then Western order, processors found themselves able (and did) to purchase milk for Class I needs at less than federal order minimum prices. When this issue was presented at a hearing, the Secretary had no difficulty concluding that these relatively small (1 to 1.5 million pound per month) operations *must* be treated equally. "The record evidence also provides strong evidence that the *Proprietary bulk tank handler* provision gives rise to disorderly marketing conditions because the order is unable to establish minimum prices that are uniform among regulated handlers, a requirement of Section 608c(5) of the AMAA." 68 Fed. Reg. 49375, 49383, c.2 (August 18, 2003 – Tentative Decision regarding Pacific-Northwest and Western Marketing Orders). That is to say, lack of uniform pricing among handlers equals disorderly marketing conditions.

Under the circumstances discussed in the Proposed Findings of Fact that follow, proponents urge the Secretary to make a legal finding that there is a lack of uniform prices among handlers. This ought to be a foregone conclusion since a producer-handler has:

> The incentive . . .[of] the additional return which he may receive by marketing his production through his own processing and distribution facilities rather than through a regulated handler. The blend price . . . of the market represents the return that he as a producer may expect for his milk under the order. . . [A] producer handler would have available the price differential between the utilization value of his own production and the order blend price which he could retain to enhance his returns as a producer or, as a handler, could use as a price incentive to maintain or increase fluid sales."

30 Fed. Reg. at 15154, c.3 (December 9, 1965 – Puget Sound Order). In other words, by definition there is a lack of uniform pricing that gives the producer-handler an advantage over his producer and handler competitors. And, leaving aside for a moment the *de minimis* exception, this is disorderly marketing. Thus, the Secretary cannot permit disorderly marketing to continue without violating yet another section of the AMAA.

The real issue regarding disorderly marketing conditions in this proceeding is that, unlike the earlier proceeding for the Arizona-Las Vegas and Pacific Northwest marketing areas, proponents and opponents can agree on one thing – producer-handlers are presently few and relatively small. So opponents argue that regulation should not occur. This misses the point as explained by the Secretary's Judicial Officer in *Independent Milk Producers, supra,* at 24-25. The Secretary cannot ignore the growth of large producer-handlers out west. Their existence certainly suggests that large producer-handlers can come into these and other markets. The Secretary cannot ignore the record evidence in this hearing of the growth of large scale producers in and very close to these markets who can become producer-handlers. Tr. 799 and 854 (Christ). And indeed, the Secretary cannot ignore the fact that the opposition represented that it wanted to have the option of being a significant producer-handler in this very market-place. Tr. 987-989 (Mike Summers). The Secretary cannot ignore the fact that (even though the argument has no legal basis) producer-handlers *after* they are established will make the Catch 22 argument that it is too late to regulate them under some kind of fairness or takings argument. The Secretary cannot be an ostrich and, as requested by opponents of limiting the exemption, ignore all of these present realities.

E. The Proposed Limitation As Applied To The Law

And so the proponents have proposed a "hard cap" or bright line test for determining when the perhaps permissible *de minimis non curat lex* should apply and when it should come to an end.[12] This is not actually a request to change the regulations or the application of the law *per se*, rather it is and ought to be viewed as an attempt to *properly apply existing law*. The exemption is not found in the statute and thus it exists as an extra-statutory creature that can and should be adjusted based upon any evidence that the *de minimis* threshold has been crossed. The other changes proposed are linguistic in an effort to deal with specific situations that have occurred elsewhere that plainly suggest that a producer-handler can cross the line into the competitive arena of regulated handlers.

So the central thrust is a bright line test that makes the rules clear for everyone, and proponents have chosen and justified at the hearing and in this and other briefs a limit of **no**

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12 Proponents do not concede that the *de minimis* exception actually ought to exist at all. Moreover, it is interesting to note that in 7 C.F.R. § 1000.8(e)(4), the Secretary has adopted a 150,000 pound a month rule as to exempt plants that are not producer-handlers. During Federal Order Reform, the Secretary expressly stated that such plants "because of their size, do not significantly impact competitive relationships among handlers in the market. This regulatory fact means that USDA has already for its part determined that the *de minimis* rule applies up to 150,000 pounds. The exemption should (and does as to non-producer-handlers) end there. As discussed in the statutory analysis, there does not appear to be a legal justification for treating a 1,000,000 pound non-producer-handler differently than a producer-handler. With the hearing notice as it is, the only way to address this issue would be to limit all producer-handlers to the same 150,000 pound threshold. However, proponents are not actually urging this result so much as recognizing that pursuant to *Alto Dairy v. Veneman*, 336 F.3d. 560 (7th Cir. 2003), it would be permissible.

more than 3,000,000 pounds per month. The justification for a bright line test is precisely a restatement of what it is, a cross-over from *de minimis* to competitive harm. For all the foregoing legal reasons and all the subsequent facts, the 3,000,000 pound limit (as a maximum threshold) is wholly justified.

F. Proposal 8 Should Be Rejected, But Proves Need For Regulation Of Producer-Handlers

Proposal 8, proposed by Michael Summers must be rejected. Under proposal 8, a producer-handler could purchase outside milk supplies equaling 10 percent December through May and an incredible 30 percent June through November. Besides being an open invitation for producer-handlers to become established and grow, the request is counter intuitive in that it would permit purchases of outside milk at the higher levels precisely during those months when the Order 5 and 7 markets require the greatest reserve supply. Permitting such purchases would then leave the pool carrying the necessary reserve on that higher level of milk, something this hearing has established is already too expensive regarding fully regulated handlers. Tr. 839 (Christ). The proposal should be denied.

However, the proposal, probably unintentionally, proves the need for adoption of Proposal 7. The very fact that producer-handlers are looking for new opportunities on this order bolstered by producer-handler growth (in size) and innovative marketing (box stores) underscores the need for the Secretary to maintain orderly marketing conditions precisely in the way that the Judicial Officer foresaw for dealing with future problems in *Independent Milk Producers, supra.*

IX. PROPOSED FINDINGS OF FACT

Prairie Farms and Dean Foods respectfully request that the Secretary make the following findings of fact pursuant to 5 U.S.C. § 557(c):

36. Exemption from the pricing and pooling provisions of a federal milk order should be a rare and highly restricted privilege. Tr. 792 (Christ).

37. The idea that a typical dairy farmer should be able to enjoy a regulatory advantage in processing his own milk has a measure of social appeal – note that key word is typical. The expectation was that such an exemption would have a negligible effect on the other producers and handlers in the market who are fully subjected to the regulatory program. Tr. 794 (Christ).

38. An exempt plant, and, in particular, a producer-handler plant, enjoys a significant competitive advantage over other producers and other handlers in the market. As a producer, the exempt producer-handler can receive more than the blend price for his milk depending on his internal transfer price between his plant and his milk production activity. This advantage is the difference between the local Class I price and the local blend price. Tr. 794-795 (Christ). When this advantage becomes significant, the Secretary should regulate producer-handlers pursuant to the concept that their impact should (if they are exempt) be negligible.

39. This producer-handler over handler advantage was $1.03 for Order 7 in 2003 (Ex. 41, page 11) and was $0.94 for Order 5 (Ex. 10, page 2). Tr. 795 (Christ).

40. Mr. Paul Christ further testified that a one cent per cwt impact on the local blend price is not trivial (is significant). Tr. 795 (Christ). Alternatively, from the handler perspective, he endorsed Mr. Hitchell and Mr. Herbein's testimony (Tr. 421 (Hitchell) and Ex. 57 (Herbein)) that a half-cent to a one to two cent per gallon impact (5.8 to 23.2 cent per cwt) impact on handlers is significant. Tr. 798 (Christ). Using "[t]he $1.03 per hundredweight potential cost advantage of a producer-handler in the Southeast market results in a 8.9 cents per gallon difference - 18 times the $0.005 and 5 times the 2 cent per gallon level of significance. Tr. 798-799 (Christ). "It is not negligible." *Id.*

41. Prairie Farms also testified that handler business is gained or lost based upon a "fraction of a cent per gallon." Tr. 562 (Lee).

42. The Secretary should not ignore the judicial history regarding her own program and should conclude that market impact must be less than the Judicial Officer's "*extreme example.*" Rather, the 3,000,000 pound limit is consistent, if not higher than, levels of significance testified to by Mr. Christ. For the Southeast, for example, it is also 4.45 times (on the most generous basis using 2 cents from Mr. Herbein's 1 to 2 cent a gallon example, rather than both Mr. Hitchell and Mr. Lee's smaller number) on both a percentage basis and an absolute cost basis of the difference found to be extreme by the Secretary's Judicial Officer (8.9 cents compared to 2 cents) in *Kraftco.*

43. Kroger testified about the market disruption caused by producer-handlers. Tr. 420-421 (Hitchell). As an integrated operation with retail store outlets, Kroger knows first hand that the customers of producer-handlers are able to offer milk at prices based upon the producer-handlers' financial opportunities resulting from its failure to pay equal raw product costs. Tr. 214-216 (Hitchell).

44. There is a great potential for both a larger number and larger-sized producer-handlers in these markets in the future. The structure of milk production is changing rapidly in the United States with more than a third of the milk produced on farms with more than 500 cows as of 2002. The farms with more than 500 cows produced 41.9 percent of the milk in the country and this number is probably higher in 2003. These enterprises are large enough to gather the resources needed to set up a bottling operation and compete effectively in the market for fluid milk products. Tr. 799 (Christ).

45. Every sale in the Southeastern United States (or elsewhere for that matter) of Class I milk by a producer-handler is a sale that can and should have been part of the regulated market. The blend price loss is the measure of this loss, but the loss is very real nonetheless. Logically, every pound that does not go into Class I (because it has been replaced by producer-handler milk) that must now be disposed of as surplus by the pool producers adds to the burden carried by the pool producers.

46. Other examples of market disruption caused by relatively small or smaller operations in other orders are also instructive for purposes of market disruption consideration here. In Idaho, two relatively small (significantly smaller than 3 million pound) handlers were at the time of this hearing's beginning obtaining milk under the proprietary bulk tank handler provision unique to that order. 68 Fed. Reg. 49375 *et seq.* (August 18, 2003). As acknowledged in that hearing record by the handler involved, and as was clear from the competitive impact in the market, those Class I handlers (not producer-handlers) were receiving substantially all if not all of their milk at prices below federal order minimums. *Id.* USDA accepted, correctly, that this constituted disorderly marketing. *Id.* USDA concluded that the provision should be eliminated:

> The record evidence also provides strong evidence that the *Proprietary bulk tank handler* provision gives rise to disorderly marketing conditions because the order is unable to establish minimum prices that are uniform among regulated handlers, a requirement of Section 608c(5)(A) of the AMAA. The record clearly reveals that this pooling feature of the Western order is being used to pool milk that could not otherwise be pooled and allows for the sale of milk for Class I milk below the order's minimum Class I price. While this provision served its function in the pre-reform Southwest Oregon-Eastern Idaho, its purpose and usefulness for the larger consolidated Western order can no longer be justified.

68 Fed. Reg. 49375, 49383, c.2. Now is the time to take that decision's conclusion and logic, substitute the term producer-handler for proprietary bulk tank handler, and provide realistic limitations to producer-handlers who have or will in the future substantially disrupt the market order system just as the relatively small juggers in Idaho caused market disorder.

47. Mr. Herbein, who attended significant portions of the hearing in addition to providing his own actual testimony, testified for proponents of limiting the exemption using both his existing database developed after many years of experience and audits and reviews of dairy companies and his years of providing expert testimony to the Pennsylvania Milk Marketing Board. Tr. 442-445. In addition to concluding that $0.005 per gallon was a significant price difference for handlers (a fact more than sufficiently corroborated by the Secretary's own Judicial Officer in *Kraftco*). Mr. Herbein testified about the various cost structures regarding plants of various sizes. Ex. 57 and Tr. 442 *et seq.* His testimony established that 3,000,000 pounds was a true "break point" in handler costs analyses. Mr. Herbein's testimony established that producer-handler sales to major box stores in the west could only occur based upon prices that regulated handlers cannot possibly match. *Id.*

48. Mr. Christ testified in favor of the proposals, attending virtually all, if not all, of the hearing. Paul Christ has over 40 years of experience working with federal milk orders with USDA, Land O'Lakes and today as a consultant. Mr. Christ noted the purposes and objectives of Federal Orders and then concluded:

> The critical features of these activities that insure the effectiveness and equity of Federal milk orders is that they be applied universally and uniformly. Without universality and uniformity, some participants in the market will enjoy competitive advantages over other participants that arise from regulatory laxity rather than from business acumen.

Tr. 793 (Christ).

49. There are several exemptions to the rule of uniformity, but only one category (plants located in Clark County, Nevada) is statutorily permitted to be excluded from federal regulation (although they are subject to Nevada state regulation). Tr. 793-794 (Christ) and Nevada Revised Statutes Chapter 584 and Nevada Regulations NAC Chapter 584 (Official Notice Requested of the Statutes and Regulations of the State of Nevada, Chapter 584 and Marketing Areas and minimum prices issued pursuant to NAC § 584.5551 *et seq.*).

50. Mr. Christ also corroborated the Secretary's own conclusions from 1965 (Puget Sound decision) that producer-handlers have a regulatory advantage that is equal to the difference between the local Class I price and the local blend price. Tr. 795-797 (Christ). That gap was $1.03 and $0.94 in 2003 for a producer-handler on these two markets. Finally, and perhaps most importantly, Mr. Christ, after 40 years of experience as a raw milk marketer concluded that "anything more than $0.01 per hundredweight reduction in the local blend price is not trivial." *Id.* at 798. That farmers respond and are sensitive to such price differences. *Id.* And that a $0.005 cent to 2 cents per gallon difference in costs for handlers is also not negligible (based upon Mr. Hitchell, Mr. Lee and Mr. Herbein's testimony). *Id.*

51. Mr. Herbein's one to two cent difference per gallon is actually higher than the Judicial Officer's conclusion in *Kraftco* that two cents per cwt is significant (in fact, an extreme example) to a handler. The differences as to these orders are equally dramatic. Mr. Christ's conclusions would lead one to regulate a producer-handler at 2,000,000 pounds for the Southeast (and something less for the Appalachian order) when considering the producer side of the equation (thus a 3,000,000 pound limit would "permit" an even more significant difference of over 3 cents per cwt return). Tr. 800 (Christ). Alternatively, on the handler side, the 2003 difference of $1.03 difference in the Southeast means that the producer-handler has a 4.45 times

advantage over the two cent price level difference that is deemed significant (or 18 times the half cent testified to by Mr. Hitchell). The 3,000,000 pound limit certainly leaves significant leeway for a producer-handler in the Southeast and Appalachian markets. Mr. Christ's testimony was provided calmly, without rancor and was not contradicted by anyone.

52. Dr. Roger Cryan also testified in support of the 3,000,000 pound cap on producer-handlers. His economic analysis based upon multiple resources both independently corroborated Mr. Herbein's accounting analysis and established an economic basis for the 3,000,000 pound limit. Tr. 583-601 (Dr. Roger Cryan). Moreover, his conclusions are consistent with those of Mr. Christ. His testimony based upon rigorous regression analysis is highly credible. His conclusion that 3,000,000 pounds is a logical break point for the exemption should be accepted by the Secretary.

53. The information provided as a Dean Foods organizational statement regarding competition in these markets and the fact that business changes for less than a cent a gallon also corroborates the testimony of Mr. Herbein, Mr. Hitchell and Mr. Lee. Tr. 807-809 (Christ).

54. For the Federal Order system to survive, plants need to be on a level playing field from a raw milk cost prospective. Historical understandings of producer-handlers no longer apply given their size, market position and ability to dispose of surplus milk. Today's producer-handlers are causing or can in the future cause disorderly marketing. Ex. 57.

55. On an economic logic basis, if a large producer-handler's cost of disposal of surplus exceeded the advantage of not being regulated, it would not make any sense to remain a producer-handler. The Secretary should conclude that the very benefits discussed throughout this Brief and others (realistically as to any plant larger than 3,000,000 pounds) must outweigh the cost of surplus disposal. Tr. 801 (Christ).

55. If changes are not made, the market will face significant producer-handlers (Tr. 977 (Summers)) and be eroded and adversely affected. The more producer-handlers can do, the more they will do. The only way to survive in this environment is to take on the characteristics of the unregulated entity because the system will not permit a regulated entity within the system to survive. If the present set of circumstances remain in place, producer-handlers will likely come into this market and grow at the expense of everyone else in the marketplace.

X. THE PROPOSED SOLUTION

Although the language issues are important to reign in problems before a producer-handler reaches 3,000,000 pounds, the bottom line solution supported by Prairie Farms and Dean Foods is a size limit on the exemption. Opponents objected to a fixed number and asserted, incorrectly, that there is no basis in regulatory law for such a bright line test.

However, as Mr. Christ said in his testimony, "fixed numerical standards are common and have been found to be necessary in all forms of regulation." Tr. 800 (Christ). Moreover, the Secretary in adopting federal milk orders has long used fixed numerical standards or their equivalent in a variety of ways. For instance, the Secretary has adopted the 150,000 pound "real" *de minimis* standard for an exempt plant. 7 C.F.R. § 1000.8(e)(4). The Secretary has throughout the federal order system fixed percentages of route disposition so as to determine whether a plant qualifies for partial or full plant regulation. 7 C.F.R. §§ 1001.7(a) through 1131.7(a). With respect to product classification, the Secretary defines fluid milk products as being less than 9 percent butterfat (7 C.F.R. § 1000.15), while fluid cream products are those with 9 percent or more butterfat (7 C.F.R. § 1000.16). Concentrated milk is defined precisely at not less than 25.5% nor more than 50% total milk solids. 7 C.F.R. § 1000.15.[13] The Secretary

[13] The issue of a 6.5% by weight minimum non-fat solids standard is also in the regulations, although recent enforcement of the "weight" provision (subject to dispute) is admittedly somewhat in doubt. 7 C.F.R. § 1000.15(b).

has drawn over the decades many, many lines for marketing areas. The Secretary has adopted numerous pooling provisions for supply plants and reserve supply plants with numerical bright line tests. The notion that the Secretary cannot draw one more line is simply absurd.

And the 3,000,000 pound limit is amply justified. Mr. Herbein's analysis supports it; the Congressional adoption of a threshold for processor contributions to the processor promotion fund supports it; the entire industry (absent the producer-handlers and producers who want to be producer-handlers of course who would be affected) supports it; and Mr. Christ's analysis supports it. Finally, and most tellingly, it is a far better, although far higher than the existing 150,000 pound exemption for all handlers, measure of the *de minimis* rule and is substantially more in compliance with the AMAA than the present rules.

As stated in the testimony, Prairie Farms and Dean Foods support the proposed language changes for the reasons stated in Mr. Hollen's testimony. However, the concern remains that as was decided by the Judicial Officer: "[i]n the past, elaborate and ingenious schemes have been employed to achieve apparent producer-handler status and thus to circumvent regulation." *Independent Milk Producer-Distributor's Assoc.*, 20 A.D. 1, 28 (1961) at 28 (and cases cited therein).

The language hasn't been enough in other marketing areas to control the growth of producer-handlers, so why should it be in these marketing areas? It needs to be strengthened to cover similar labels and similar products. It needs to be clear that a retail store chain can balance by putting 100% of the producer-handler's milk in one store and 100% of a regulated handler's identical product in another store using the same label. And most importantly, assuming that a producer-handler does ever lose its status, it should take time to reestablish. Otherwise, as we have seen in other pooling of milk settings, a producer-handler could cause itself to lose qualification conveniently in a month where it could draw from the pool and then jump back off in a future month.

But even then the language is not enough. The only true limit is a poundage limit. And Mr. Christ's testimony amply justifies a 2,000,000 pound limit for the Southeast (lower for the Appalachian) and certainly thus a 3,000,000 pound limit.

XI. LEGALLY IRRELEVANT "FACTS" AND THE ANTI-DEAN FOODS SCREED

The evidence cannot be diverted, through a frolic and detour, by irrelevant discussions or attacks on industry players based upon alleged market share calculations for cooperatives or proprietary handlers. For instance, given the clear statutory meaning and the limited *de minimis* exception that may apply, there is simply no relevance to a discussion of a producer-handler's cost of production. 23 Fed. Reg. 6050, 6053, c.2 (August 8, 1958) ("These reasons as justification for an exemption are not valid. Cost of production cannot be used as a sound basis for granting an exemption from pricing and pooling….").[14] Similarly, the AMAA does not provide a basis for a decision based upon how many hours a producer-handler works versus a regulated handler or a producer under the order. The AMAA does not provide for such an "adjustment" based upon that or whether an extended family owns the farm as opposed to a single individual be she a widow or an unmarried person. The AMAA does not permit an exclusion for creative marketing. The AMAA does not say that a handler located closer to the farm in the desert or in the mountains is not regulated, only perhaps that it will (as it is likely to be) subject to a location adjustment. The AMAA speaks to "uniform prices" applied "to all handlers." And the question of a potential *de minimis* exception does not open the door to novel

[14] In 1958, the producer-handlers asserted and the Secretary rejected as relevant criteria: (1) higher labor costs; (2) maintenance of 'show places' from which the industry in general benefits by promoting the sale of more milk for fluid use; (3) use of land with higher value and taxation; and (4) maintenance of more even seasonal pattern of production. *Id.*

discussions of why a producer-handler should not be regulated. The shoe is on (or ought to be on) the other foot – the producer handlers, seeking exemption from plain statutory construction rules that ought to lead to their wholesale regulation ought to prove their right to an exemption. All of these other things are legally, if not factually irrelevant.

The most obvious and pernicious example of this *ad hominem* form of argument was the legally irrelevant and usually factually inaccurate portrayal of Dean Foods. It wasn't just that the discussion focused on Dean Foods' alleged business and alleged market share in the Southeast or elsewhere. It was the implication and insinuation that somehow Dean Foods' existence justified a wholesale violation of the AMAA. Whatever the facts as to Dean Foods (and none alleged by any witness or counsel are admitted herein), they are irrelevant to any determination in this proceeding. Once again, we turn to the words of the AMAA. There is nothing in the AMAA that permits USDA to take into consideration the alleged size of one handler to *negate* regulation of another. When we discuss producer-handler sizes in this brief or in the testimony it is solely to show, if such showing is legally necessary, that large producer-handlers fail to meet the *de minimis* test. All else is irrelevant and should be excluded by the Secretary in making her decision herein.

Nor is the situation in Las Vegas relevant. In the first instance, this exception exists only as a result of Congressional action, not administrative fiat. Congress has spoken (Congress may be wrong, Congress may change its mind, Congress may or may not have had a rational basis for this distinction), but Congress has drawn a distinction. Again the AMAA does not draw a distinction for producer-handlers. In the second instance, the resulting situation is different in that the Nevada Dairy Commission regulates the prices paid by handlers to producers. This is not a case where regulated operators are facing competition from unregulated operators in

Arizona. Indeed, no one at the hearing gave any example of having competitive issues with the one plant then operating in Las Vegas. As of the close of testimony, the complained of Dean Foods' plant had not begun operations. There is thus no factual record for concluding that such a plant will have any competitive impact as a result of its regulatory status.[15]

But the Dean Foods frolic and detour discussions also distract one from the central fact that regulated handlers and pool producers of all sizes are complaining, not about Dean Foods, but about producer-handlers. The complaint is not about competitors who are on an equal regulatory footing, the complaint is that regulated handlers play by the rules that are inapplicable to their highly successful producer-handler competitors. Tr. 790 *et seq.* (Christ).

In a prior proceeding, opponents, and or the counsel representing parties herein, also argued that it is unfair, or perhaps even an unlawful taking of property, to change the rules after plant and farm investment has been made on so-called reliance of the regulatory facts. The only obvious relevant regulatory fact in federal milk orders is that the regulations often change. There is no legal right to rely on existing regulations. Federal Milk Orders are by their nature voluntary associations of producers (majority vote) that can be terminated (i.e., the Western Order) or amended at any time. Plants in federally regulated territory may become unregulated (i.e., Clark County plants) or may face future regulation with little or no notice. Pooling provisions change causing a shift in regulation from one order to another or even full regulation when partial regulation existed prior to the change. 16025 Fed. Reg. at 16046. The only thing constant in the federal order system is change. And anyone in this industry who makes business decisions without considering the risk of regulatory change is either uninformed or sought and received inadequate legal advice. This red herring in the prior proceeding works against opponents here.

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15 Dean Foods is actively supporting legislation that would result in federal order regulation (partial or full depending on circumstances) if the new plant in Las Vegas sold milk in Arizona (thus creating equality with any other like facility located anywhere in the United States).

If the Secretary takes no action because there is no Sarah Farms in operation in the Southeast presently, and Mike Summers fulfills his dream of becoming a producer-handler, and then proponents again ask for relief and the Secretary acts, we can predict as reliably as the sun rising in the east and setting in the west, the response. "Too late; unfair; we made an investment in reliance; takings." It will all be legally wrong and insufficient, but we will hear it nonetheless because it is and will be designed to delay, distract and deny proper relief.

There is more than the hint by opponents that they view full regulation by federal orders as an unlawful taking without compensation prohibited by the U.S. Constitution. There is no case law to support this thesis; indeed the opposite is true. By definition, if regulation of these producer-handlers amounts to an unlawful taking, so to does the entire system of FMMO pricing and pooling. Regulation of cooperatives, as in *Rock-Royal* and its progeny, dispels this myth. Regulation of producer-handlers can only be a taking if the entire FMMO system is unlawful. Given the high number of U.S. Supreme Court cases that have recognized and upheld the FMMO system, the likelihood of such a judicial result is highly unlikely and must be discounted by the Secretary.

XII. FEDERAL ORDER REFORM DECISION NOT TO ALTER REGULATORY STATUS AND THE APPLICABILITY OF *MOTOR VEHICLE MANUFACTURERS*

Opponents also repeatedly challenged the Secretary's authority to act at this time with respect to the producer-handler issue on the grounds that proponents allegedly cannot demonstrate changed circumstances since the completion of the process known as Federal Order Reform in 1999. Proponents disagree: (1) there is no justification for the exemption in the statute thus obviating the need to show changed circumstances under the standard enunciated in *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29 (1983); (2) the

Secretary affirmatively chose not to change the regulatory status of any producer-handler in Federal Order Reform regardless of the facts or circumstances; (3) the Secretary chose a different Class I pricing option than that eventually adopted by Congress; no one today can say that the Secretary, had he known that Congress was going to adopt a different (higher) Class I pricing structure that makes the economics of being a producer-handler more attractive, would not have taken a new and different look at producer-handlers under those *subsequent* circumstances; and (4) the Secretary did not have before him the evidence in this administrative record regarding the impact of producer-handlers in other marketing areas. As such, proponents, and thus the Secretary, need not demonstrate any change in circumstances post-2000, but such change can be and has been demonstrated regardless.

Returning yet again to the theme that there is no statutory exemption whatsoever, it is not up to proponents to demonstrate that producer-handlers should not be exempt. Rather, given the statutory requirements, opponents must demonstrate that an exemption is allowable. They cannot for all of the foregoing reasons. Moreover, if the evidence of market impact in other markets is insufficient to overcome the arguably permissible *de minimis* exception, then to put it bluntly there will never be regulation of producer-handlers. And the industry knows this "regulatory" fact. The hearing demonstrates that the industry awaits the outcome of this proceeding with all but bated breathe. Without asserting or threatening that it can or will happen, can anyone doubt that both producers and handlers and others (e.g., distributors and retailers) will be forced to change their operations or proceed economically, regulatorily or judicially in order to become competitive because uniformity is denied them? The problem of unregulated or under-regulated raw milk competing with fully regulated raw milk prices cannot and should not be underestimated. As *Kraftco* demonstrates, regulated market players must and will find ways to compete with those who act outside the rules. And the result is never pretty.

Federal Order Reform was a global consolidation and review of class prices. It was not, and indeed could not have been given its complexity, a review of each individual tree in the very large forest. In this regard, the Secretary simply chose to treat marketing areas, pricing, pooling, and other uniform language issues globally rather than individually. It is for this reason that the Secretary chose not to intentionally fully regulate any handler that was unregulated before Federal Order Reform. 16025 Fed. Reg. at 16046, c.3. Moreover, the only proposal put forward would have eliminated the exemption in its entirety, not create a poundage limit (bright line test) as is proposed today. Thus, the refusal to consider that proposal (again looking at the forest and not the trees) is legally irrelevant to this entirely different proceeding today. Again the Secretary took a global position: "[h]owever, no changes have been made that would intentionally regulate a producer-handler that is currently exempt from regulation under their current operating *procedures*." *Id.* at 16135, c.2 (note the term procedures and not size or market impact).

This leads to the crucial difference beyond the Secretary's global rather than individual examination in Federal Order Reform. The 1996 letter request submitted to the Secretary's designee, references a 6 million pound plant in Texas, but provides none of the rich and full detail of the 16-22 million pound plant in Arizona today that sells to major box stores and other major supermarket outlets. The Secretary's statements in 1999 thus were not based upon the actual Class I price levels post-1999 Decision or any of the facts discovered in 4 weeks of hearings during 2003 and 2004. In 1999 (the data relied upon for the 1999 decision of course ended mostly with 1997 and 1998), the Secretary could not know how a producer-handler had grown so substantially in the interim in another marketing area. In 1999, the Secretary could not know that a producer-handlers would supply major box stores that can set the retail price for all retailers. In 1999, the Secretary did not have the benefit of the expert testimony upon which the proposed 3,000,000 pound cap is based. In 1999, the Secretary in fact had no specific proposal save the proposal to eliminate the exemption entirely.

Thus, the decision in 1999 in Federal Order Reform has no legal significance under the *Motor Vehicle Mnfrs. Ass'n* standard except to the extent it stands for the following principle that is in support of proponents' proposal: "We have frequently reiterated that an agency must cogently explain why it has exercised its discretion in a given manner." 463 U.S. at 48-49 (citations omitted). The statute provides no discretion once USDA decides to implement a milk order. Once it does so, subject to adjustments that are not relevant to this proceeding as discussed above, USDA must provide uniform prices paid to all producers by all handlers. Assuming, without conceding, there is any discretion, it is the *de minimis* discretion only. No other discretion exists. None. And if the Secretary is going to continue to exercise this dubious ground for discretion, it must under the case law cogently explain why. *Id.* Indeed, if *Motor Vehicle Mnfrs. Ass'n* stands for anything more it is that the agency rule "would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, *entirely failed to consider an important aspect of the problem,* offered an explanation for its decision that is counter to the evidence [of the law] before the agency, or is so implausible that it could not be ascribed to a difference in view or product of agency expertise. *Id.* All of this is by way of saying that proponents have no obligation or duty to prove, as they have anyway, that circumstances have actually changed since federal order reform.

Moreover, and again with all due respect to the present Secretary's predecessor, a misstatement of the law (that the exemption exists or was blessed by Congress) cannot be a basis for asserting *Motor Vehicle Mfrs. Ass'n.* The Secretary (like any other federal agency) is not estopped by a misstatement or misapplication of the law. *Reinhart v. United States Dept. of Agric.*, 39 Fed. Appx. 954, 956 (6^{th} Cir. 2002) (even clear agency violation of law did not allow for waiver of time limit for filing appeal). The exemption has no legal foundation save potentially as a statement (inconsistent as it is with the 150,000 pound exemption) of *de minimis non curat lex.* As such, the prior statements are not binding on the Secretary in the slightest.

XIII. PRIOR REGULATORY PROCEEDINGS

Opponents will no doubt point to recent federal order rulemaking proceedings as evidence that the Secretary should not (or even cannot act) in this instance. We would be the last to argue that prior proceedings are irrelevant, but they must be put in context and fully understood. Moreover, one cannot look at those two proceedings in isolation when there is a wealth of regulatory an judicial history regarding producer-handlers. The Texas (1988) producer-handler proceeding involving Gore, Inc. (54 Fed. Reg. 27179-27184) (June 28, 1989) (Recommended Decision) and (54 Fed. Reg. 34986) (Sept. 6, 1989) (Final Decision) and the Arizona (1993) producer-handler hearing involving Heartland Dairy (58 Fed. Reg. 67703-67708 (Dec. 22, 1993) (First Recommended Decision); 59 Fed. Reg. 56414 (Second Recommended Decision); and 60 Fed. Reg. 55989-55991 (Nov. 6, 1995) (Final Decision and Order) are relevant only to a point. But so too are all of the earlier proceedings and resulting court decisions from the Puget Sound and the eastern United States. But the Gore and Heartland proceedings differ from the earlier proceedings in material respects. Both these proceedings resulted in Recommended Decisions, but the Gore proceeding was terminated after the Recommended Decision without any Final Decision and Heartland Dairy ceased operations as a producer-handler (and eventually ceased handler and finally producer operations entirely) after the hearing but before the Recommended Decision. In the Gore case, with the proceeding terminated, the Recommended Decision, having never become final, has no legal significance. 7 C.F.R. Part 900.

The Heartland Dairy situation created a change in circumstances that then permitted the Secretary to reach different conclusions. If Heartland taught the industry anything, it was the already well worn lesson, that any regulatory provision may be used to the fullest extent to create private opportunities at the cost to society as a whole, all of which is contrary to the central thesis of our Republic. James Madison, *Federalist Papers*, [1787], no.10.

Not surprisingly the history of federal order treatment of producer-handlers (sometimes producer-distributors and sometimes exempt handlers with their own farm production) is far richer and more complete then the somewhat attenuated proceedings involving Gore (terminated) and Heartland (ceased producer-handler operations while proceeding pending). To see why the present situation is so objectionable, one should review the following proceedings (recognizing that the statutory provisions for "uniform prices" paid to all producers by "all handlers" has never varied in 67 years:

> In some districts, exempt handlers have cut retail and wholesale prices below prevailing prices of fully regulated handlers in efforts to increase their fluid milk sales with the result that fully regulated handlers have lost some fluid sales to handlers with exempt own farm milk. In some districts, such practices have tended to detract from the effectiveness of the order in promoting orderly and stable marketing conditions and these practices and resultant undesirable conditions may be expected to expand into other districts and magnify in intensity in the near future unless the order is appropriately amended.

23 Fed. Reg. 6050, 6051, c.2 (Aug. 8, 1958). If one substitutes the words "Southeast and Appalachian Marketing Areas" for "some districts", this 46 year old decision applies perfectly to the facts propounded at this hearing. This is hardly a change in regulatory policy necessitating

Motor Vehicle Mfrs. Ass'n analysis. In a stunningly perceptive and prospective look at large producer-handlers, the Secretary in 1958 continued:

> Under the present order language a multiple farm operator can produce exempt milk from one farm while delivering milk to regulated handlers from any number of other farms and receive the uniform price for the milk. Cows can be shifted or the milk may possibly be shifted in a concealed manner from the farm or farms from which milk is delivered to regulated handlers to the farm on which exempt milk is produced. Such practices enable an exempt-handler to balance from the pool the day-to-day and seasonal surplus associated with the fluid sales exempt from pricing and pooling while producers under the order receive no benefits from the exempt handler's fluid sales.

Id. at 6051, c.3. The very reason that a bright line test as proposed by proponents is required is that at some point all of these abilities to avoid regulation become too valuable to ignore and too difficult for the Secretary to uncover. "In the past, elaborate and ingenious schemes have been employed to achieved apparent producer-handler status and thus circumvent regulation." *In re: Independent Milk Producer-Distributor's Assoc., supra.*[16]

These decisions remain equally valid and applicable today and proponents urge their application (as not being a change in policy at all) immediately.

XIV. THE REGULATORY FLEXIBILITY ACT CLEARLY PERMITS ADOPTION OF THE PROPOSALS

Opponents to the proposals suggest that the Regulatory Flexibility Act, 5 U.S.C. § 601 *et seq.* may affect the Secretary's adoption of proposals herein. As conclusively demonstrated below, the Regulatory Flexibility Act ("RFA") does not require additional analysis or special review in this matter, but even if it does, the regulatory problem that needs to be solved, the

[16] Opponents throughout the hearing complained that they are already regulated because in order to achieve exemption they have to maintain their operations in a certain way and must file supporting documentation. There is simply no legal support for the conclusion that this constitutes "regulation" as the term has been used consistently in the federal order program for 67 years. Instead as in the *Independent Milk Producers* case just cited, the term is "circumvent regulation" or "exempt handler." Moreover, as noted in the section on legal relevance, these so-called costs of being a producer-handler are not justifications for the exemption from regulation. 23 Fed. Reg. at 6053, c.2.

proposals presented and the alternatives offered all meet the requirements or guidelines of the RFA.

The Small Business Administration, the agency charged with enforcement of RFA, has described the major purpose of the RFA as being:

> [T]o establish as a principle of regulatory issuance that federal agencies endeavor, consistent with the objective of the rule and applicable statutes, to fit regulatory and informational requirements to the scale of entities subject to regulation.

The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies, U.S. Small Business Administration, Office of Advocacy, Washington, D.C., 1998, p. 1.

Importantly, the RFA does not exempt small businesses from regulation. There is no basis to conclude that small businesses based upon that fact alone are exempt from pooling and pricing provisions of federal orders. At no time in the history of the AMAA has USDA, Congress or the Courts concluded that being a small business exempts one from minimum price regulation entirely, except to the extent USDA has adopted a uniform definition for exempt plants that is size based, but is far smaller at 150,000 pounds than the operations in question here.

Instead, under the RFA the agency must, when it determines that there will be a substantial economic impact on a significant number of small entities, conduct additional analysis regarding the impact on small businesses. And as stated in the Hearing Notice (Ex. 1), the Secretary will, within the statutory authority of the program, ensure that the regulatory and informational requirements are tailored to the size and nature of small businesses. But the limitations are clear:

> The RFA does not seek preferential treatment for small entities, require agencies to adopt regulations that impose the least burden on small entities, nor mandate exemptions for small entities. Rather, the RFA *encourages* agencies to examine public policy issues using an analytical process that identifies, among other

> things, barriers to small business competitiveness; and seeks a level playing field for small entities, not an unfair advantage.

The Regulatory Flexibility Act, p. 2 (emphasis added).

The first question then is does the RFA require any additional or special analysis. The clear answer here is "no" as to these proposals. As to the Southeast and Appalachian markets, proponents and opponents agree that there would be no present regulatory impact on any current business. Moreover, such a business when it reaches 3,000,000 pounds may not even be small based upon a determination by USDA as to whether the producer or the handler numbers count for this purpose. We do not concede that 3,000,000 pound producer-handlers are small businesses for Regulatory Flexibility Act purposes.

Second, by definition, no producer-handler exceeding 3,000,000 pounds per month can possibly be a small business as a producer since such production would exceed the $750,000 per year farm income limitation. It is possible that they could qualify as a small business handler, but recall that they are called producer-handlers for a reason. Put together as one small business and one non-small business, the overall business cannot be a small business for RFA purposes. This is consistent with the fact that the Secretary has taken the position (e.g., *Milk in the Mideast Marketing Area, Proposed Rule,* 67 Fed. Reg. 30871 *et seq.* at 30871, c.3 (June 11, 2002)) that if a plant is part of a larger company operating multiple plants, the local plant will be considered a small business only if the business taken as a whole has fewer than 500 employees. Otherwise a large regulated handler could designate its plant as a separate business from its other operations and its diary operations could further subdivide dividing up the various plants so each "handler" has fewer than 500 employees. There is no justification to treat 3,000,000 pound plus producer-handlers as small businesses for RFA purposes.

Regardless, the proposals do not require Initial or Final Regulatory Flexibility analyses because there cannot be shown to be a substantial economic impact on a significant number of small businesses. Even assuming that the number of small businesses impacted would be one or two or three in the future, the term "significant number of small businesses" simply cannot mean this. Therefore, there is no special imposition of regulation on some small businesses that is not also imposed on all other businesses, all of which in Arizona tend to be well above the national average.

Finally, with respect to the Regulatory Flexibility Act, proponents request that the Secretary make an express finding that the solution adopted addresses the regulatory problem presented in this Record. Again, while not definitive given the lack of express requirements by the RFA, such a finding surely is justified given the extensive discussion in the hearing record, the number of proposals in the Hearing Notice intended to deal with the issue, and the conclusion, espoused by almost every proponent witness, that there is no more critical problem than the lack of uniformity in the application of the prices in the marketing area. The proposed solutions in the proposals are plainly designed to fix the defined regulatory problem.

XV. COMMENTS ON ADMISSIBILITY OF EVIDENCE IN RULEMAKING PROCEEDINGS

Various objections were made to the admission of evidence, especially as to a previously given witness statement by Mr. Herbein even though the witness was available for cross-examination. This statement was properly admitted. The objections cannot be sustained. F.R.E. 803(6) is more liberally construed than that. For instance, in *United States* v. *Reese*, 568 F.2d 1246 (6^{th} Cir. 1977), a government exhibit consisting of photocopied newspaper articles, which were dated by a hospital employee, placed in a hospital scrapbook, and which purported to show the visiting hours of patients at a hospital, were admitted under F.R.E. 803(6) through the testimony of an employee of the hospital with knowledge of the hospital's practice of keeping these records. The exhibit was admitted in that criminal action to show that the appellant could not have been visiting his wife at a certain time. In *United States v. Bowers*, 593 F.2d 376 (10th Cir. 1979), *cert. denied*, 444 U.S. 852 (1979), a postal service report concerning security procedures was properly admitted in a criminal case even though the custodian who testified as to the origin of the report had not prepared it.

A USDA case is itself instructive. In *United States v. Mendel*, 746 F.2d 155 (2d Cir. 1984), *cert. denied*, 469 U.S. 1213 (1985), a USDA technician's Market Cattle Testing Program report was admitted even though the underlying report had been prepared by a slaughterhouse, not USDA.

But the test for administrative proceedings is not even as stringent as the test under the Federal Rules of Evidence. Hearsay is and has been since at least 1938 wholly admissible in such proceedings so long it is "the sort upon which responsible persons are accustomed to rely." *National Labor Relations Board v. Remington, Rand, Inc.* 94 F.2d 862, 873 (2nd Cir. 1938), *cert. denied*, 304 U.S. 585 (1938). In fact, hearsay (even if Exhibits 22 and 23 are hearsay which is not conceded), "if reliable and credible" can constitute *substantial* evidence in a variety of administrative settings. *Richardson v. Perales*, 402 U.S. 389 (1971) (overruling in agency action "legal residuum rule" and inviting agencies to admit evidence that would be inadmissible in court); *Calhoun v. Bailar*, 626 F.2d 145, 149 (9th Cir. 1980), *cert. denied*, 452 U.S. 906 (1981) (hearsay as substantial evidence); *Hoska v. United States Department of Army*, 677 F.2d 131, 138 (D.C. Cir. 1982) (relevant and material hearsay is "admissible in administrative proceedings *and in adverse action proceedings in particular*") (emphasis supplied); and *Veg-Mix, Inc. v. USDA*, 832 F.2d 601 (D.C. Cir. 1987) (administrative law judge in Perishable Agricultural

Commodity Act enforcement action permitted to consider company invoices even though no custodian was offered to represent their authenticity).

Mr. Herbein's statement was wholly within these parameters. He was present and was fully subject to cross-examination by the same counsel who were present for the earlier testimony. Moreover, an obvious purpose for the rule in administrative settings is to permit them to move along. All of the proponents' evidence should be considered as substantial evidence.

XVI. CONCLUSION

For all the foregoing reasons, proponents urge immediate rejection of the proposal that would merge Orders 5 and 7 and adoption of proposals 5 and 7.

Respectfully submitted,

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