

**BEFORE THE UNITED STATES DEPARTMENT  
OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE**

**In the Matter of** :  
: **Docket Nos.:**  
**Milk In the Pacific Northwest and** : **AO-368-832,**  
: **AO-271-837,**  
**Arizona - Las Vegas** : **DA-03-04**  
:  
**Marketing Areas** :

**COMMENTS AND EXCEPTIONS OF DAIRY FARMERS  
OF AMERICA, INC. (DFA) UPON RECOMMENDED  
DECISION**

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## **I. INTRODUCTION**

These comments and exceptions are filed on behalf of Dairy Farmers of America, Inc., (DFA) with respect to the recommended decision to amend the provisions of the Arizona – Las Vegas (Order 131) and the Pacific Northwest (Order 124) marketing orders with respect to the producer-handler exemption. The proposals were the subject of extensive public hearings held in Phoenix, Arizona, September 23-25, 2003; Seattle, Washington, November 17-20, 2003; and Alexandria, Virginia, January 20-24, 2004. The thoughtful recommended decision of the Secretary is now the subject of a massive, website-generated email campaign ultimately designed to nullify, while delaying on an interim basis, the Secretary's long overdue, proposed action. In these comments and exceptions, DFA urges the Secretary to implement the recommended decision at the earliest possible date, as it has been proposed, or, preferably, as strengthened in the manner suggested herein. DFA's dairy farmers, their fully regulated customers, and the member dairymen and fully regulated customers of the other cooperatives which have been requesting this action for so many years, are now entitled to prompt, final action.

These comments and exceptions will address: (1) the continuing need for the most immediate implementation of the amended regulations; (2) the constitutional and statutory attack on the regulation of producer-handlers; (3) the Regulatory Flexibility Act and the status of the objecting producer-handlers; (4) the multiple bases of support in the record for the fundamental conclusions in the Recommended Decision; (5) the baseless allegations of improper ex parte contact with the Department; and (6) DFA's exceptions to the Recommended Decision's (a)

definition of the calculation of the 3 million pound regulatory threshold for producer-handlers and (b) failure to adopt certain safeguards regarding the structure and distribution patterns of producer-handlers.

## **II. THE ORDERS SHOULD BE PROMPTLY AMENDED TO RESTORE ORDERLY MARKETING.**

DFA's first and most important priority at this stage of these proceedings is that the order amendments be implemented at the earliest possible date. The findings are clear: the current regulations create disorderly markets and cost the pool producers in these orders hundreds of thousands of dollars each month.<sup>1</sup> It is just as apparent that the tactics of opponents are aimed more at delaying the proceedings -- with, for instance, countless, but baseless, emailed website-based "comments" in opposition to the recommended amendments -- than at providing information upon which the Secretary might make a reasoned decision with full information available.<sup>2</sup>

## **III. THE SECRETARY HAS THE STATUTORY AND CONSTITUTIONAL AUTHORITY FOR THE ACTIONS PROPOSED**

The regulation of large producer-handlers in these orders has been legally attacked, and no doubt will continue to be attacked, on statutory and constitutional grounds. There is no basis

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<sup>1</sup> Using the low end of the Recommended Decision's blend price impact findings, each month the pool producers in these orders are losing \$200,000 to \$300,000. That is a very, very conservative estimate of the cost of, or benefit of, delay in these proceedings, given that one of the producer-handlers in Order 124 testified that full regulation would cost it up to \$1,000,000 per year. (Koester, Tr. 1776 )

<sup>2</sup> In this regard, we respectfully call to the Secretary's attention DFA's opening brief at pp. 57-69 wherein we discussed the failure of the opponents to provide information for the hearing record about factual issues material to the decision; and the impact which this failure or refusal should have upon the Secretary's findings upon the key issues.

for the legal attacks on either front. DFA joins in the Dean Foods et al brief with respect to the constitutional law arguments and analysis; and will not repeat that analysis which is both incisive and comprehensive. The statutory authority has also been fully briefed in DFA's opening brief at pp. 50–52; and in the opening brief of United Dairymen of Arizona which embodied (and has now memorialized) years of research and scholarship of Sydney Berde, Esquire, the now-deceased “Dean of the Milk Bar.” The arguments of Sarah Farms, et al, and Dr. Knutson, that the statute does not authorize regulation of producer-handlers because they do not “purchase” their milk would require re-writing the 1937 legislation, its legislative history, and court precedents interpreting and applying it for over sixty years. The Secretary should dismiss all of these legal arguments as baseless.

#### **IV. THE PRODUCER-HANDLERS WHICH WILL BE REGULATED ARE NOT SMALL BUSINESSES WITHIN THE MEANING OF THE REGULATORY FLEXIBILITY ACT**

\_\_\_\_\_ It would be the cruelest of legalistic ironies to DFA's thousands of small business dairy farmer member-owners, if these industrial-sized dairy farms which are not small businesses as dairy farmers, could transform themselves into small businesses, entitled to some special legal scrutinies, by integrating forward into the fluid processing business. Sarah Farms et al have no right to such status as the Secretary so correctly found in the Recommended Decision.

The exemption of producer handlers from pooling in Order 124 has cost dairy farmers in that order, the majority of whom are small businesses, a bare minimum of \$.02 to \$.04 per cwt on their blend prices since the inception of federal order reform in January 2000, which means \$7 to \$14 million. In Order 131, the cost to dairymen has been proportionately greater because of the

greater impact on the pool (\$.04 to \$.06 per cwt), as found in the Recommended Decision. This dairy-farm level impact has been caused by the exemption from the pool of the large, industrial sized farms represented by the exempt producer handlers. There is nothing in the Regulatory Flexibility Act which should allow these admittedly non-small-business dairy farm enterprises to somehow claim a tactical regulatory advantage in these proceedings by getting bigger.

The Secretary applied the small business analysis to producer handlers in the only way that makes any sense in a milk order hearing under the AMAA – a statute intended to provide regulations for the benefit of producers qua producers. The Secretary should affirm this finding in the final decision.

**IV. THERE ARE MULTIPLE SOURCES IN THE RECORD SUPPORTING THE FUNDAMENTAL CONCLUSIONS IN THE RECOMMENDED DECISION THAT THE LARGE PRODUCER-HANDLERS HAVE A COMPETITIVE ADVANTAGE WHICH HAS LED TO DISORDERLY MARKETS**

The key findings in the Recommended Decision are more than amply supported in the hearing record and should be reaffirmed in the final decision. These findings are: (1) that the large producer handlers have a competitive advantage vis-a-vis their fully regulated handler competitors which is approximated by the difference between the blend price and the Class I price in the orders; (2) that the balancing costs for large producer-handlers do not mitigate this price advantage; (3) that the large unregulated producer handlers have caused disorderly marketing by reducing the orders' blend prices by more than \$.02–\$.04 in Order 124 and \$.04 to \$.06 in Order 131; and (4) that the large unregulated producer handlers have caused disorderly marketing by using their raw milk cost advantage to capture sales from regulated handlers. We will summarize some of the evidence which supports these findings:

The Blend v. Class I price advantage. This price advantage, although disputed in a vague and conclusory fashion by the producer-handlers, was testified to by multiple witnesses, expert and lay alike. These witnesses include: Hollon (Exh. 32; Exh 33, Table A1-2;), Cryan (Tr. 895–896, 902–04; Exh. 26), Van Dam (Tr. 1483), Herbein (Tr. 765–766), Hitchell (Tr. 239), and Christ (Tr. 1595). This point is both fundamental and essentially undisputed, since the opponents provided no data concerning their costs which could support any other conclusion. The Recommended Decision’s finding is unassailable.

The balancing costs of producer handlers do not justify the exemption. As the Recommended Decision noted, the producer-handler exemption has historically been sometimes justified on the basis of balancing costs offsetting the Class I minus blend advantage. Here, however, the evidence overwhelmingly demonstrated that there is no such offsetting cost for large producer handlers: Elvin Hollon demonstrated, without rebuttal, that using any set of reasonable assumptions, the balancing costs of large producer handlers do not overcome their price advantage (Exh. 33, C1–4; Tr. 1009–1015; See also Christ, Tr. 1601–03 ). Dr. Terry Smith established that modern production technology is such that if a butterfat surplus were to be a financial burden for a large producer handler, the herd could be managed to produce a more tailored butterfat percentage for the sales mix. (Smith, Tr.1283–1288) The data provided by the Order 124 Market Administrator at the request of Northwest Dairymen (Exh. 7, Table 6) conclusively documented that the producer-handlers in that order have very, very low ratios of Class III and IV utilization, circumstances which could not possibly be considered burdensome or such as to negate the advantage of avoiding pool equalization. (Van Dam, Tr. 1392) In both orders the producer handlers have, and use, out-of-area non-pool Class I sales to balance their

operations: The Order 124 producer-handler non-pool Class I sales to Alaska (e.g. Brandsma, Tr. 2551–2552) and the Order 131 producer-handler has sales into California. (Muirfield, Tr. 168) The Recommended Decision’s conclusions that the large producer-handlers do not bear their proportionate share of the Order’s surpluses and that their surplus expenses cannot justify their price advantage are unexceptionable.

The pool producer losses. The blend price reductions and income losses to pool producers are unexceptionable findings. Indeed, the arithmetic of these findings is just that, arithmetic. In Order 131, the magnitude of Sarah Farms’ sales was stated in the Recommended Decision to represent 12 to 18% of the Order’s Class I volume, a calculation well founded upon, e.g., Exh. 10, Table 11; and Exh. 22. Most of the record estimates of the blend price loss, e.g. Exh 16, show blend price reductions well in excess of the very conservative \$.04 to \$.06 in the Recommended Decision. In Order 124, the loss of 10% of the Order’s Class I sales, arithmetically reduces the blend price at least \$.02 to \$.04 cents per cwt. The aggregate losses to producers are serious, and plainly disorderly.

The handler sales losses. The handler testimony of Krueger, Vanderpool, Hitchell, McBride, and Arbuthnot was essentially unchallenged and unimpeached. Indeed, in both orders the macro evidence of increased sales penetration in a growing market (Order 131) and market share maintenance in a declining market (Order 124) documents the findings made by the Secretary when analyzing the record and applying the agency’s expertise. Shamrock, in Order 131, documented clearly, and convincingly, that the sales prices of Sarah Farms were beyond its ability to compete at order minimum prices. This is disorder per se. Carl Herbein’s detailed analyses, examples, and expert testimony further detailed how nationwide, and localized, cost

structures at the handler level make it impossible to compete with unregulated competitors of a size beyond 3 million pounds. All of this testimony was unchallenged with either direct information from the opponents (of which there was none) or expert testimony of handler costs and competitive dynamics (of which there was no credible<sup>3</sup> testimony). The Secretary's findings are unexceptionable and should be promptly reaffirmed.

**V. THE ALLEGATIONS OF ALLEGED EX PARTE RULE IMPLICATIONS ARE BASELESS, INTENDED SOLELY TO OBSTRUCT AND DELAY THE PROCEEDINGS, AND NEED NOT BE FURTHER ADDRESSED.**

The April 7, 2005, Sarah Farms "Motion to Supplement the Record Due to Ex Parte Communications" has been fully answered, we believe, by the Memorandum of May 23, filed by the Deputy Administrator Dairy Programs. DFA joins in the legal analyses and comments made by Dean Foods, et al on this topic and adds the following comments on its own behalf.

The provisions of 7 C.F.R. Section 900.16 are self-evidently and historically, as the promulgation history indicates, intended to insure that rulemaking proceedings are **public**, not private-behind-closed-doors proceedings. That being the case, there is something with a slightly tongue-in-cheek quality about alleging an "ex parte" violation for the content of a speech which was taped and transcribed at a very public gathering. Furthermore, the public speech simply reiterated the arguments already of record in the public record of the rulemaking proceedings; and there is no evidence that any USDA employee was in the room at the time (although, as the Deputy Administrator has stated, USDA employees were invited to attend, and did attend, the Dairylea meeting). Sarah Farms' "Motion," notably not joined by the Order 124 producer

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<sup>3</sup> The only attempt in this regard was the discredited testimony of Mr. Morrison, who, among other things, could not demonstrate an ability to understand or perform butterfat - skim cost/pricing calculations at a dairy processing plant.



handlers, is just another attempt to obfuscate the true issues in this proceeding.

## **VI. EXCEPTIONS TO THE LIMITATIONS IN THE PROPOSED ORDER LANGUAGE.**

The proposed amendments to the producer-handler language in both Orders 124 and 131 make a single and crucial change to the language provisions, limiting producer-handlers to 3 million pounds of in area route disposition of Class I products. There are no changes made in the operating limitations which were requested. DFA, joins with Dean Foods, et al, and respectfully requests that these matters be reconsidered.

1. The three (3) million pound in area Class I distribution limit. DFA requested that producer-handlers in these orders be limited to 3 million pounds in “total route disposition and transfers in the form of packaged fluid milk products” during the month. The requested limitation was **not** upon disposition within the marketing area; it was upon total disposition so that a large producer-handler could not evade the size limitation by splitting its volume into two marketing areas, or one federal order area and unregulated areas. The proposed language will unnecessarily expand the size limitation. We say unnecessarily because the Recommended Decision indicates that the reason for the limitation was the published proposal language in the Hearing Notice. This result was not required by recent and controlling authority (Alto Dairy v. Veneman, 360 F.3d 560 (7<sup>th</sup> Cir. 2003)), and we request that it be reconsidered.

2. Container and label limitations. As the Recommended Decision acknowledges, one of the key means by which producer-handlers avoid carrying their own surplus is by marketing all their production to customers which then look to the pool for any additional needs. Packaging products in the same size container and with the same label is the direct means for this artifice.

To address this in Order 124, producer-handlers in Order 124 should be subject to the same limitation which presently applies in Order 131 and prohibits producer-handlers from distributing products in containers and with labels that are the same as regulated handlers. The record supports this language limitation. (Hitchell, Tr. 221; Flanagan, Tr. 1298–1299) This limitation should apply chain-wide to all stores using the particular private label. (Hollon, Tr. 2754)

## **VII. CONCLUSION**

The Secretary has taken the first, critical step in this proceeding to rectify a situation which, if not addressed, will lead to the disintegration of the entire federal order system. The exemption from federal order pooling for producer-handlers must be limited as set forth in the Recommended Decision, and, preferably as further advocated in these exceptions.

DFA thanks the Secretary for the action reflected in the Recommended Decision and requests its prompt implementation.

Respectfully Submitted,

Date: June 13, 2005

By: \_\_\_\_\_

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