BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of:	)	**DOCKET NO. AO-368-A32;**
MILK IN THE PACIFIC NORTHWEST	)	**AO-271-A37; DA-03-04**
AND ARIZONA - LAS VEGAS	)	
MARKETING AREAS	)	

PROPOSED FINDINGS OF FACT AND CONCLUSION OF LAW

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I. Executive Summary

The proposed modifications to the producer-handler definitions and associated regulations must be denied for all of the following reasons, each of which will be discussed in greater length in this brief. First, none of the proposals are justified given the fact that no disorderly marketing conditions exist in either Order 124 or Order 131. The Department has had the opportunity to review the long-standing producer-handler exemptions on several occasions in recent history, most recently in 2000 with Federal Order Reform, and each time has failed to find any disorderly marketing conditions warranting a change in long-standing policy. The proponents of this "reform" have likewise been unable to demonstrate any disorderly marketing conditions in the affected Orders, let alone any purportedly caused by producer-handlers.

Second, the proposed cap of 3,000,000 pounds per month was arbitrarily selected and is wholly unsupportable by the evidence presented during the three weeks of hearing testimony. The proponents' post-hoc rationalizations for the selected cap defy logic and the evidence presented. Moreover, the testimony from Carl Herbein offered by proponents in support of the cap, is both unreliable and unverifiable and the producer-handlers, in a separate document filed concurrently herewith, have asked the Secretary to strike that testimony.

Third, what the evidence has shown is that producer-handlers do not enjoy any advantage, let alone the alleged "unfair advantage" over other handlers in these Orders as claimed by the proponents. There is no evidence to support that suggestion. Producer-handlers are subject to regulation, are subject to risks that others do not experience and furthermore, all in the marketplace have the opportunity to become a producer-handler. The claimed "advantage" if it exists at all, is available to all that are willing to accept the significant financial risks associated therewith. The

consistent decline of producer-handler numbers in all markets suggests that the "advantage" is nonexistent.

Fourth, the requested changes are beyond the scope of the Department's authority under the Agricultural Marketing Agreement Act ("AMAA"). The Secretary cannot establish minimum prices for producer-handlers because producer-handlers do not purchase the milk used in their processing operations.

Fifth, the proposals contradict the express and long-standing policy of the Department. The producer-handler exemptions remain virtually unchanged in seventy years of dairy policy. There is no evidence to show that the regulations should be changed at this juncture.

Finally, the proposed changes are not needed to effectuate the purposes of the Federal Orders at issue in this hearing. In this regard, there has been no suggestion that the consumer population in the affected orders is not receiving an adequate and wholesome supply of milk at a reasonable price.

II. Statement of Position

A. The Opponent Producer-Handlers Have Standing To Challenge the Proposed Regulations

This brief is submitted on behalf of producer-handlers located in Order 124 and Order 131. These producer-handlers, Smith Brothers Farms, Inc., Edaleen Dairy, Mallorie's Dairy, and Sarah Farms ("opponent producer-handlers") would each be severely and adversely affected by the proposed changes to producer-handler regulations as contained in the Federal Register Vol. 68, Pgs. 46505-46509 and the amended proposals of Dairy Farmers of America, Northwest Dairy

Association, and United Dairymen of Arizona. Ex. 32, 35, 45. The opponent producer-handlers oppose each of the proposals in their entirety.

B. Summary of the Proposals

Each of the proposals numbered one, two, and three and amended proposals would require a producer-handler to contribute funds to be shared by their competitors. These contributions will be assessed on milk farmed by producer-handlers and used in their own plants. If adopted, the regulations would require producer-handlers to account to the Producer Settlement Fund on milk not purchased from a producer, as required by law.

These forced contributions will be triggered upon a producer-handler reaching Class I sales in excess of an arbitrarily selected 3,000,000 pounds per month:

> [W]ith regard to the newly-inserted Section (d), situations that would cause the loss of producer-handler status resulting either from route dispositions and transfers of packaged fluid milk products in excess of 3 million pounds per month or purchases of fluid milk products in excess of 150,000 pounds per month, would cause the loss of producer-handler status for the month in which the violations occur.

Hollon, 2753.

Proposal number four would eliminate the ability of a producer to pool its milk on a Federal Order if the producer is subject to a State Order that provides for minimum prices. Hollon, 1049. The effect of this is to create an absolute trade barrier in the movement of milk from a state with a state order into the Federal milk marketing area, in violation of the AMAA. It would also make the balancing of a plant located in Arizona, not part of the dominant cooperative operating in Arizona, nearly impossible by denying the availability of milk from nearby California. This, coupled with the

proponents' desire to make Sarah Farms a pool plant and the millions of dollars of assessments arising out of that "regulation," would make the operation of a pool distributing plant in Yuma, Arizona, economically impossible. It would also effectively insulate Arizona from any outside competition.

Under the current regulations, the Market Administrator is called upon to verify producer-handler status for any particular entity. The qualification of any recognized producer-handler is not within the scope of this hearing, and is not even a determination that could be made in such a proceeding. Accordingly, the proponents' attempts to second-guess the Market Administrator's determinations about qualification are misguided. It is not surprising, however, that the proponents, in their ongoing vendetta against Sarah Farms, Mallorie's Dairy, and all other producer handlers would attempt to introduce "evidence" that is beyond the scope of this hearing.

In addition, there are other technical changes to the Orders contained in the various proposals that would further restrict the way producer-handlers operate their businesses. Hollon, 1047-1057 The first of these redefines "producer-handler"so as to eliminate the Department's tried and true "sole risk" definition. It would impose upon the Department an extraordinary and unnecessary burden without providing any benefit to the Order. The second deals with the timing of a change in supplier of milk at the retail level. The proponents seek to create technical disqualification of a producer-handler unless that producer-handler takes over a new customer on the first day of a month. The Market Administrator's current interpretation of this regulation is reasonable, workable, and consistent with the language and intent of the regulation. Even though the current interpretation prevents a producer-handler from balancing his supply to a customer with milk from a 7(a) handler, the proponents seek a hyper-technical interpretation to increasingly burden the Market Administrator

and to disqualify the unwary producer-handler, despite the fact that the producer-handler does not balance off of the Order.

The hearing record is devoid of any evidence supporting a claim that any of the marketing areas are experiencing disorderly marketing conditions or that the current status of producer-handlers has created disorderly marketing conditions. Rather, the record is replete with speculation, hyperbole, conjecture, and inaccurate statements woven together in an attempt to paint a false description of the marketing conditions in those Orders. Perhaps the proponents were attempting to use the time honored adage that if you repeat something often enough and loud enough, that somehow your " audience" will believe it is true. The deliberate use of these misleading statements is to encourage and induce the Department to impose upon four family-owned and operated businesses obligations so onerous that the proponent competitors would be able to force these four producer-handlers out of business–freeing up those sales for the proponents to acquire.

C. The Effects of the Proposals

Each of the producer-handlers submitting this brief produce in excess of 3,000,000 pounds of Class I sales per month and would be subject to minimum pricing and pooling should the Department elect to impose any of these new regulations. Krueger, 560 (estimating Sarah Farms' volume at 17 million pounds per month; Ex. 35, p. 12-13 estimating Mallorie's Dairy at 4 million pounds per month, Edaleen Dairy at 5 million pounds per month, and Smith Brothers Farms at 7.5 million pounds per month.) Without conceding the accuracy of the proponents' "estimates," they will be presumed for discussion purposes only, in this brief. Testimony of the affected producer-handlers has established that the imposition of minimum prices would effectively tax these hundreds of thousands, even millions, of dollars per year per operation. Koester, 1801; Flanagan, 2347;

Brandsma 2548; Hettinga 2637. Using the production estimates provided by the proponents, and an assumed difference between the Class I price and the blend price of $1.70, the annual assessments would be as follows:

	CWT Per Month	Months Per Year	Assumed Difference Per CWT	Gross Annual Assessments
Mallorie's Dairy	40,000	12	1.70	$816,000
Edaleen Dairy	50,000	12	1.70	$1,020,000
Smith Brothers	75,000	12	1.70	$1,530,000
Sarah Farms	170,000	12	1.70	$3,468,000
Total				$6,834,000

As Carl Herbein, witness for the proponents, pointed out in his rebuttal testimony, the amount of the assessments would exceed the estimated profits that a producer would obtain by selling milk at minimum class prices. *Compare* Ex. 68 "Net Income Before Taxes" *with* Gross Annual Assessments above. Although proponents claim that these funds will come from the processor side of the operation, the evidence shows that the money will be paid in the producer-handlers' capacity as producers. These funds from farm operations would then be used to subsidize competing farmers and make the producer-handler plants less competitive vis-a-vis pooled handlers. As one of the opponents testified:

> Even if the AMAA permits the Secretary to require settlement fund contributions on milk that is never purchased from a producer, the new regulations would take millions of dollars per year from producer-handler operations, redistribute the money to other producers, and return absolutely no benefit to the producer-handler operations. Edaleen's milk price to our customers cannot be increased to make up the

substantial cost we would have to incur if the amendment were adopted. Our pool payments just cannot be recouped. The assessment will be a direct reduction from the bottom line.

Brandsma, 2548.

Mr. Brandsma's testimony echoed that of former USDA Chief Economist Ron Knutson who accurately labeled the proposed impoundments a confiscatory tax. Knutson, 2147. The ultimate effect of these regulations, is to implement this tax for the sole purpose of eliminating otherwise successful competitors from the affected Orders. In other words, to do through regulation what the proponents could not do through fair competition.

These huge monetary assessments would force these producer-handler operations to drastically change the way that they do business. Indeed, they may have no choice but to end their farming operation. Alternatively, they may choose to stop bottling milk. Or, as the testimony has established, (and as the proponents would prefer) they may be forced to terminate their businesses altogether.

D. The opponent producer-handlers submit this brief in opposition to all proposals in their entirety both as noticed and as amended by the proponents at the hearing.

Smith Brothers Farms, Edaleen Dairy, Mallorie's Dairy, and Sarah Farms oppose all of the proposals submitted both in the Federal Register and at the hearings. The evidence before the Department is insufficient to demonstrate (1) a need for changes to the producer-handler regulations or (2) changes in marketing conditions since order reform that would support the drastic change in

policy requested by the proponents. In addition, the Department does not have the legal authority to assess producers for milk that is never "purchased from producers."

III. Identification of the Hearing Participants

A. All proponents and their supporting witnesses are large players in the dairy industry--significantly larger than each of the opponent producer-handlers.

The proponents of these changes are giants in the dairy industry. Proposal number one was submitted by Northwest Dairy Association, the largest cooperative in Order 124, which represents over two-thirds of the producers in Order 124. *See* Ex. 5, p. 35 (896 total producers), Van Dam, 1335 (603 members of NDA). Proposal number two was submitted by Dairy Farmers of America, which is the largest cooperative in the nation, controlling well over 25% of the milk produced in the United States. United Dairymen of Arizona, Northwest Dairy Association and Dairy Farmers of America submitted proposal number three. United Dairymen of Arizona is the single largest cooperative in Order 131 and controls 88% percent of the milk in the Order. Boyle, 144. Despite having a small presence in Order 131, Northwest Dairy Association and Dairy Farmers of America have chosen to support that proposal as well. Van Dam, 1343; Hollon, 1021-22. Proposal number four is submitted by United Dairymen of Arizona.

While not formal proponents of the suggested changes, testimony was heard in support of these proposals from Dean Foods Company (Ernest Yates, 654) the single largest processor of fluid milk in the United States; Shamrock Foods Company (Mike Krueger, 533, 3064), a dominant participant in the fluid milk processing industry in Order 131; Kroger Company (John Hitchell, 213), the single largest grocer in the United States; and the largest producer organizations in the State of California (Michael Marsh, 244; James Tillison, 368).

An idea of the relative size of the proponents as compared with the opponent producer-handlers can be found by referring to Exhibit 54 of the hearing record. This article, entitled "A Decade of Change and a Year of Challenges" lists the largest 100 dairy operations in the United States. Number one is Dean Foods Company with over eight billion dollars of sales in 2002. Dairy Farmers of America is also prominently represented in this list. DFA itself is the ninth largest processor with sales of 1.6 billion dollars. National Dairy Holdings, a partnership half controlled by DFA, is listed at number six with sales in 2002 of over two billion dollars. Partners or affiliates of Dean Foods and DFA appear throughout the list. *See* Highland Dairy (#42), Keller Creamery (#45), Roberts Dairy (#50), Kohler Mix Specialties (#60), Horizon Organic Dairy (#64), Melody Farms (#75) and Wilcox Dairy Farms (#76).

Other proponents and supporters of the proposed regulations appear in this list of the largest. Number seven is Kroger Company with sales of 1.9 billion dollars. West Farm Foods (#14) is the processor arm of proponent Northwest Dairy Association. West Farm Foods had sales in 2002 of 1.3 billion dollars. Shamrock Farms is listed at number 58 with sales exceeding 210 million dollars in 2002 and Shamrock Foods "is the largest dairy in the Southwest" and "process[es] 70 million gallons of milk annually . . ." See Ex. 56. None of the opponent producer-handlers appear on the Dairy 100 list.

It is also worthwhile to note that the persons testifying in support of these proposals fell into two categories. First, there were the cooperative opponents, including their officers and agents. Second, there were the processor proponents. The only dairy farmer testifying in his capacity as a farmer, is a large Arizona farmer supplying to Sarah Farms' competitor, Shamrock Foods. McClelland, 642. Mr. McClelland, while undoubtedly a dairy farmer, is also the Chairman of

Shamrock Foods. Mr. McClelland, along with his son and sister, controls Shamrock Foods, and his bias in this hearing is obvious. McClelland, 643; Ex. 56. He wants to tax his competitors to improve his own bottom line, both on the farm and at the plant.

Any other dairy farmer who took the stand testified on behalf of a cooperative or in his capacity as a member of a cooperative and at the direction of that cooperative. The lone dairy farmers who testified at this hearing in their capacity as farmers were the opponents, witnesses from Smith Brothers Farms, Edaleen Dairy, Mallorie's Dairy, and Sarah Farms as well as Alan Ritchey. Each of these farmers testified in opposition to the proposed 3 million pound cap. Not a single dairy farmer outside of the opponent producer-handlers testified from Order 124.

B. Opponent producer-handlers are small businesses which operate independently of the cooperative structure.

In contrast to the behemoths advocating these new regulations, the only four operations which would be affected by these regulations are family owned and operated companies who are considered small businesses under the Regulatory Flexibility Act. As processors, they employee fewer than five-hundred employees. Koester, 1773 , 1780 (110 employees); Flanagan, 2344 (80 employees); Brandsma, 2549, 2555 (70 employees); Hettinga 2625. As the Department has noted "most parties subject to a milk Order are considered as small businesses." Ex 1, 68 Fed. Reg 46505-06 (August 6, 2003). As the Department is aware, milk Orders cannot regulate producers of milk. 7 U.S.C § 608c(13)(B). Milk Orders only regulate processors of milk. Accordingly, these operations can only be judged as small businesses according to the size of their processing operation. Although these integrated operations will be impacted as producers as much as handlers, it is their capacity as

a processor which must be the measuring stick for determining if they are, in fact, small businesses under the RFA.

Each of the opponent producer-handlers is unique, with differing market strategies and strengths. Mallorie's Dairy, for instance, was founded by a veterinarian interested in dairy farming. They have serviced the same grocery chain for over forty years, each business growing as a result of their mutual interaction. Similarly, Smith Brothers Farms is a business that has existed for decades. Even today, a majority of its sales are made directly to the residence of the consumer, through milkmen. Smith Brothers provides high-paying union jobs to its employees, a fact of which DFA's expert witness was unaware. Sarah Farms is a true success story. It is named after the founder's daughter and, like most producer-handlers, prides itself on supplying its customers with a quality product produced from its own cows. It has taken the lead in innovative marketing practices in Order 131 like using a tamper-proof seal to prevent contamination and to provide a longer shelf life for its product. Milk from Sarah Farms makes the journey from cow to store in about 24 hours, often shipped in cardboard boxes to protect the milk from damaging sunlight. Finally, Edaleen Dairy is a quintessential family business. The Dairy has been in the family for generations. Once owned by Mom and Dad, it is now co-owned with their children and managed by their son and sons-in-law. They manufacture their own ice cream, and supply niche markets, as do the other opponent dairies.

C. The proponents are competitors of producer-handlers

1. Both processors and cooperatives compete directly with producer-handlers.

In addition to dwarfing producer-handlers in terms of size, volume, and economic muscle, the proponents and those who have testified in support of these changes compete directly with the producer-handlers for sales of fluid milk and dairy products to the consuming public. That is, competitors of producer-handlers are turning to the Department to assess producer-handlers millions of dollars per year, making it more difficult for producer-handlers to compete in the marketplace. For example, Shamrock Foods competes directly with Sarah Farms for sales in Order 131. Krueger, 535-36. Kroger Company also competes with Sarah Farms for milk sales. Hitchell, 214-15. In Order 124, Wilcox Dairy competes with Smith Brothers Farms, Edaleen Dairy, and Mallorie's Dairy for sales to the consuming public, as does West Farm Foods (a division of NDA). Hollon, 1070; McBride, 1513. As this brief will describe in greater detail, there is neither evidence in the hearing record nor any legal basis to justify adoption of these proposals.

Not only do the processor proponents stand to benefit if producer-handlers are squeezed from the marketplace, but the cooperative proponents stand to benefit as well. By definition, producer-handlers cannot be members of cooperatives. Hollon, 1083. If the exemption from pricing and pooling were removed, it would likely behoove the producer-handlers to join a cooperative association. As the hearing testimony established, cooperative organizations require that all of the members market the entirety of their farms milk production to the cooperative association. Hollon, 1083. The nature of the cooperative arrangement is such that the farmer pays a marketing fee to the cooperative for the services rendered by the cooperative. Hollon, 1085. The relatively large farm production marketed through cooperatives such as NDA, DFA, and UDA would result in additional membership fees totaling thousands of dollars per year for the cooperative organization that it would not otherwise have. Not only would the member producers of these cooperatives be able to

confiscate millions of dollars from the producer-handlers through the equalization pool, but the cooperatives themselves would benefit through assessments and marketing fees collected from the producer-handler organizations.

2. It is incongruous for Dean Foods and DFA to demand that producer-handlers participate in the producer settlement fund.

The anti-competitive goal of the proponents is particularly clear due to the high degree of participation of Dairy Farmers of America in this hearing. While DFA does not have a significant number of producers in Order 124, and has no producers in Order 131, it has spent an enormous amount of time and money in an effort to have the Department implement these proposals.

> We pool milk on 10 of 11 federal orders. We do not pool milk on Order 131, but have an extensive marketing arrangements with the dairy farmer members of United Dairymen of Arizona, UDA, for the purchase of supplemental milk supplies and to provide seasonal balancing services to DFA. UDA markets and pools milk on Order 131. We have members pool milk supplies and have investments in processing in Federal Order 124. We are appearing here in coordination with the other proponents, UDA and the Northwest Dairyman Association, NDA.

Hollon, 1022. DFA's director of fluid milk marketing and its counsel have participated in three weeks of hearings and unknown hours of preparation. DFA hired an accountant to testify on its behalf. DFA paid this accountant thousands of dollars for his testimony and supported similar regulations in the Appalachian and the Southeast Marketing Orders; which decision is still pending before the Department. Docket No. AO-388-A15, AO-366-A44, DA-03-11. It is evident that DFA wants only to increase its stranglehold on the procurement of milk in the United States. These

proposals have nothing to do with benefitting farmers. They have everything to do with creating a monopoly. Otherwise, DFA would not have expended such huge resources to establish policy in a geographic area where it has no impact and little interest.

Despite its testimony that DFA, "support[s] the federal order system because we believe it is the most fair and equitable manner to market dairy farmers' milk that will insure them of a reasonable prices in common terms of trade," its actions speak louder than its testimony. Hollon, 1021-22. DFA terminated the Western Order. When the Federal Orders, in DFA's assessment, conflict with its self-interest, out they go. "[I]f the large producer-handler can earn a return and grow his business, pressure to terminate the orders will be impossible to resist." Hollon, 1036. The incongruity here is that DFA speaks about regulating producer-handlers and simultaneously is deregulating an entire marketing area for the first time in modern history, with no replacement at hand.

Similarly, Dean Foods Company petitions the Department to regulate its competitor in the Southern portion of the Arizona-Las Vegas Marketing Area while it has constructed a larger bottling facility in the Northern portion of the Marketing Area that is exempt from regulation entirely. Thus, Dean Foods is currently capitalizing on the largest single unregulated population center in the nation. Yates, 679-80. Ironically, at the same time as Dean Foods is taking advantage of this regulatory loophole, it is complaining that producer-handlers are somehow "unregulated." The fact is, however, that producer-handlers are and have always been subject to extensive government regulation and audit—more than Dean Foods plant in Clark County can ever be.

3. This Hearing Is Only the Latest Attempt by the Proponents To Eliminate Producer-Handlers From the National Landscape

This hearing follows repeated regulatory hearings, lawsuits, and legislative efforts targeting producer-handlers by these same proponents. It is apparent that Sarah Farms has been singled out for elimination because it is perceived to be the most successful producer-handler in the nation. NDA and DFA have bootstrapped its proposals for Order 124 to UDA's anti-competitive play placing Edaleen Dairy, Mallorie's Dairy, and Smith Brothers Farms at risk. It is likewise apparent that this hearing is not the end of these maneuvers. Dean Foods, DFA, and others of their ilk will not stop until all competitors in the marketplace are eliminated–fairly or unfairly. Of course, this is not surprising given DFA's penchant for anti-competitive activity, which they refuse to apologize for:

> * * *
>
> A. DFA operates under a consent decree today. It's a matter of record.
>
> Q. And I can go through -- I've got about five different reported cases, but you'd acknowledge that there are a number of cases in the past, in 1940 and currently, in which DFA has had some issues with regard to anti-competitive behavior?
>
> A. That is true.
>
> Q. Does anti-competitive behavior have an effect on whether a market is orderly or disorderly?
>
> A. I suppose it's kind of like beauty. It's in the eye of the beholder.

Hollon, 1150-51.

In reviewing the proponents' requests, the Department should accord testimony and evidence its due weight given its source and the motivation of the party responsible for its introduction. Since

the proponents cannot eliminate the producer-handlers in the marketplace, they will employ all of their economic might in an effort to regulate them out of existence.

IV. The proponents have failed to produce the quantum of evidence required to compel the Department to abandon its long-standing policies regarding producer-handlers.

The proposals represent far more than a simple amendment to the marketing Orders for the two affected areas The proposals completely reverse the course of seventy years of Department policy excluding producer-handlers from minimum prices and mandatory pooling. Accordingly, such a drastic change in policy requires substantial justification, which the proponents have failed to demonstrate.

Since the origin of the Federal Milk Market Orders during the 1930's, producer-handler operations have been exempt from pricing and pooling requirements. The record is without any evidence that exemption afforded producer-handlers have ever been removed, modified, or even that the Department has seriously suggested doing so. Therefore, the adoption of proposals one, two, or three would represent a complete reversal of course of a Department policy that has been in place for over 70 years.

In order to make such a drastic change in policy, the Department has always required a particularly strong showing of hard facts and data demonstrating great injury or market chaos. Absent such evidence, significant changes of policy such as those requested here should not and have not in the past been granted. Regardless of the origin of the producer-handler exemption, the position of the Department on the continued exemption of producer-handlers has been made clear in the *Gore* and *Heartland* rulemaking decisions and has nothing to do with regulatory ease, efficiency of operations, milk processor assessments, or the other red herrings trotted out by the

proponents.

The proponents have relied heavily upon marketing conditions from the 1930's, suggesting that the origin of the producer-handler exemption is rooted in administrative efficiency, with no evidence to either to corroborate or discredit this assertion. However, the rationale for the producer-handler exemption as defined by the Department in recent years has absolutely nothing to do with "administrative efficiency." In hearings during the 1980's and 1990's the position of the Department has been made perfectly clear. In *Gore*, the Department terminated a rulemaking similar to this one. In doing so, the Department explained:

> Although the marketing of milk by producer-handlers has the potential of creating disorderly marketing conditions, it has not been found necessary to regulate fully this type of operation. In fact, the policy has been to exempt such types of operations. Such policy has been based, generally, on findings in regulatory proceedings that producer-handlers have no significant advantage in the market in their capacity as either handlers or producers as long as they are solely responsible for their production and processing facilities and assume essentially the entire burden of balancing their production with their fluid milk requirements.

54 Fed. Reg 27179, 27182 (June 28, 1989). In *Heartland,* the Department recognized a means to game the system and provided some relief. At the same time, the restriction of producer-handlers based on size was rejected. 58 Fed. Reg 67705 (December 22, 1993). More recently, during the period 1999-2000, changes to producer-handler status were considered and dismissed during order reform.

Public comments were received regarding the extent of regulation that should apply

to producer-handlers. The majority of public comments supported the status-quo regarding the regulatory treatment of producer-handlers, emphasizing that they should remain exempt from regulation in accordance with current order provisions and that the provisions should be regional in nature so as not to affect or change the current regulatory status of producer-handlers. One of the public comments received proposed that the exemption of producer-handlers from the regulatory plan of milk orders be eliminated. **This proposal is denied.**

64 Fed. Reg. 16135 (April 2, 1999) (emphasis added).

The Department has never even suggested that the producer-handler exemption exists to promote administrative efficiency, for regulatory ease, because of any milk processing assessments, to promote efficiency of bottling operations, to ensure the ability to service smaller grocery stores, or is tied to the wholesale price of milk or the price of milk at warehouse stores. *Contra* Hollon 2844-49. As noted above, each of these rationale are ruses by the proponents in order to disguise their monopolistic play as rational policy making. These arguments have nothing to do with the justification of the producer-handler exemption.

In addition to the rationale offered by the Department in past decisions, Congress repeatedly expressed that the legal status of producer-handlers is not to be altered. While the most recent two farm bills did not contain such an expression of intent, Congress did not affirmatively change its position on the legal status of producer-handlers. Indeed, the Department summarized the history of Congress's position on the status of producer-handlers in his proposed rules following order reform:

In the legislative actions taken by the Congress to amend the AMAA since 1965, the

legislation has consistently and specifically exempted producer-handlers from regulation. The 1996 Farm Bill, unlike previous legislation, did not amend the AMAA and was silent on continuing to preserve the exemption of producer-handlers from regulation. However, past legislative history is replete with the specific intent of Congress to exempt producer- handlers from regulation. If it had been the intent of Congress to remove the exemption, Congress would likely have spoken directly to the issue rather than through omission of language that had, for over 30 years, specifically addressed the regulatory treatment of producer- handlers.

64 Fed. Reg 16135 (April 2, 1999).

Because the Department examined the validity of producer-handler designations during order reform and positively concluded that no changes were appropriate, the proponents here bear the heavy burden of proving that the marketing conditions in Orders 124 and 131 have, in fact, significantly deteriorated between January 2000 and September 2003. There is no such evidence in the record because there is no disorder.

The proponents' own witnesses confirmed that the conditions now are substantially the same now as during order reform.

Q. [T]he fact is that price wasn't so significant that Food for Less was willing to stay with Sarah Farms; correct?

A. At that time, that is correct.

Q. Well, "at that time," that was in 1999; correct?

A. Correct.

Q. And you served them in 2000; correct?

A. Yes.

Q. And Sarah Farms marketed them in 2000; correct?

A. Correct.

Q. Sarah Farms had that assumed price disparity in 2000?

A. Correct.

Q. Food for Less didn't go back to them?

A. But they eventually would, in my opinion.

Q. In your opinion. They didn't actually do anything, because you told me they are out of business.

A. For that specific customer, that's correct.

Q. That's what we're talking about. So 2000, you were available to provide supply, Shamrock was, so was Sarah Farms. We had this price disparity. Food for Less stayed with you; correct?

A. Correct.

Q. Same is true in 2001?

A. Correct.

Q. Same is true in 2002?

A. Correct.

Q. And the same is true in 2003 until they went out of business?

A. Correct.

* * *

Q. And then there was Order Reform that occurred in'99-2000. Are you aware of

that?

A. Yes.

Q. And at that point, Shamrock, along with UDA, was attempting to get the Secretary to, again, change the regulation with regard to producer-handlers?

A. Yes.

Q. That change did not occur; correct?

A. Has not yet.

Q. It still hasn't, has it?

A. We're here.

Q. Exactly. And let me ask you the question. Tell me the market conditions that have changed since the end of '99 to 2000 in the 131 Order area.

A. The market conditions that have changed is that there's a flat, at best, Class I market that is increasingly served by captive plants and, to a greater extent, a producer-handler.

Q. But if your suppositions in Exhibit No. 22 are to be believed, that same type of market condition would have occurred from '97 to '98; correct?

A. I think '97 to '98 shows some increase, yes.

Q. And then there was an increase, if your suppositions again are correct, from '98 to '99; correct?

A. That's what it shows.

Q. And if your suppositions are correct on Exhibit No. 22, there was a change in '99 to 2000; correct?

A. Yes.

Q. So all of the marketing conditions that you're complaining of now would have occurred also back then at the time of reform; correct?

A. I think we were complaining then. We've been complaining.

Krueger, 595-96, 606-07.

In any event, this hearing concerns two distinct marketing areas. The situation in Order 124 is different from that in Order 131. Witnesses from both DFA and NDA conceded that the Pacific Northwest is different. The proponents have failed to demonstrate disorderly marketing conditions in either Order. However, should the Department find disorderly marketing in Order 131, Edaleen Dairy, Mallorie's Dairy, and Smith Brothers Farms would direct the Department's attention to the testimony of the proponents witnesses. After arguing, without supporting evidence, that a large producer-handler can gain market share at will, Elvin Hollon followed the statement with this caveat, "This seems to describe the retail market scenario in Order 131, and **is a concern in Order 124** as well." Hollon, 1034. Testimony from several witnesses referred to marketing conditions in the future tense and speculated about events that might occur as demonstrating the need for these amendments. In addition, the testimony of NDA's witness conceded that the marketing conditions in Order 131 were being used to bootstrap Order 124 into these proceedings-- an implicit concession that disorderly marketing is not occurring in that area. *See* Van Dam, 1344 ("Our testimony today will be directed toward the situation as it exists in Order 124, but it is the example of what is happening in Order 131 that most clearly illustrates what could happen in any order."). This was obvious even to Sarah Farms's owner who observed:

I honestly feel that [Sarah Farms is] just a pebble in the shoe [of the proponents], and

> myself, I probably deserve it, these [Order 124 participants] are -- are like salt of the earth, good family people, and there shouldn't be hearing on this, they're doing good business, they're doing the business the American people should, should be, free enterprise, do your own thing, and I think that this milk legislation is protecting the big guys and protecting the big co-ops.

Hettinga, 2725. Given these concessions, the Department should reject the proposals for the Pacific Northwest out of hand.

V. All noticed proposals and the resultant variations presented at the hearing should be rejected by the Department outright.

The proposed modifications to the producer-handler definitions and associated regulations must be denied because (1) they are not justified given the fact that no disorderly marketing conditions exist in either of the affected Orders; (2) the proposed cap was arbitrarily selected and unsupportable by the evidence; (3); producer-handlers do not enjoy an unfair advantage over other handlers; (4) the changes requested are beyond the scope of the Department's authority under the AMAA; (5) the changes requested contradict the express and long-standing policy of the Department; and (6) the changes requested are not needed to effectuate the purposes of the Federal Orders at issue in this hearing.

A. No Disorderly Marketing Conditions Exist Justifying A Change to the Orders.

As a threshold to amending the Orders, the proponents must demonstrate that since the promulgation of the Order (i.e. January 2000) that maintaining the existing regulations will fail to control the disorderly marketing of milk. All of the affected producer handlers were in existence at the time of order reform. Thus, the focus has to be on the activities of producer-handlers between

January 2000 and September 2003, and that the activity markedly differs from the activities in 2000 and that such activity is directly contributing to disorderly marketing.

1. There is a sufficient supply of good and wholesome milk efficiently reaching the consumer.

The purpose of the federal milk marketing orders is to provide an adequate supply of good and wholesome milk to the consuming public at a reasonable price. This is consistent with the intent of Congress in passing the AMAA, as expressed at 7 U.S.C. § 602(4):

> It is hereby declared to be the policy of Congress . . . to establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in Section 8c(2) as will provide, in the interests of Producers and Consumers, an orderly flow of the supply throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.

Additionally, 7 U.S.C. § 608c(18) refers directly to the purpose behind the establishment of minimum prices paid to producers:

> The Secretary of Agriculture . . . shall fix prices as he finds will . . . insure a sufficient supply of pure and wholesome milk to meet current needs and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs and be in the public interest.

Before the enactment of the AMAA, the competition among farmers to sell to the fluid milk processors led to price competition which ruined farmers and led to an inadequate fluid milk supply to mothers and young children. The situation in 2003-2004 is vastly different. Today, the largest single problem facing the milk industry is an oversupply of milk, leading to low farm prices. Indeed,

there is not a single incident in the record of this hearing, nor recent memory of any market in either Order 124 or Order 131, where the consuming public was unable to obtain as much wholesome milk as it wanted at a reasonable price and the surplus supply is more than ample. Albright, 2497-2505; Hollon, 2581-86; Van Dam, 2905-11.

Moreover, there is no evidence that either the supply or price of milk in the two orders at issue in this hearing is fluctuating unreasonably at all; let alone as a result of producer-handler activity. There is so much milk in these markets that with or without producer-handlers, the quantity of milk previously or currently available to the consuming public is more than adequate. Albright, 2500. In fact, producer groups recognize the problem caused by this surplus of milk. Led by National Milk Producers Federation and Dairy Farmers of America, producers nationwide, including United Dairymen of Arizona and Northwest Dairy Association, are engaged in a program entitled "Cooperatives Working Together" ("CWT"), in order to reduce the current milk supply and to boost producer prices. Cryan, 924-25.

There are no inefficient movements of milk in the markets. Historically, the Department has used order promulgation, amendment, and suspension to insure that there is no disorderly movement of milk. From time-to-time, situations such as the unexpected closing of a plant, a fire, or other sudden changes in market opportunities require producers historically associated with the order to make extraordinary efforts to maintain qualification for the blend price. This has happened in Order 131 on several occasions over the last ten years. Once, UDA experienced problems with its powder operation and was required to move large volumes of milk to non-pool plants. More recently, there was a contest between competing cooperatives to supply the Class I handlers in the Arizona market. Milk came from as far away as Idaho, Colorado ,and New Mexico, displacing Arizona milk. In order

for the Arizona producers historically associated with the order to maintain qualification, changes had to be made in response to that disorderly market. No such emergency exists here. In fact, the Department has already denied the proponents' request to expedite this hearing.

2. Producer-handlers have not adversely affected producer prices since 2000.

The prices for classified milk have not been altered by the activities of the producer-handler in Order 131 or the continued existence of producer-handlers in Order 124. The evidence would have to show that pool plants marketing in these orders have not timely paid the minimum prices required by the order. Since there is no such evidence, it cannot be said that producer-handlers are contributing to erosion of the classified price.

As for producer prices, there has been a claim that if the milk marketed to consumers through the producer-handler in Yuma, Arizona were added to the pool both in terms of producer milk and the Class I utilization, the uniform blend price in Arizona would increase several cents per hundredweight. Ex. 16. Similarly, Northwest Dairy Association has estimated that the impact on the Pacific Northwest would be only two to four cents on the blend. Van Dam, 1357, 1422. (Opponents do not concede the accuracy of the assumptions or calculations in Exhibit 16 or the proponents' testimony, but refer to it for convenience and illustration.) NDA is already re-blending their producers more than that to offset losses at their bottling plants.

Q. Have you reblended a ten cent assessment against your producers?

A. For what period?

Q. I believe it ended this September, but that could be wrong. Maybe it's ongoing.

A. We did have a, you know, a work stoppage accrual that was assessed to the

producers.

Q. And that cost your producers ten cents a hundredweight?

A. For a four month period, yes.

Q. What other assessments -- types of assessments might you make in the future against your producer's blend prices?

A. That's up to the board.

Q. Are there any assessments currently?

A. We have a nine and a half cent operating fund --

Q. Okay.

A. -- that is -- you know, that is assessed to all producers to offset the cost of the coop.

Q. Anything else?

A. They are being assessed the five cent CWT assessment.

Q. Okay. Anything else?

A. Not that I can -- you know, they're going to be assessed, you know, if there's a quality assessment.

Q. How about a make allowance adjustment?

A. Is that October or November?

Q. I don't know. It's your letter. "Effective with -- October," and this is a letter from Mr. Marshall. "Effective with the October milk proceeds, we will implement a five cent per hundredweight, FMMA will make allowance adjustment (phon.)."

A. Okay. Yeah, that would be effective with this check that's going out --

Q. Okay.

A. -- this week.

McBride, 1354-36; Ex. 38. On the other hand, the four family operations that are the targets of this rulemaking gambit face losses in the millions of dollars.

Although any increase in prices to producers is a plus to those producers, the range of potential benefit is a fraction of the changes that occur month-to-month in the statistical uniform blend price and are less than one percent of the blend price. (2.8 cents versus 2003 blend prices of $11.32). Van Dam, 1422; Order 124 Compilation of Statistical Material. The Department has never considered such a fluctuation evidence of disorderly marketing.

If significant volumes of milk were not now being marketed from Arizona dairies into California, the blend price in Arizona would be significantly reduced. If reduction in producer income resulting from growth of production is sufficient to establish disorderly marketing, then the Department should be considering proposals that do not limit producer-handler size, but producer size. Of course, limiting the size of a producer is both politically and legally undesirable. But, in terms of market impact, it is indistinguishable.

3. The Existence of Producer-Handlers Has Not Created Disorderly Marketing Conditions; No Such Conditions Exist

Upon careful examination of the change in the amount of milk bottled by producer-handlers in the Arizona and Pacific Northwest orders, there is no evidence of inefficient movement of milk or any producer historically associated with the order being denied qualification as the result of the activities of producer-handlers. In fact, a review of the statistics submitted by the Market Administrator's office from January 2000 through the present, which is the period of time since the

most recent amendments to the Orders, shows that there is virtually no change in the percentage of Class I sales controlled by producer-handlers. Utilizing the Market Administrator's data, it is evident that in Order 124, the percentage of Class I sales controlled by producer-handlers has actually declined from 2000 to 2003. Ex. 5, p. 36-37 and table below. (Similar Data for Order 131 is restricted).

	Class I In Area By P-H	Total In Area Class I	PH Share
2000	227,290,194	2,180,011,506	10.43%
2001	228,397,603	2,183,888,279	10.46%
2002	219,175,100	2,175,414,672	10.08%
2003 (Jan-June)	105,686,931	1,078,591,649	9.80%

The proponents have offered testimony to "prove" the alleged negative impact that producer-handlers are having on these marketing areas. Their arguments have been that: (1) the quantity of the Class I market "controlled" by producer-handlers is growing "unabated" and (2) producer-handlers have exerted such fierce pricing pressure on the marketplace that others cannot compete. In contrast, other witnesses have testified about the inaccuracies of those propositions/allegations.

As shown by the Market Administrator's exhibits and other testimony at this hearing, the "growth" of producer-handlers has been flat to negative. In Order 124 (or its predecessors), the number of producer handlers has fallen from 73 in 1975 to 11 in 2000, and the average daily pounds has increased only 4.7% from 1985 to 2000. Ex. 7, Table 4. In Order 131, the number of producer-handlers has fallen from 7 in 1982 to only 2 today. Data on production growth is restricted. Ex. 10. As the evidence at the hearing also established, the number of producer-handlers nationwide continues to steadily decline. By these numbers alone, the only conclusion properly to be drawn is

that there is no "unabated growth" of producer-handlers, nor has this mythical boom created disorder that needs to be addressed.

There was also the repeated assertion that there are named and unnamed producers of such a size that they could become producer-handlers and take over significant Class I sales.

> Just as in the initial hearing in Phoenix, there are likely some individual in this room today who are here to get schooled on how to exploit these provisions and to learn whether this loophole will be there in the future for them to exploit. The issue has even led to discussions in some portions of the U.S. Dairy marketplace to lower regulated prices in order to provide some competitive equity. The drive to exploit this loophole is, or will, create organized disorderly marketing.

Hollon, 1023.

This potential has existed in the Arizona market for many years, and the current situation is no different. It would be premature to enact regulations dealing with marketing conditions that do not currently exist. If and when a large producer would decide to enter the market as a producer-handler, the marketing conditions and the producer-handler's operations may be such that orderly marketing is not only maintained, but enhanced. Speculating now puts the Department in the position of potentially creating inefficiencies in the system based on ignorance of future events and results.

4. Retail Pricing Is Irrelevant to a Finding of Disorderly Marketing

Some of the proponents have argued that producer-handlers have the ability to sell milk at less than Class prices plus processing costs in order to gain and maintain market share at the retail level. *See generally*, Herbein, Krueger, Van Dam. This discussion has two aspects–the retail price of milk and the raw milk price at the plant. Each of these aspects has been treated by the Department

in different ways.

The first aspect, the retail price, is centered upon retailing of milk and unfair practices. The Department is prohibited from regulating retailers and has refused to exercise any authority over unfair methods and trade practices in the handling of milk. 7 U.S.C. § 608c(7)(A). This refusal is due, in part, to the fact that it would require the Department to regulate directly or indirectly the retail price of milk.

Although in recent years the Department has begun to survey retail prices in some markets and reports that data, the Department has never audited wholesalers and retailers on the prices that they pay for their product nor, in auditing plants, have sales prices been audited.

There is nothing in the AMAA that prohibits any handler, including producer-handlers, from selling milk to the public at or below its cost, however defined. In states in which unfair trade practices regarding milk sales exist, the selling of milk below cost is a commonly prohibited act. For example, California prohibits retailers from selling milk for less than the price paid. The issue has never been addressed on a national level.

When a plant complains to the Department that it cannot supply a retailer profitably based on the retailer's shelf price and asks the Department to take action to address this situation, it is seeking relief the Department is prohibited from giving. After all, the first determination that must be made is that the alleged practice complained of is, under law or regulation, prohibited. If not prohibited, how can the Department say that it is wrong in the first place? And absent a legal wrong, how can a remedy be fashioned?

Thus, before any discussion of retail prices of milk and their impact on the Federal Order system the Department would be required to establish unfair trade practices or standards before it

could determine any such violation. The absence of such federal practices or standards precludes the Department from conducting such an analysis in this hearing. As a result, without any act that is prohibited there can be no rational basis upon which to formulate relief. It would be arbitrary and capricious.

Essentially, the argument made by the proponents is that producer-handlers can, and the emphasis is on the potential and not the reality, sell milk at a price that is less than the minimum class prices plus processing, packaging, and transportation. *See* Hettinga, 2633. While the proponents have made this claim, it is only conjecture and surmise. Instead, real evidence must be the touchstone.

To start with the retail price and derive the plant's cost of milk, as Carl Herbein has done, is foolhardy. Over the years, there has been a total lack of correlation between what retailers sell milk for and what producers receive for that milk. There are several practices that decouple retail milk pricing from class pricing. The most common practice is that of a "loss leader." Milk is one of those staples in the shopping cart to which consumers know the price. The use of a low price for milk, even one lower than the store's cost, is a frequently used tactic to attract the consumer to the marketplace. Another technique is to maintain current retail price levels when producer prices increase or delay the implementation of higher prices for one or more months. For example, a retailer may delay the implementation of higher milk prices to maintain a competitive position in the marketplace. Conversely, when prices fall, stores may hold higher prices longer than is required by the raw milk price.

Also unknown is how plants transfer the raw product costs to the sales price for their products. This is complicated because virtually every plant has a multitude of milk products to sell.

There are variances in butterfat content and size. There is also the practice of selling brand-name and private label milk at different prices in the store even though it is identical milk from the same plant. Unknown is how the plant allocates its raw milk costs and other costs between two differently priced items that essentially are at the same cost to the processor. For example, the plant could sell the brand-name milk at such a higher price to the store so that it could sell the private label milk at less than cost. The blended result would be a profitable sale to the plant. There are many more variables involving marketing, timing, cost accounting, and business judgment that go into the retail pricing of milk that it is beyond the scope of this hearing and the authority of the Department to accurately determine. The only way to accomplish that task would be to obtain, over an extended period of time the actual invoices paid by the stores less discounts, credits, and any other reduction in price and compare that to the actual prices at which milk was sold. None of that information is in this record, and, so again, Carl Herbein's alleged "data" has no usefulness.

Another variable that is part of the product mix is the growth in personal size bottles of milk such as twenty ounce "Chugs" marketed by Dean Foods and similar products like Shamrock's UHT milk. These are very profitable products. If they are profitable, it is not unreasonable for a plant to sell the commodity white gallons at a cheaper price to obtain cooler space for these higher price products.

In the highly competitive retail market of milk, as a part of the equally competitive retail marketplace, it is unreasonable to expect the retailers to be fully candid and truthful about their cost and pricing of dairy products. For example, Shamrock Foods' representative testified that:

> Q. And what you testified to is that you could sell this at $1.73 and make a profit but you would decline to do so because you would be concerned about some of your

other, bigger customers getting this information; correct? Is that your testimony?

A. No, that's not.

Q. Could you sell it at $1.73?

A. Yes, I could. But it --

Q. And make a profit?

A. -- would be inequitable with our -- with our reflection of all costs to all customers.

Q. And make a profit, at $1.73?

A. On an incremental basis, yes, I could.

Krueger, 3094 (testifying that Shamrock Foods would choose not to match Sarah Farms pricing).

Mr. Krueger's testimony from Alexandria, Virginia in January 2004 is inconsistent with his prior testimony from Tempe, Arizona in September 2003. In Tempe, Mr. Krueger acknowledged that Shamrock Foods does not negotiate contracts identical to all customers:

Q. Can you tell me -- and I think you probably are going to tell me it's proprietary but I'll ask it anyway – isn't it true that the profit margin on something like this12-fluid-ounce milk container for Shamrock is higher than gallon milk?

A. It depends.

Q. You mean sometimes it is, sometimes it's not?

A. Yes.

Q. Does that depend on what kind of contract you're able to negotiate with the ultimate customer?

A. Yes.

Krueger, 622. If Shamrock truly negotiated equitable contracts for each customer, it would be

expected that the profit margin for the same product would be consistent customer to customer. However, a careful review of the hearing record established that Shamrock's pricing is apparently as variable as its testimony. In addition to establishing the inconsistency in the testimony, these exchanges confirm that Sarah Farms's price to its customers can be profitably matched by fully regulated handlers, contrary to the repeated allegations of the proponents' witnesses. Again and again, the real evidence establishes no basis for the requested sea change in the treatment of producer handlers.

When any plant comes to the Department with a tale of woe regarding the marketing of its products without any reference to the total product mix or without tangible evidence of its own pricing structure, there is an incomplete picture to tie an unreliable anecdote or bald speculation to the development of national policy. In any event, price is not the only factor when a retailer selects a milk supplier. The complex mix of variables include factors of quality, product mix, consumer acceptance, service, and traceability of product that are important to the marketplace, but in differing rates of importance to different buyers.

For anyone to state that raw milk cost and the potential to have it at a lower price is the sole, or even predominant, factor affecting the selection of a milk supplier is impossible to say. The Department should not be involved in regulating such decisions. The Department has never looked at changes in retail and wholesale supplies as a basis for finding disorderly marketing. Such a finding would place Dairy Programs in the role of regulating retail pricing.

5. The Anecdotal Evidence of Alleged Account Switching, Even If Accurate, Does Not Rise to the Level of Disorderly Marketing.

"New competition and account switching is normal market behavior and not -- and certainly

not evidence of chaos." Knutson, 2151. The vague and selective stories offered by various witnesses convey, at best, an incomplete picture of the competitive situation in Orders 124 and 131. At worst, these "facts" are speculative, third-hand recollections and re-tellings. Accepting for discussion purposes the veracity of these isolated events, they collectively establish that competition for wholesale customers is healthy.

> Q. Okay. One of the positions advocated by the proponent during the course of this hearing that you may or may not have heard, is the claim that somehow the regulated handler cannot compete with the producer/handler on price with regard to certain customers, including the warehouse stores and others. I noted that you had in your testimony this Inland example and Starbuck's and Safeway. Why is that important?
>
> A. Well, it's important because it indicates that indeed they can compete on the basis of price. They have been competitive on the basis of price and I'm sure that it's not been -- the only example that one could come up with, but it's a striking example and it's a clear case where even though the exemption from Class One pricing and pooling exists, Safeway has seen the ability to go in and compete and take away that account.
>
> Q. And let me share with you an exhibit that you haven't seen, but I'm going to ask you to make some assumptions and I'm going to read, for my purposes of my questions on this. During the course of the hearing in Phoenix, Shamrock had presented an exhibit, Exhibit 22, which is headed Sarah Farms gallon volume estimated by account monthly estimates. I think it was Mr. Krueger who testified about it. And I'm not asking you to accept that it is true, but only asking you as often

happens in these hearings to make certain assumptions. There are certain footnotes in that exhibit which indicates, for example, at footnote five that Sarah Farms had served Wal-Mart for a period of time from '99 to 2000 and Ador (phon.) Farms served them in 2001 and Shamrock served them from 2002 to the present. Now, Shamrock is a regulated handler. If, in fact, it couldn't compete on price with Sarah Farms, would you expect to have a situation where Sarah Farms apparently lost an account and Shamrock got it?

A. No, you would not expect that.

Q. Why not?

A. Well, because you know, the contention is that these guys are not competitive as a result of the exemption. That clearly that they can be competitive.

Q. There's also an indication at footnote six about another smaller account that ultimately moved their business to Shamrock. Shamrock claims and I'm asking you to assume it, not that it's a fact, but it's an assumption, that it was because of service and quality issues, and that leads me to two questions. First of all, is price always the key issue to a customer with regard to its purchase of milk?

A. No, it's not. I mean, that's clear enough from my discussions with the producer/handlers and from past experience.

Q. And second, if in fact, the regulated handler couldn't compete with the producer/handler on price for all of the accounts, would you expect to be seeing switching from producer/handlers to regulated handlers?

A. No, it would not.

Q. Then there's actually another one in footnote nine, Food Fer [sic] Less, which I think is no longer in business, but it serves our example because the assumption is that Shamrock had the business, lost the business to Sarah Farms, and then got it back. Again, in addition to your Starbuck's example from their own exhibit, we've got more examples that price is not the key thing, right?

A. Yes.

Q. And that they obviously can compete on price, Right?

A. Yes.

Q. Now, certain questions that Mr. English asked you and bear with me, I'm not going to yell at you, so if in fact, you can't hear me, I'll speak up, okay?

A. Okay.

Q. I want you to make certain assumptions, okay? I want you to assume that everything eh [sic] told you as testified to by Mr. Krueger regarding pricing and benchmarking and direct cost and all that other business that he asked you about. It's not true, but I want you to assume it to be true. Okay.

A. Uh-huh.

Q. Does that change any of your opinions as to whether or not there is evidence of disorderly marketing in 131?

A. Absolutely not.

Knutson, 2294-97.

Contrary to the proponents' claims, these events are "not evidence of chaos." Instead, this is merely evidence of ongoing healthy competition in the marketplace, as Shamrock Foods's own

exhibit and testimony demonstrated. *See* Ex. 22, and Krueger *generally*, at 593-96.

Similarly, testimony from processors in Order 124, particularly that about Vitamilk indicates that competition among all handlers is brisk. While the proponents would have the Department believe that producer-handlers were the sole cause of Vitamilk's demise, the evidence tells a more honest story. Vitamilk lost half of its sales volume due to regulated handlers with integrated bottling and retail operations. Brandsma, 2543, Ex. 52A. The anecdotal sale Vitamilk lost to Edaleen Dairy (Vander Pol, 470) accounted for less than two percent of total sales, and was about 50 times **smaller** than Vitamilk's losses to Kroger and Safeway. Brandsma, 2543-54.

Of course, all of this is premised on the accuracy of the witnesses accounts, which they have either refused or failed to confirm. *See* Krueger, 610 (refusing to divulge the three national accounts who purportedly told Shamrock Foods that they have low processing costs).

Q. Is the information provided on Meadow Sweet also provided by your sales staff?

A. Yes.

Q. And they've informed you that Etteline [sic, Edaleen] products were being sold into the Portland market by Meadow Sweet?

A. Yes, they did.

Q. Did you verify that in any way?

A. Did I drive to Portland and check about the stores?

Q. I didn't ask you if you drove, I asked if you verified it.

A. No.

Q. So that could be wrong, you don't know?

A. Could be, I don't.

Q. So you're not making a representation that this is accurate?

A. I'm -- you know, presenting information that's given to me from our sales people.

McBride, 1528

B. The proposed cap at 3,000,000 pounds of Class I sales is arbitrary and unsupported by any factual evidence.

The proponents have selected a cap of 3,000,000 pounds, at which point a producer-handler exceeding that amount would be subject to minimum pricing and pooling requirements on its entire production. The proponents have offered various reasons why they have selected a 3,000,000 pound cap as opposed to a higher or lower number. The timing for the selection and the alleged reasons are discussed below.

The justification for the 3,000,000 cap was created after the cap itself was selected. On that basis alone, the cap should be rejected by the Department. At the latest, its appears that the decision to propose a 3,000,000 pound "cap" was made in June 2002. That was the time period when United Dairymen of Arizona first made a request to Dairy Programs that a cap for producer-handlers be implemented.

In preparing this summary and in reviewing the request for hearing filed by United Dairymen of Arizona, it was discovered that an unacceptable and patently false justification for this hearing was made by UDA to the Department. The production of Sarah Farms was so grossly overstated by UDA that this claim could not have been an oversight. In this regard, the June 20, 2002 letter from UDA to Dairy Programs states, "With the Class I-blend price advantage that Sara [sic] Farms enjoys, plus its **over 1.5 million pounds per day of available own farm production . . .**" (emphasis

added). This translates into production of 45 million pounds (or more) per month. In contrast, the proponents' testimony under oath estimated Sarah Farms's production at 17 million pounds per month. Therefore, the figure used in UDA's request was overstated by nearly three times.

There are two explanations for this gross overstatement: (1) UDA took an unjustified stab in the dark without any good faith basis for the estimate, or (2) UDA deliberately exaggerated the number to spur the Department to hold a hearing. Neither explanation should provide any solace to UDA or, more importantly, the Department. This misstatement of fact, if it indeed influenced the Department to schedule this hearing, has cost the opponent producer-handlers tens of thousands of dollars and hundreds of hours of time in defending their businesses in this public forum. While the hearing record patently establishes that the requests should be denied, a close scrutiny of the June 20, 2002 letter reveals that the "facts" were never what UDA purported them to be in the first instance.

For whatever reason, the Department chose not to request comments on the UDA proposal until the spring of 2003. When opened for comment, Northwest Dairy Association and Dairy Farmers of America adopted the 3,000,000 pound proposed cap of United Dairymen of Arizona in their commentary. The 3,000,000 pound cap was incorporated into proposals 1, 2, and 3 and published in the Federal Register. Therefore, the selection of 3,000,000 pounds as the "cutoff" was made long before this hearing began. In fact, it was made over one year before.

Elvin Hollon, testifying on behalf of Dairy Farmers of America, summarized the reasons for the selection of a 3,000,000 pound cap in his testimony in Alexandria, Virginia. Mr. Hollon testified that 3,000,000 pounds was a preferable number (1) because it was consistent with the studies of Carl Herbein and Roger Cryan that determined that economics of scale for milk processors vanished at

3,000,000 pounds; (the accuracy of these studies and data is discussed elsewhere) (2) because Congress exempted milk processors processing less than 3,000,000 pounds of milk per month from contributing to the milk processor promotion fund; (3) because a DFA commissioned study concluded that a 3,000,000 pound per month producer-handler could serve "a number of small retail stores"; and (4) because anecdotal evidence about producer-handlers and their impact on the blend price is "evidence" of disorderly marketing. Hollon, 2846-47.

None of these arguments carry the day. If anything, the arguments instead demonstrate that this number was arbitrarily selected and that attempts at any justification for this figure were made later.

1. The Herbein/Cryan testimony is dependent on the validity of the Herbein study; which is fatally flawed in its methods and its transparency.

The lynch pin for the proponents' entire case is the testimony of Carl Herbein. In an exchange with one Dairy Programs Marketing Specialist, the witness for NDA could not identify any justification for the selection of a three million pound cap other than Carl Herbein's "study."

> Q. Okay. To the extent that the Secretary may disagree with the precision that's behind -- we have one reason that says there's a promotion program level where it kicks in, and I understand that's one of the reasons of being offered, the other number that I hear, that speaks to the precision of 3 million, rests on Mr. Herbein's study, that's supported by testimony by other folks that say that that analysis is valid. To the extent that it turns out that it's not does not carry the weight that you hope that it does. What else could we point to that would speak to why the number should be 3

million?

A. If there is valid other data, we certainly would be willing to include that in our reasoning. We have seen - - we have seen we have done the best we can do with the data we have available to us, having only one plant that reaches down to that size. Nonetheless, we feel like we had some good slope data that indicated that we were in the right range. If there is other data, we certainly would listen to it very carefully.

Van Dam, 2935-36. If Carl Herbein's testimony is not admissible or not believable, then the proponents case must fail. Moreover, even if his study is accepted, it still does not establish the existence of disorderly marketing and is not basis to change significant, long-standing policy.

Separately, the opponent producer-handlers have moved to strike Herbein's testimony as being irrelevant and unreliable. To the extent that the Department concurs, then the entirety of the argument for the three million pound cap has absolutely no basis in the record. *See* Van Dam, 2935-36. That motion and its arguments are incorporated into this argument in order to establish that the testimony of Mr. Herbein is unreliable.

In short, the proponents argue that a producer-handler had an economic advantage in delivering to the retail outlets. Rather than show true and actual data from their own operations subject to cross-examination by the opponents, the proponents substituted Carl Herbein and his "study" as a proxy. In doing so, they denied the opponents any ability to cross-examine the truthfulness or applicability of the "facts" which Herbein propounded. In reality, the silence of true facts from the real market participants is ample evidence that the alleged price advantage of producer-handlers does not exist. Had it existed, the proponents would have provided real evidence rather than a fabricated study advanced in order to justify a predetermined result.

Mr. Herbein's testimony established that his study was conducted during the summer of 2003 while the cap figure was selected in the year 2002 or before. This timing shows that Mr. Herbein's study was (1) engineered to demonstrate a breakpoint somewhere near 3,000,000 pounds or that (2) the dart board selection of 3,000,000 pounds over one year prior was astonishingly accurate. Of course, Mr. Herbein has not provided the Department with any of his underlying data or any way to assess the validity of his tests so the Department will never know which is the case.

The author and creator of Nero Wolfe, Rex Stout, has had attributed to him the following quotation, "There are two kinds of statistics, the kind you look up and the kind you make up." Carl Herbein won't let anyone look up his statistics. Rather than providing a transparent analysis, his testimony is a case study in hiding the ball. Herbein's study is comprised of hand selected data, pulled from a data base that no one can see, compiled into categories that no one can verify, adjusted for regional prices that were calculated in a way that no one can examine, and applied against prices at stores that nobody has shown the Department or the opponents. Reliance on Carl Herbein's study is reliance on the unknown. It is reliance on the unseen and on the unverifiable. The Department has demanded in the past and should demand today more from those who wish to change policy than what DFA and Carl Herbein have offered.

In fact, Carl Herbein indicated that he wouldn't advise a client to base a business decision on information like that utilized in his "study."

> Q. Let me ask you a follow-up hypothetical. Let's assume that, again, you're asked to do due diligence on a potential acquisition. Rather than financial statements, all you get is a statement from the president or CEO of the publicly traded, or privately held company in my example would be better, that simply says, "We have a database. The

financial statements are all good. We're making this much money." And you have the opportunity in the next 24 hours -- you can't do anything else. You've got to rely upon this by the company. What would you advise your client to do?

A. Well, that wouldn't happen in real life.

Q. I asked in my hypothetical to go ahead and answer it.

A. If that was all we had to do, I would say to my client, "This guy's a nut. Stay away from him." But that wouldn't happen.

Herbein, 827-28.

Because the opponent producer-handlers have been denied every and any opportunity to cross-examine Carl Herbein about the important decisions he made in order to arrive at his conclusions and the prices upon which he based his study, the entirety of his testimony should be disregarded. This is not only a matter of fairness to the four businesses that would be negatively affected by the proposals, but it is as important to the integrity of the rule making process. The Department must base its decision on accurate and verifiable information. No such information is available here. As stated, the conflicting statements from the proponents about the timing and selection of their 3,000,000 pound cap raises a serious question whether this study was engineered to achieve a predetermined certain result.

In addition, the testimony of Dan Morrison suggested that Mr. Herbein's numbers were inflated. Morrison, who worked for Dean Foods (a proponent of the cap) as a cost accountant and director of their dairy financial operation, called the numbers "extraordinarily high." Morrison, 1901, 1917 (suggesting that Herebin's costs were 15 to 25 cents higher than would be expected for an efficient processor). The experience of Mr. Hettinga is consistent with Mr. Morrison's

conclusions:

At the hearing, the testimony of Carl Herbien, that was used to suggest that our prices were unattainable by a regulated handler, were based on plants whose product mixes were not disclosed but were almost certainly more diverse than that of Sarah Farms'. My experience has shown that the cost of processing, packaging, and labeling is about the same regardless of the size package that is run. A plant running straight white milk gallons will have a lower overall cost per gallon than will have a plant running a product mix of multiple sizes and SKUs. The composite cost information provided to the Secretary is meaningless as a basis for comparison. Sarah Farms' cost per white gallon should be no more than the cost of Shamrock. In fact, it should be less.

Mr. Herbein's study looks only at 2 percent white gallons. Without knowing what the same store was charging for whole milk or skim milk, it is possible [sic, impossible] to know whether or not the stated price for 2 percent represented a markup over the actual cost from the plant or a markup over some blended milk cost to the plant. Also, the stated period of time is stated to represent January through June 2003, there is nothing stated to indicate the days of the month or the dates of the month these costs were surveyed. This is relevant because the store may be pricing milk based on prior months' costs or anticipation of the following month. As a dairy processor, butterfat costs me money. A gallon of whole milk costs more than a gallon of reduced-fat milk, which costs more than a gallon of skim milk. Sarah Farms prices its products based on the butterfat content. I have noticed that the stores price milk

rather uniformly. To the consumer, there isn't much difference between the cost of a gallon of skim milk and a gallon of whole milk, even though the whole milk costs the store more. Also, the figures cited by Mr. Herbein for transportation are highly overstated, based on my experience. Finally, pallet costs do not correlate to those for Sarah Farms because we offer a pallet exchange program. The whole purpose is to keep the cost of my product low -- and it works.

Hettinga, 2633-35.

In addition, Mr. Herbein's numbers are inflated when compared with those in the Cornell study and have no cross-over for plants less than 12 million pounds per month–the critical size plant as far as this hearing is concerned. The Cornell Study, of which official notice has been taken, involves only plants with weekly processing volumes greater than 11.7 million pounds per month. Cornell, p. 5 ("Processing volume for all plants ranged from 1.36 million gallons to about 5.98 million gallons per month (11.7 million pounds to 51.5 million pounds).") Furthermore, for the data where plant costs do cross-over, the costs reported by Mr. Herbein are consistently higher than those reported by Cornell. *Compare* Herbein's range of plant processing costs for plants 12 million pounds and over (33.5 cents to 43.4 cents) to that for the Cornell Study (12.3 cents to 28.0 cents). Ex. 25, Table B; Cornell, p.15.

Not only is DFA asking the Department to rely on Carl Herbein's testimony, but other witnesses have used Carl Herbein's testimony to enhance or add to their own testimony. Roger Cryan of National Milk Producers Federation stated that Carl Herbein's data was quite applicable to this hearing in assessing whether a processor was efficient enough. Cryan attempted a statistical regression to fit a curve identifying processing costs. While the accuracy of this statistical analysis

was criticized roundly by Dr. Ron Knutson, the data for plants smaller than 12,000,000 pounds of production per month is gleaned entirely from the study of Carl Herbein.

> The Cornell study is very difficult to use at the levels we're talking about -- around 3 million, 2 million, 5 million pounds -- because their data did not go below any plants that had 13.3 [sic, 11.7] million pounds, so the extent of the line to those lower levels is not really appropriate. And that's why I've relied on the Herbein data, which I believe to be reasonable data.

Cryan, 905. While the Maine study and Cornell study provide data for larger plants, these studies have no examples or data for plants in the size area for those that will be regulated by the outcome of this hearing. Ex. 26, Table 1. In fact, Dr. Cryan described the extrapolation of the Cornell data to lower levels as "not really appropriate." Carl Herbein's data provides the lone reference for the most important section of the Cryan testimony. Accordingly, if Mr. Herbein's testimony is faulty then, as night follows day, the testimony of Dr. Cryan must similarly be discounted.

Both Mr. Herbein and Dr. Cryan committed errors in their analysis, as testified to by former AMS Chief Economist Dr. Ron Knutson. Among the problems identified were (1) utilizing a sample size that was too small; (2) utilizing plant data from plants other that producer-handlers to predict costs for producer-handler plants; (3) utilizing plant data for plants outside Orders 124 and 131; (4) failing to account for differing product mixes and distribution; (5) utilizing adverse (or judgmental) selection as opposed to random selection; (6) utilizing the consumer price index to adjust non-consumer costs; (7) utilizing averaged data to calculate an R-squared coefficient; (8) and failing to account for variables other than plant size in analyzing the Cornell Study. *See* Knutson, 2140-43. It is obvious that in addition to the paramount question of transparency, there are large problems

with the testimony of Carl Herbein and others who rely on his "study."

2. The unexplainable justification of the 3,000,000 pound cap by referring to the milk processors' dairy promotion program is illogical.

The change in the exemption for the milk processor assessment was adopted by Congress on May 13, 2002 as part of the Farm Security and Rural Investment Act of 2002. While at least occurring before UDA submitted its proposal, UDA's request for a hearing does not rely on the new amendment at all. Like Mr. Herbein's testimony, this suggests that the 3,000,000 pound cutoff was established without any factual basis and instead was rationalized after the fact.

The milk promotion statute is not part of the AMAA. It is an entirely different statute with an entirely different purpose. Congress has never stated that its terms apply to the regulation of producer-handlers under the AMAA. The promotion assessment applies to all handlers in all markets irrespective of whether they are subject to FMMO, state regulation, or no regulation. Thus, there is no connection between that assessment and whether producer-handlers should pay into a producer settlement fund.

In passing that cap, Congress did not amend the AMAA, as it pertains to producer-handlers, and certainly Congress did not expand the Department's authority beyond that to assess minimum prices for "milk purchased from producers."

3. DFA's attempt to justify the cap by calculating the number of small grocery stores that can be serviced under the cap is an interesting exercise, but provides no justification for the 3,000,000 pound number and only demonstrates that the real goal of the proponents is to freeze producer-handlers out of the growing and lucrative segments of the

marketplace.

Mr. Hollon's testimony about the ability of a producer-handler to service small retail stores may be academically interesting, but it is inappropriate in setting dairy policy. Instead, this study shows is that a producer-handler under 3,000,000 pounds can supply milk to stores that are rapidly going out of business and becoming marginalized. Knutson, 2144. The real purpose of the study is to suggest that producer-handlers should stay out of the growing markets and larger markets for fluid milk and leave that to the "big boys" such as Dean Foods, DFA, and NDA. The implication is that as long as producer-handlers stay in their place, that no one will have any problems. Just like the other alleged bases for justifying the 3,000,000 pound cap, this study was performed after 3,000,000 pounds was selected as the cutoff.

What is striking about this argument is that witnesses from the Northwest, proposing to limit producer-handlers complained about the lack of such small customers and their resulting demise. (*See, e.g.* Vitamilk, Sunshine). It is disingenuous for the giants of the dairy industry to try to limit producer-handlers to servicing only those customers that the proponents know will not even exist in the near term.

Fundamentally, it is DFA and the others that seek to regulate producer-handlers based upon retail sales. The Department is not authorized to regulate retailers, nor is it authorized to regulate producers. This argument demonstrates that these proposals would result in the regulation of producers who are also handlers by looking to their activity in the retail markets.

Finally, the proposals would also establish a trade barrier by denying producer-handlers access to larger marketers who have a broader geographic reach.

4. The limitation is arbitrary and capricious and provides for draconian

penalties for exceeding the proposed cap

The proposed limitation of three million pounds means that if a producer-handler has three million and one pounds of production he becomes fully priced under the order. At three million or less pounds per month, the producer-handler has no obligation to the pool. Once a producer-handler reaches one pound more, however it is obligated to pay he difference between the blend price and Class I price. If, for example, that difference is $1.20, the obligation is $36,000.01. On a per hundredweight basis, this pound of milk represents a price of $3,600,001.00 per hundredweight! All of this assessment will be borne by milk owned and produced by the producer-handler. If the Department were to adopt a higher cap, the rate would only go up on this marginal pound of milk.

The penalty associated with this assessment means that producers will take substantial steps to avoid reaching that level, including keeping their sales substantially below three million pounds, in order to avoid even an accidental occurrence. The target would be about ten percent less. This is because the scheduling of delivery of orders and actual receipt at months end would be the most likely cause of a producer-handler being trapped. One day is approximately three percent of monthly production and three days represents a weekend with a holiday. Quite simply, these regulations would be tantamount to regulating the farm production of producer-handlers.

The current regulations limiting the ability of producer-handlers to purchase milk from other producers to 150,000 pounds of milk per month have the same effect. For example, assume that a producer-handler has monthly Class I sales of 5 million pounds of milk and for a given month, purchases three loads of milk, as is allowed. For simplicity, the Department can assume that the cost of those three loads of milk is $15.00 per hundredweight. If one of those trailers in overloaded by one hundredweight, that producer is not in compliance with the qualification requirements and

will be assessed a pool obligation on the entirety of its own farm production. Again, at the rate of $1.20 per hundredweight, that extra pound would result in an assessment of $60,000.00 on all of the producer-handler's milk. This is $6,000,000.00 per hundredweight on that marginal pound of milk.

The money collected from these assessments would be paid into the producer settlement fund, and the producer-handler would receive absolutely no benefit from the assessments. Even if the proponents are correct in their argument that the AMAA permits the Department to require settlement fund contributions on milk that is never purchased from a producer, the new regulations would take millions of dollars per year from these producer-handler operations, redistribute this money to other producers, and return absolutely no benefit to the producer handler operations. The producer-handler has invested the time, capital, and effort to develop plant capacity and customer base for its products under the long-standing policy and regulations of the Department. It also bears the risk of having to maintain its own supply of milk, largely independent of outside sources. This substantial investment in time, money and lives would be decimated by an unreasonable and unnecessary seismic shift in policy which deprives producer-handlers of the fair value of their farm production.

C. Producer-Handlers Do Not Have an "Unfair Price Advantage"

1. All market participants play by the same rules–an inherently "fair" practice.

The second aspect of the argument that handlers are having difficulty competing for retail sales is whether or not one party has a lower raw milk cost than another. A statement often repeated by the proponents in this hearing is that producer-handlers can "purchase" their milk at a lower price than regulated handlers. Aside from the inaccuracy of the statement that producer-handlers purchase

any milk, and the attendant legal consequences on that lack of purchase, this testimony misconstrues and mischaracterizes the cost of sales for a producer-handler.

Another oft-repeated phrase by the proponents is that producer-handlers do not play by the same rules and that we need to "level the playing field." Muirfield, 164; Hitchell, 216; Marsh 267; Arbuthnot, 415; Krueger, 535; Yates, 662; Smith, 1290; Van Dam 1366. This is untrue. Every single producer and every single handler has the right to become a producer-handler at any time. Their choice to not avail themselves of the producer-handler provisions is one that they have made to their best economic advantage.

The playing field is already level; all participants have an equal opportunity to compete. Simply because some have decided that one particular course of action is most economically advantageous, that does not mean that others who have reached differing conclusions are unfairly treated or do not have the same opportunity.

Indeed, if the playing field is tilted at all, it is tilted as a matter of economic reality in favor of the larger market participants, like Dean Foods. Large processors (Safeway, Kroger, etc) enjoy the financial advantage of a captive market and vertical integration. Others can leverage their size and geographic scope to gain market share regionally by shifting resources and profits from one plant to another. The comparatively smaller producer-handlers do not have any of these economic luxuries. Dean Foods has dairy sales exceeding $8 billion per year and exerts significant national control in the dairy industry. DFA owns plants and has the ability to absorb plants, enter into joint ventures, etc. *See* Ex. 54; Hollon, 1068, 1187.

The canard that this hearing was required in order to "remove a regulatory loophole" is equally misleading. The use of the word "loophole" implies that someone has found a way to obtain

a result in a way not contemplated by the law. That is not the case here; the producer-handler exemption is long-standing, long-debated, and has survived numerous challenges. All participants know of its existence, but few have embraced it and its appeal has been limited.

In actuality, the goal of the proponents and the other witnesses testifying in support of these proposals is to eliminate producer-handlers from the market place. *See* Ex. 18, p. 5 ("Now may be the time for reform of the federal milk orders to eliminate the discriminatory producer-handler exemption.") The goal of these changes is to stifle competition in the marketplace and to secure additional market share for the giants of the dairy industry. The goal is also the removal of innovative dairy operations to benefit a select group of larger market participants. It is nothing more.

The testimony of witnesses supporting the proposed amendments repeatedly refers to producer-handlers as "unregulated" entities. This is also false. The only way that a producer-handler is not "regulated" is with regard to the payment of minimum class prices and participation in the producer settlement fund. Producer-handlers are (and have been) regulated. They must satisfy all of the requirements for designation as a producer-handler set forth in the applicable order. (7 C.F.R. § 1124.10 and § 1131.10) They must make and maintain records regarding the sources and dispositions of their milk. (§1124.10(d) and § 1131.10(d)) They must submit monthly handler reports as must other plants located in the order. They are prohibited by rule from purchasing more than 150,000 pounds of milk per month from producers. (§ 1124.10 and § 1131.10) They are not eligible for the benefits of a producer with regard to participation in the blend price (§ 1124.12 and § 1131.12). Milk which they sell to handlers in the order is down allocated to the cheapest class (§ 1000.42). As compared to "regulated plants" who have no limitation on how much milk they can purchase or who they can sell to, producer-handlers are indeed regulated.

2. The risk structure and balancing costs of being a producer-handler impose a regulatory price that has discouraged most from seeking producer-handler status.

A producer-handler is a unique regulatory entity with a risk structure unlike any individual producer or individual handler. Accordingly, the risk structure is different from any producer risk or any handler risk. The risks are not additive, but geometric.

Producer-handler operations take on an enormous amount of risk. The very definition of producer-handler and the requirements laid out by the Department require that such operations take on the sole and exclusive risk of both the farming operation and their processing operation. No individual farmer, other than a producer-handler, has so great a risk. "Producer-handlers bear huge amounts of risk in the event that there are problems at their processing facility. A stoppage in production can mean the loss of raw milk that cannot be replaced by a purchase from another farm." Hettinga, 2635. In contrast, the cooperative structure spreads the risk of a plant problem, a lost retail market or lost wholesale market among the cooperative association thereby reducing the likelihood of a catastrophic financial loss. Similarly, no processor who is not a producer-handler assumes the risk that they would be wholly unable to provide their customers with an adequate supply of milk. A processor who is not a producer-handler can always go out and purchase additional milk at a reasonable cost. That processor does not bear the risk of a catastrophic loss that would reduce his or her milk supply as would happen to a producer-handler if sickness were to devastate their herd. Likewise, a fully regulated handler who is provided a load of milk that is unusable would simply refuse to pay for that load of milk and request an additional load of milk from its supplier. A producer-handler does not have that opportunity. Beene, 1765-67.

Risks and probability, when combined, are geometric not arithmetic in nature. In other words, the risk of being a producer plus the risk of being a processor is less than the risk of being a producer-handler. Being a producer-handler is equivalent to a double or nothing bet. The producer-handler is taking a risk that he will incur a loss on the farm. If he does not incur a loss on the farm, he then takes the risk that he will not incur a loss as a processor. It is not a situation where a producer-handler is taking the risk of farming and the risk of processing. Instead, he is taking the risk of farming and if successful, he can then take the risk of processing. This accounts for the inherent and increased risk that the proponents repeatedly failed to acknowledge. To the opponents and others who across the country who have chosen to be producer-handlers, this increased risk is worth taking for the reason that they do not want to be part of the cooperative system. They enjoy the challenge in being a producer-handler, and they believe that the additional potential returns are worth the risk. Obviously, they are in a small minority of market participants.

Producer-handlers are responsible for balancing their entire milk supply, and thus, do not disrupt the market. The Department's own statement of policy regarding the producer-handler exemption is intertwined with the ability of the producer-handler to balance their own milk supply:

> [P]roducer-handlers have no significant advantage in the market in their capacity as either handlers or producers as long as they are solely responsible for their production and processing facilities and assume essentially the entire burden of balancing their production with their fluid milk requirements.

Gore, 54 Fed. Reg 27182 (June 28, 1989). Existing regulations provide more than adequate assurances that this is in fact the case. The proponents have tried mightily to provide the Department with an erroneous impression that no producer-handler can bear their own balancing costs. Van

Dam, 1354. This is an absolutely fallacious proposition.

The testimony of the various producer-handlers indicate the difficulties associated with having the responsibility for coordinating supplies of raw milk and demand for consumer products. *See generally*, Heerspink, Koester. The financial risk to the producer-handler of balancing is real and substantial. Each of the opponent producer-handlers described in detail on the record the struggle they have everyday in balancing their supply of milk.

As a starting point, a producer-handler must account for the seasonal fluctuation in milk supply. They must be able to provide all of their customers with the fluid milk that they demand even in times of low production. Accordingly, in times of high production the producer-handler will almost necessarily have a surplus of milk that must be disposed of. To the extent that this milk is sold for less than the Class I price, there is a balancing cost to the producer-handler.

Of course, a rational businessperson will try to sell this milk or otherwise dispose of it at the highest possible value in order to create a sale that is actually profitable to the producer-handler. In many cases that is not an option. However, selling surplus milk for even a fraction of its cost of production is better than making no return at all.

The opponent producer-handlers dispose of their surplus in many different ways but always at their own costs. For instance, Edaleen Dairy disposes of its surplus milk by manufacturing ice cream, which it sells at its own store. Heerspink, 1978. Both Edaleen Dairy and Smith Brothers Farms supply surplus milk to Matanuska Maid. Koester, 1786; Brandsma, 2552. These sales, as the testimony established, are at less than class prices. At other times, surplus milk is sold to plants owned by cooperative associations. Sometimes these sales are accepted. Other times the plant refuses to take the surplus. It is fully within their right to reject such purchases. For the most part,

this industry is still subject to free will. When such sales occur, there is a reduction in the Class price paid to the producer-handler. This reduction, according to the cooperatives, represents their costs of operating the plant and their investment in the plant. This reduction from the Class price is a balancing cost. That cost is borne by the producer-handler, not the cooperative plant. No cooperative plant is forced to accept the surplus milk and often they do not; when they do, they exact a price. It is intellectually dishonest for them to allege that this cost is not borne by the producer-handler.

The testimony of Northwest Dairy Association and Daniel McBride suggest that because producer-handlers sell to Matanuska Maid in Alaska, there is a balancing cost shifted to the regulated marketplace. McBride, 1512. That argument is without merit. Mr. McBride argues that if the producer-handlers didn't sell to Matanuska then NDA would. However, Mr. McBride's testimony demonstrated that this is purely a matter of economics.

Q. Okay. What is the price you charge Matanooska [sic] for the milk you supply?

A. My -- I don't have the prices, and again, that would be proprietary information anyway.

Q. Could be less than class price?

A. Doubt it.

Q. Could be much more than class price?

A. Possible.

Q. Could be double class price?

A. Doubt it.

Q. Doubt it. Let's say hypothetically, you did charge them twice class price, and there

were another supplier of milk that would charge them one and a half times class price. If you were Matanooska, [sic] what would you do?

A. Hypothetically, why would they ever want to buy milk (indiscernible)

Q. Who else besides producer/handlers that you say supply milk to Matanooska [sic] and West Farm Foods or NDA, who else are you aware of that regularly supplies milk to Alaska?

A. Well, we know Safeway has stores up there, and I believe Afford Myers (phon.) has some stores that --

Q. Who supplies to Matanooska [sic]?

A. That's bulk milk that they receive either from us or from producer/handlers.

Q. So if not for the producer/handlers, you would have a, I don't want to say monopoly. Maybe that is the right word. You would have a -- the sole ability to supply their plant, right?

A. They could go -- I mean, they could get the milk out of a Portland plant.

Q. Okay.

A. You know, someplace else, you know, other handlers.

Q. But absent a competitive environment, you could pretty well dictate a price for them?

A. We consider pricing. If they can get it cheaper, you know, I'm sure that's what they would.

McBride, 1531-32. Mr. McBride's' cooperative sells milk to Matanuska Maid, but at a higher price. The producer-handlers do not. Likewise, Mr. McBride's testimony shifts the focus away from his

own balancing problems and costs that he would incur under any circumstances and blames the producer-handlers for NDA's own excess supply. Nothing in the Order prohibits NDA from selling to Matanuska Maid at a lower price. It does not, however, get credit for prices under Class I sold to a non-pool plant. Sales by Pacific Northwest producer-handlers to Matanuska Maid in Alaska do not, as NDA suggests, shift balancing costs to the pool. Matanuska Maid is not a pool plant and not located in the marketing area.

There is also no obligation for the producer-handler to offer a full product line. The decision to offer a limited line of products is a business decision based on processing efficiency and an individual entity's calculation as to how to maximize profit. No plant, fully regulated or otherwise is required to offer any specific product, and the assertion of the proponents that by not doing so, another plant is "required" to do so is a simple fallacy.

No processor must manufacture sour cream, fluid milk, buttermilk, yogurt, or any other dairy product. Presumably, expansive product lines are offered because they are profitable. Simply because Sarah Farms or another producer-handler chooses to supply only fluid milk to its customers that does not force the market place to balance a thing. A customer could choose not to purchase from a supplier who does not offer a full product line. That choice is for the customer to make. If a customer purchases fluid milk from one supplier who cannot provide other dairy products they must quite logically turn to another supplier. That supplier could mandate fluid milk purchases in addition to purchases to other products. That decision is for the processor to make. Accordingly, prices for all dairy products can be set at whatever the market will bear. If a supplier like Shamrock Foods feels that the price of dairy products must be higher for those customers who do not purchase fluid milk from Shamrock, then its price can be adjusted accordingly. It's a matter of economics,

of profits and losses, and business structure. It is not a matter of balancing costs. If the proponents can't make enough money selling dairy products other than fluid milk, then the proponents ought to stop manufacturing these "unprofitable items."

3. The proponents' argument is tied to the erroneous premise that a producer-handler enjoys an economic advantage over regulated handlers.

The proponents allege that producer-handlers enjoy an "unfair economic advantage" over a fully regulated handler. In order to address whether this allegation is true, two things must be considered. First, the Department must accurately measure what financial benefit, if any, producer-handlers receive. Second, the Department must decide whether this advantage is "unfair." When the financial benefits of not having to pay minimum prices and to participate in the producer equalization pool are measured accurately and offset by producer-handler balancing costs, the advantage that the proponents have alleged vanishes. The remaining "advantage" is perfectly acceptable given the increased risk that producer-handlers have in the marketplace.

The margin of a producer-handler is the price at which it sells its milk less the cost of production. Proponents wrongly assert that the "advantage" a producer-handler gains by not paying into the equalization pool is measured by taking the applicable Class I price and subtracting the order blend price. This represents the obligations of a 100% Class I handler who is fully regulated under the Order. However, a producer-handler's "cost" for its milk is not the blend price. A producer-handler receives its milk at the costs of producing it. Therefore, the formula should be modified by replacing the Order Blend Price with the producer-handler's cost of production. To the extent that the cost of production exceeds the Order Blend Price a producer-handler must expend more to

receive its raw input than a regulated handler. This has been the rule rather than the exception for much of the last three years. Next, one must take into an account that a producer-handler does not have 100% Class I utilization. So, if a producer-handler were a regulated handler it would not be paying into the pool the Class I price on all of its sales. What a producer-handler is actually paying in this equation is something less than the Class I price, and from that figure the price of production must be subtracted. This yields some sort of presumably positive number; but far less than the simple (and unjustified) number the proponents have advocated at the three weeks of hearing.

Furthermore, adjustments must be made for the balancing costs as have been discussed elsewhere in this brief. Every time a producer-handler disposes of milk at less than Class price such as sales to a cooperative plant, shipping from Matanuska Maid Dairy in Alaska, or milk that must be sold at a deep discount to a periodic purchaser, this advantage is correspondingly reduced. Balancing cannot be measured in sales of surplus milk alone, it is embedded in the production of milk at the farm, lost sales, and in production efficiencies and inefficiencies.

The actual margin is proprietary information for any business and was not introduced into the hearing record nor will it be disclosed in this brief. However, the testimony under oath does establish that balancing costs are real to a producer-handler and that this alleged advantage is not all that the proponents have made it out to be.

History demonstrates that this purported advantage cannot be that great because the number of producer-handlers is constantly declining. Few (if any) farmers becoming producer-handlers, and few (if any) plants acquiring farms to qualify under subsection 10 of their Order. The question repeated throughout the hearing was "if there is a huge advantage why aren't more people taking advantage of it." The answer was never satisfactory. It was usually, "I don't know" or "somebody

is going to if we don't take care of this 'problem.' " This is the same kind of unsubstantiated and speculative testimony that the Department has repeatedly rejected when producer-handler regulations were before it in the past.

Assuming for the sake of argument that an advantage exists, albeit at lower values that the proponents claim, the producer-handler is entitled to receive it. A producer-handler incurs additional risks, as described in this brief. Rational people do not take on additional risk without the prospect of additional reward. To take on risk without an additional benefit is not reasonable business policy.

If such an economic advantage exists, to require the producer-handler to disgorge that benefit to its competitors and to other farmers does not further the goals of the Federal Order system. Despite the regulatory environment of the dairy industry, America is still a free market economy. America encourages small businesses. America encourages entrepreneurship. Americans shun socialist and communist economic policy as flawed theories, and rightfully so. America's economic system is based upon a prospect of wealth and success for those who are diligent and hard working and willing to take a risk. Producer-handlers are the epitome of entrepreneurial risk takers that should be encouraged and not discouraged.

The producer-handler bears, by law, the entire risk of its operation. There is an investment in livestock, real estate, property, employees, equipment, plants and facilities, shipping capacity and others. This investment is that of the producer-handler and not of the marketplace. This investment was made in reliance upon regulations and policy that has stood for over 70 years. To take millions of dollars from these operations every year and distribute it among its competitors or the marketplace is anti-American. It is the antithesis of capitalism. It also raises serious constitutional questions for the opponent producer-handlers; such as violation of due process under the Fourth and Fourteenth

Amendments to the Constitution.

D. The Agricultural Marketing Agreement Act Does Not Permit the Department to Require Producer-Handlers to Pay Into the Pool for Their Own Farm Production or to Regulate Producers.

The AMAA provides authority to establish minimum prices paid to producers for **purchases** of raw milk. 7 U.S.C. § 608c(5)(A). By definition, producer-handlers do not purchase milk from their farm operations. This has been adequately explained by the producer-handlers who have testified at this hearing. The AMAA contains specific references to producer-handlers that demonstrates a total exemption for milk produced by the entity that processes the raw milk. For example, Section 8c(5)(k)(I)(11) requires that certain tax-exempt producers be treated as producer-handlers.

Proponents relied upon the *Ideal Farms* case during this hearing. The court in *Ideal Farms* misinterpreted the importance of the phrase "including producers who are also handlers." 7 U.S.C 608c(5)©). Because producer-handlers were exempt from the minimum pricing required under 608c(5)(A), Congress found it necessary to limit the exemption to only that milk produced by a handler, and not to that milk which a producer might acquire from other producers. Had Congress intended the Department to require producer-handlers to pay into the pool on their own farm production, such a statement would be superfluous. In short, there are producer-handlers who only use their own milk, and there are producer-handlers who purchase additional supplies from other producers. While the Department can regulate the purchases made by the latter, it has no authority to assess the former.

The statement that the milk is "acquired for marketing" is unnecessary to give plain meaning

to the statute and to effectuate its terms. The facts in *Ideal Farms* are not completely stated. The terms of the "lease" of the farms are not stated, but it takes no imagination to figure out that the "leases" were merely a scheme to call what was truly a purchase of milk something else in order to avoid the regulations. That is not the case with producer-handlers. Under current definitions, the farm and the plant are required to be maintained at the farmer's "sole risk and enterprise."

A producer-handler does not "acquire" its raw milk. To acquire means "to gain possession or control of; to get or obtain." All of these concepts, gaining possession of, getting, and obtaining, imply the wresting of possession or ownership from a prior owner. To produce means "to bring into existence; to create." Production is a action undertaken by the originator or the initial owner. Secondly, an "acquisition" is not necessarily a "purchase." To purchase includes the concept of acquisition, but also contemplates an exchange of value, "the act or instance of buying." The single entity producer-handler does not do either. To make this claim is both a legal and factual fiction and requires a leap in logic which the Department should not make.

Because the producer-handler is a single operation, any regulations that limit the ability of the producer-handler to produce additional quantities of milk will necessarily affect the producer-handler in its capacity as a producer. Congress has repeatedly expressed that the ability of the producer to produce milk shall not be regulated. *See* 7 U.S.C. § 608c(13)(B) ("No order issued under this Chapter shall be applicable to any producer in his capacity as a producer.") The proposed amendments force the producer-handler to choose between paying into the pool for its own farm production or limiting the size of its production. The farm operation of a producer-handler is so inextricably intertwined with the processing operation that at least to lenders, the assets of one part is collateral for the other

Q. All right. Are you involved in the financing of your enterprise?

A. Yes, I am.

Q. And do you from time to time have to borrow money?

A. Yes, I do.

Q. And do you have to put up collateral for that money?

A. Yes, I do.

Q. And when you go to the banks, what collateral do they ask for?

A. Just the collateral that I have in my cattle.

Q. Will they accept any collateral from your plant equipment or your plant?

A. Zero.

Ed Brandsma, 3107. To assess a producer-handler on its own farm production will necessarily regulate the operation of their farming plans. To do so violates the AMAA's prohibition on marketing orders that regulate producers.

E. Adopting The Proposed Changes Would Fundamentally Shift The Long-Standing Policy Of The Department.

The Department has a long-standing policy of exempting producer-handlers from the pricing and pooling requirements of the Federal Orders. This policy has been expressed in repeated decisions addressing similar issues to those presented at this hearing. Since 1988, the Department has considered changes to the producer-handler exemptions on at least four occasions. In 1988, amendments were considered to the Texas and Southwest Plains Orders when the Pure Milk and Ice Cream Company acquired producer handler status. Those amendments would have imposed a

quantity limitation on the size of producer-handlers. In the recommended decision on the proposals, the Department stated:

> Although the marketing of milk by producer-handlers has the potential of creating disorderly marketing conditions, it has not been found necessary to regulate fully this type of operation. In fact, the policy has been to exempt such types of operations. Such policy has been based, generally, on findings in regulatory proceedings that producer-handlers have no significant advantage in the market in their capacity as either handlers or producers as long as they are solely responsible for their production and processing facilities and assume essentially the entire burden of balancing their production with their fluid milk requirements.
>
> Although producer-handlers have not been fully regulated as a general practice, the Act provides the authority to regulate handlers of milk to carry out the purposes of the Act. With respect to producer-handlers, guidelines from the legislative history indicate that there is authority to regulate such operations if they are so large as to disrupt the market for producers. However, on the basis of the overall history of the treatment of producer-handlers, a size consideration, in and of itself, is not particularly relevant to the issue. Even large operations in relation to the markets they serve have continued to be exempt from full regulation. Consequently, **any decision to fully regulate a producer-handler type operation must be supported by substantial evidence of the existence of disorderly marketing that is a direct result of producer-handler activity.**

54 Fed. Reg. 27179, 27182 (June 28, 1989) (emphasis added).

Just one year later, the issue of producer-handler status was addressed in the consolidation of the Rio Grande Valley, Lubbock-Plainview, and Texas Panhandle orders. The Department rejected AMPI's suggestion that a producer-handler exercise "complete and exclusive control over the operation, both at the plant and farm level" and limit purchases from pool plants to 5,000 pounds per month. The proposal also limited the types of customers a producer-handler could have and excluded them from chain stores and much of the retail market–just as AMPI's successor suggests here. The Department cited virtually the same reasons expressed in the recommended decision on the *Gore* hearing. Producer-handlers were not disruptive where they were responsible for the balancing of their own supply. Like Orders 124 and 131, the Rio Grande Valley had a significant producer-handler presence. In the four years leading up to the consolidation of these marketing areas, producer-handlers accounted for between seven and eleven percent of route disposition. 55 Fed. Reg. 43345, 43353 (October 29, 1990). This approximates the production of producer-handlers in the two orders at issue in this hearing.

In 1992, UDA attempted to impose additional regulations on producer-handler operations. The Department rejected the UDA proposal to require minimum production in excess of Class I route disposition by producer-handlers in the Central Arizona Marketing Area. The Department rejected the UDA proposals because they "lack[ed] objective standards and instead relie[d] on subjective judgments" and would otherwise "penalize producer-handlers and fully regulated handlers even when a P-H was acting in a totally unobjectionable manner." The same statements can be made about the arbitrary caps proposed here to address an alleged "disorderly marketing" problem that does not exist. The Department also noted that UDA and Shamrock Foods dominated the Arizona Order in terms of balancing capacity and producer milk. 58 Fed. Reg. 67705 (Dec. 22, 1993). While

there are some additional market participants in the Arizona-Las Vegas Order now, the market is still controlled by only a handful of participants, including Shamrock and UDA.

Finally, the Department was requested during the course of Federal Order Reform to address the producer-handler exemption. Submissions suggesting the curtailment or elimination of producer-handler regulations were made by United Dairymen of Arizona, Associated Milk Producers, Inc., and Vitamilk Dairy. Ex. 18, 21. These are the very same entities that have testified in this hearing, and they are using the same arguments they used in their petitions to the Department in 1996. Despite these requests, the proposed rule of April 2, 1999 made it clear that the proponents' request was denied rather than simply passed on. The Department stated that:

> It has been a long-standing policy to exempt from full regulation many of those entities that operate as both a producer and a handler. . . . Some modifications have been made to the producer-handler provisions in the consolidated orders for standardization. However, no changes have been made that would intentionally regulate a producer-handler that is currently exempt from regulation under their current operating procedures. . . . **One of the public comments received proposed that the exemption of producer-handlers from the regulatory plan of milk orders be eliminated. This proposal is denied.**

64 Fed. Reg. 16135 (April 2, 1999) (emphasis added).

Upon a review of the Order statistics in this hearing and the testimony given, there is no evidence that the marketing conditions in either of these two orders are different from January 2000 when the current regulations took effect. In any event, as discussed earlier, the two Orders must be considered in isolation.

F. The Proposed Amended Changes to the Proposals by UDA, DFA, and NDA are Not Needed To Effectuate The Terms Of The Order.

Dairy Farmers of America, United Dairymen of Arizona, and Northwest Dairy Association have submitted amended proposals which differ from the proposals published by the Department in the original hearing notice. Key changes are suggested regarding references to "sole and exclusive ownership." Purportedly, these changes are intended to "reflect the status of the modern farming operation and to address issues such as leases of property, livestock, and equipment." Changes to regulatory language are not necessary to address this situation. The Department and the Market Administrators have already dealt with this situation by treating leases as owned property where the farmer exercises control over the property as a true owner would. Complicating the matter further by rewriting and redrafting regulations for this purpose is not necessary.

The changes in the ownership and control language as proposed, narrows who may qualify as a producer-handler even to the point of prohibiting qualification. For example, proposed §1131.10(a)(4) prohibits a producer-handler from even indirect association with or the holding of a financial interest in another handler's operation. While the language proposed would prevent such an indirect, non-management interest, the testimony elicited from Elvin Hollon by USDA both explains how difficult the proposed language would be to enforce and also what the proponents hope to accomplish with their seemingly innocuous change:

> Q. -- Number 4, "The producer-handler is neither directly nor indirectly associated with the business control or management," et cetera, it's almost an administrative question, but how deeply or how -- in your opinion, how detailed should we consider ownership, for example if a producer-handler owns stock in Eltree [sic, Altria], Kraft

is a handler --

A. Okay.

Q. -- is one share of Kraft -- or one share of Eltree [sic, Altria] something that should be considered disqualifying? In other -- it seems to be a little trivial, in this -- that instance, but that's --

A. That's a fair question. I would say, in that example, no, that that probably should not disqualify. In all cases there's probably going to be some level of judgment that is going to have to be applied, and we've had quite a bit of discussion with some of the market administrator staffs over these particular issues, and, you know, in some cases things are fairly clear, there may be a certain amount of -- there would be some legal filings, that would indicate some kind of common ownership, that would be a factor, some -- it gets to be harder. Some cases, you can tell that there is, you know, management control in some form exercised over different operations. So -- if there's a -- for example, your example of company A and a share in another company, there's probably not much opportunity to influence the management of Kraft, in that example, by the producer-handler. If there is an opportunity -- an opportunity to influence and there could be some legal connection, I think that might be an indication of how deep the market administrator might dig to examine that.

Q. Following up just a little bit -- well, the ownership business, that's described in the next section -- actually, I believe it's below, but -- where leasing would now be allowed, and I assume leasing in both directions, for example if a producer-handler owned property that was to be leased to -- for a shopping center, where an anchor

store would be a Safeway, a Kroger, some other publics [sic, Publix], whatever, again --

A. That would be, I think, too distant.

Q. Okay. I'm trying to get a handle on how a market administrator would administer, literally, this kind of a provision. We have a lot of land and property holders who are also producer-handlers, so I'm just trying to get a handle on where the intent goes here and --

A. I think -- again, that's a difficult question to answer, and part of that's why you're asking.

Q. Right.

A. It seems like that where the two direct businesses, being a producer and being a procedure, have some common business link and where there can be some influence, you know, again, just using that as an example, back to -- that producer-handler would not have a -- exert a lot of influence over Safeway, you know, over what their -- how they run their business. On the other hand, if it were a single convenience store, there might be some relationship there. The percentage of ownership, leasing a piece of property would be small, but being involved in the ownership of the store might be somewhat larger.

Hollon, 2821-23.

In today's modern commercial dairy enterprises, there are a multitude of financial transactions going on between producers including the buying and selling of cattle and feed, pooling of feed inputs, and other transactions in which it could be argued that there is an indirect financial

interest. Aside from the proponents' unabashed disdain for producer-handlers and their desire to totally eliminate them from the face of the Earth, the proposed language has no meaning or purpose. The simple definition of the producer-handler having all the risks of the producer and all the risks of the handler is sufficient to determine whether an enterprise qualifies as a producer-handler. Much of the broad language proposed by UDA, NDA and DFA was rejected by the Department in the creation of the New Mexico-West Texas Order and was eliminated in order reform form language that had appeared in predecessor orders to the Pacific Northwest and New York-New Jersey. The language is so broad and intrusive that the only way for the Department to truly enforce it to the extreme requested would mean that the Department would be regulating producers as producers.

Also, in the area of indirect financial interest, the ever present familial tie could interfere with the ability of a producer-handler to qualify. There is no dispute that within the modern commercial dairy operations, the family relationships between producers is ever present. To ensure that there was no indirect relationships, the Market Administrators would be required to examine intricate and intimate financial arrangements among family members. This intrusion into non producer-handler business affairs is beyond the experience of the Market Administrators' offices. In the end, the simple equation of determining who is ultimately at risk is more transparent.

Arguably, under the newly proposed language, a producer handler would be prohibited from even owning stock in Dean Foods Company. In proposed § 1131.10(b)(1), the elimination of the final sentence would prohibit a farmer from owning distinct farming operations and treating one as a producer-handler operation, despite their treatment as separate entities. For example, a farmer owning farms in Arizona and Minnesota could not treat the Arizona farm as a producer-handler without processing the milk from the Minnesota farm in the same operation. The inclusion of the

words "or partially" and "or indirectly" in 1131.10(b)(2) would prohibit a producer-handler from owning any interest in a separate processing facility that operates independently of the producer-handler operation.

In the past, extensive language was present in the New York-New Jersey Milk Marketing Order and Orders in the Northwest. The intent of these provisions was to eliminate the ability of the producer-handler from riding the pool or otherwise circumventing the regulations applicable to a producer-handler. Recognizing that other safeguards are sufficient to prevent such exploitation, these regulations have been relaxed. In 1999, in promulgating the producer-handler definition that we have now, the Department wisely eliminated all of that language and should not add it today.

The Market Administrator is properly interpreting the phrase "to a wholesale customer during the month." Under the current § 1131.10(e), a producer-handler is prohibited from distributing to a wholesale customer who is service by a pool plant that supplies the same product in the same size package with a similar label to the wholesale customer during the month. Under current interpretation, the Market Administrator has been interpreting "wholesale customer" as an individual location or store. This workable definition is appropriate. For example, if a chain of grocery stores operates ten stores in the marketing area, a producer-handler is not prohibited from selling to just one of those stores. It is not obligated to supply the other nine. Some of the proponents of regulating producer-handlers would prefer an interpretation that "customer" means all stores. The reason for this is obvious. If so, producer-handlers would be prohibited from selling to chain stores. Limiting retail access to any handler, including producer-handlers, is beyond the power of the Department.

Another complaint is made regarding the fact that a producer-handler may begin shipping milk to a wholesale customer in the middle of the month. During a short period of time, it is

possible that milk of the same size package with a similar label from a pool plant will be in the cooler with the producer-handler's milk. Some have argued at this hearing that this violates a literal reading of the regulations. A literal reading, as they would propose, would require that if a wholesale customer desired to shift its sales to a producer-handler, it would have to do so on the first day of the month and that the cooler would have to be totally empty of any other product. Otherwise, the producer-handler would be subject to full regulation. The Department would be placed in the position of regulating the retail establishment. It would also promote waste and inefficiency and remove good and wholesome product from the marketplace. Complete enforcement would require the Market Administrator to be in the store to ensure compliance. This is administratively absurd. The purpose of subsection (e) is to ensure that producer-handlers do not ride the pool through the grocery stores by supplying all the milk that they can and forcing the stores to purchase their additional needs from a pool handler. The Market Administrator's current interpretation is consistent with the language of the regulation, ensures that producer-handlers are not "riding the pool" indirectly, does not promote waste, and wisely allocates the limited resources of the Market Administrator's office. The current determination of the Market Administrator not to pool a producer-handler in such a situation "for inventory" should continue. *See* Wise, 135. Note that if the proponents' suggested interpretation prevails, a producer-handler could be pooled for losing an account to a regulated handler and would prevent the retailer from deciding what supplier of milk is best for its customers and owners.

Such language does not currently appear in Order 124, and there is no need to add it now. The proponents have demonstrated little need to institute such language in the Pacific Northwest. However, if the Department decides to adopt such language for Order 124, the interpretation of the

Market Administrator should be consistent with the current interpretation used in Order 131.

Testimony was heard from producer-handlers in Order 124 about sales of surplus milk to Matanuska Maid Dairy in Alaska. One of the changes in the proposals would eliminate the ability of a producer-handler located in Order 124 to service the dairy, located in an obvious deficit market and subject the citizens of Alaska to the milk offered by NDA at higher prices. That portion of the proposals prohibiting sales as Class I milk to the non-pool distributing plant of any other handler would preclude sales by Producer-Handlers to Matanuska. Proposal 1, § 1124.10(a)(5)(ii). Provisions such as this are wholly unnecessary. This is just one more power play that should be put down as such.

G. Proposal Four Subjugates The Federal Orders To The California State Order.

Proposal Four contains language that is aimed specifically at the ability of producers to pool milk on a Federal Order while simultaneously participating in a state market-wide pricing and pooling plan. California, which borders Arizona, immediately comes to mind.

Although it is facially attractive to talk about "double dipping" between a federal and state order, a practical review of this provision shows that a producer located in California pooling milk on a handler located in Arizona would not be "double-dipping." This is because California operates at the producer price level, a quota and overbase, payment system. Under this program, all producers receive a uniform blend price in the form of the overbase. Some producers, on some of their milk, are entitled to an additional payment of $1.70 per hundredweight for their "quota" milk. Those entitled to receive payment on their quota milk have acquired this right mostly by purchase. Those producers who have moved California milk into the Arizona market, they have sold their quota, and if they again participated in California, are only then entitled to the overbase price.

The California Pooling system imposes an inherent difficulty in pooling on milk in California and a Federal Order. California producers selling milk into California are compelled to participate in the state pool and cannot choose to exempt themselves from its provisions. The California Department of Food and Agriculture has recently issued a decision that requires a producer participating in the state order to do so for a period of twelve months at a time. Therefore, California producers are saddled with a trade barrier to participation in the Federal Orders because the state system does not permit dual participation.

Additionally, the notion that a benefit can be obtained by "double dipping" is a fallacy. Assuming that a producer elects to participate in the California system as an alternative to receiving a federal Class III price for his milk, the producer would almost certainly not benefit financially by doing so. The California overbase price, on average, is lower than the FMMO Class III price. In the event that the producer would receive the California quota price, a higher value would be paid, but that additional value is not due to any marketing activity of the producer, but is obtained by the fact that the producer has already acquired ownership in California quota.

If the proposal is adopted, a producer in California would have to have a twelve month agreement with a handler in Arizona to pool all of his milk during that period of time because that producer would have to de-pool his milk from the California system. If, for any reason, the Arizona handler ceases to pool that milk, the California producer would be subjected to huge potential losses while marketing his milk as an ineligible producer in California. If he does not claim the exemption from California, and his milk is diverted to a manufacturing plant in California, the handler of his milk in Arizona is subject to an substantial reduction in the value of milk received by the handler. The penalties are such that a California producer would be effectively barred from participating in

the Arizona Order because of the penalties imposed.

Similar language to has been adopted by the Department in other Federal Orders recently, However, none of those have the close proximity of California milksheds to Arizona Plants and the ease to move milk between Arizona and California. Also, at the time that the provision was adopted for Order 124, the twelve month ineligibility, now part of the California rules, neither existed nor was being proposed.

Another difference between Arizona and the Pacific Northwest and other Orders that have adopted this provisions is that in Arizona, there is only one manufacturing plant. That plant is owned by UDA. Non-UDA producers and cooperatives who wish to supply plants in the Arizona market would be required to balance off of California plants. Efficiency would dictate that such a cooperative would obtain members in California and should not be ruled out by Federal Order regulations. In short, this proposal, will create a trade barrier, prohibiting milk from efficiently moving between the states of Arizona and California.

VI. Conclusion

At the insistence of some of the largest publicly traded corporations and cooperatives in the United States, the Department has held a hearing on the proposed change of over seventy years of Department policy regarding producer-handlers. After three weeks of hearing, a mountain of exhibits, and dozens of witnesses, the only conclusion to be drawn is that the proponents have failed to establish any evidence, let alone the substantial proof required to justify a change to the Department's long-standing policy regarding producer-handlers. No matter how much money the proponents spend, no matter how often they repeat the same phrases, the bottom line is that there is nothing that has changed since order reform that would warrant the adoption of the proposals.

Enough is enough.

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CERTIFICATE OF SERVICE

The foregoing was Statement was served upon the following parties on August 2, 2004, by electronic mail, FedEx Overnight Service, and /or first-class United States Mail service as indicated.

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