UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

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

POST - HEARING BRIEF FOR

CALIFORNIA DAIRIES, INC.,

DAIRY FARMERS OF AMERICA, INC., and

LAND O'LAKES, INC.

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I. INTRODUCTION

After months of preparation, thousands of pages of submissions, and forty days of lay and expert witness testimony, including personal statements by the affected milk producers in California, it is clear that California, which is responsible for over 20% of the nation's milk production, must be brought under the Federal Milk Marketing Order ("FMMO") system in order to enhance California producer income and maintain orderly market conditions and an orderly supply of milk.

The failure of California regulations to establish minimum prices for California producers which reflect national values for classified milk uses has cost California dairy farmers a California discount of more than $1.5 billion dollars since 2010. The milk marketing system in California has been failing for some time now. After trying to restore order to the system through other methods, and being repeatedly rebuffed at each attempt, California dairy producers have now invoked their Congressionally granted right to petition the Secretary of Agriculture ("Secretary") to intervene and issue an FMMO covering California. A California FMMO is necessary in order for California dairy producers to obtain the full nationally defined value for all uses of milk produced in the state.

The California FMMO contained in Proposal No. 1[1] will not only enhance producer income and promote and maintain orderly marketing conditions, but will also address longstanding conditions of disorderly marketing. It is also the only proposal before the Secretary which advances the clear expectation of Congress in 7 U.S.C.

[1] All references to Proposal No. 1 refer to Proposal No. 1, as modified, unless otherwise indicated.

section 7253 (the "Farm Bill") that a California FMMO recognize quota value. The California FMMO represented in Proposal No. 1 is necessary to bring the California dairy industry into the federal system of national class prices for dairy farmers and processors in the state, and to promote and maintain orderly marketing conditions.

A. Proponents Of A California FMMO.

The proponents of Proposal No. 1, California Dairies, Inc., Dairy Farmers of America, Inc., and Land O' Lakes, Inc. (collectively, the "Cooperatives" or "Proponents"), represent, collectively, 75% of the milk produced in California.

California Dairies, Inc. ("CDI") is a California dairy marketing and processing cooperative owned by its 390 dairy farmer member-owners located throughout California. Its members produce 18 billion pounds of milk annually, which represents approximately 45% of the milk produced in California. CDI owns processing plants in six locations in the state that, in 2015, produced approximately 38 million pounds of butter and approximately 785 million pounds of powdered milk products. Its products are marketed throughout the United States and internationally.

Dairy Farmers of America, Inc. ("DFA") is a national dairy marketing and processing cooperative owned by almost 14,000 dairy farmers located throughout the United States. In California, DFA represents 260 dairy farmer members located throughout the state, and owns and operates processing facilities in Hughson, Turlock and Ventura. Its products are marketed throughout the United States and internationally.

Land O' Lakes, Inc. ("LOL") is a national dairy marketing and processing cooperative with over 2,200 dairy farmer member-owners. LOL has a national membership base, whose members are pooled on the California system and five

different FMMOs. Land O'Lakes members own several cheese, butter powder and value-added plants in the upper Midwest, East and California. Currently, its 200 California member-owners supply LOL with over 16 million pounds of milk per day that are primarily processed at LOL's two California plants located in Tulare and Orland. LOL also operates a dairy dessert plant in Turlock, California. It markets its products throughout the United States and internationally.

But the Proponents are not the only supporters of a California FMMO. The near unanimous support for Proposal No. 1 by all producer segments of the California dairy industry is unprecedented. Support at the hearing was voiced not only by the petitioning cooperatives, but also by the three largest California dairy trade organizations – Western United Dairymen, Milk Producers Council, and California Dairy Campaign – which represent the vast majority of California dairy farmers, and by nearly every California producer that testified at the hearings. Independent producers also testified in support of a California FMMO. Not one California producer organization voice was heard in opposition.[2] The producers have spoken, and they want and need a California FMMO.

B. Overview Of Need For FMMO.

California's unique milk regulatory and producer pricing scheme began over 80 years ago with the enactment in 1935 of the Young Act that provided for

[2] Mr. James Ahlem is both a producer and a handler as co-founder of Hilmar Cheese, and thus not in the same position as all the other testifying producers. While Mr. Ahlem testified that he had some concerns about Proposal No. 1, he noted that the regulatory instability in California over the last six years motivated him to locate a new plant in Texas. It is important to note that not one producer for Hilmar Cheese (without an ownership stake in Hilmar) testified against the issuance of an FMMO.

establishment of a classified minimum pricing scheme. There followed over the years refinements and enhancements to the system – component pricing, classified pricing based on finished product prices/values, formula pricing – culminating in the most unique features of the California program: marketwide pooling and the establishment of quota.

The California system worked reasonably well for many years, protecting the interests of dairy farmers, handlers and consumers alike. But in recent years, the system has become dysfunctional. California minimum producer prices, particularly those for milk used to produce cheese, began to diverge sharply below the nationally uniform prices established by the nation's FMMOs under which approximately 82% of the nation's milk production outside of California was priced. This divergence significantly contributed to the inability of California's minimum prices to cover the costs of production. The resulting dysfunction has caused economic stresses that accelerated the flight of producers from dairy farming and the conversion of dairy farm land. Those often multi-generation dairy farmers have been forced to transition to more economically sustainable regions to establish dairy farms or to other, more reliable and economically viable agricultural pursuits such as almonds.

The failure of California's system to regulate out-of-state milk shipped to California plants due to interstate Commerce Clause concerns exacerbated the frustration of California's dairy farmers. The dairy farmers' multiple efforts to seek redress from the price discrepancies were usually rebuffed, in whole or in part, by the California Secretary of the Department of Food and Agriculture, save a temporary and inadequate one year adjustment in the Class 4b price for milk utilized for cheese,

effective August 1, 2015. However, this temporary, limited-scope fix is not enough to repair the dysfunction in California's milk marketing system, and California producers must turn to their Congressionally granted right to petition the Secretary for a California FMMO.

The U.S. Congress clearly grasped the importance of bringing California into the FMMO system. In both the 1996 Farm Bill, and its re-adoption in 2014, Congress provided that "[u]pon the petition and approval of California dairy producers," the Secretary shall designate California as a separate Federal milk marketing order, which shall have the "right to reblend and distribute receipts to recognize quota value." 7 U.S.C. § 7253. Congress had never, prior to the 1996 Farm Bill, specifically referred to establishment of an FMMO for a particular area or a particular state. Nor had Congress ever in the past directed the Secretary to include in an FMMO provisions recognizing a value or right created under state law. These legislative enactments clearly demonstrate a strong Congressional interest that California join the FMMO system, as well as Congress' understanding that recognition of quota value is essential to California dairy farmers.

C. Overview Of Legal Argument For A California FMMO.

The provisions of the 2014 Farm Bill are unique, expressing a strong Congressional intent that California, with the nation's largest dairy production, be brought into the FMMO system. Accordingly, Congress, in enacting the Farm Bill, made the issuance of a California Order mandatory upon petition and approval by the producers, without requiring any further showings regarding the state of the industry.

The Cooperatives have shown that a California FMMO will effectuate the goals of the Farm Bill and the Agricultural Marketing Agreement Act ("AMAA"). The

Cooperatives have requested issuance of an order for the enhancement of producer prices and to "establish and maintain . . . orderly marketing conditions" and "an orderly flow of the supply" of milk to market. 7 U.S.C. § 602(1-4). Under the express terms of the AMAA, the Cooperatives need only show that the order will effectuate these goals. The Cooperatives have met this burden.

Even were any showing of disorder necessary, the Cooperatives have also made this showing. The price inequity of the California system versus the FMMO system has been a significant contributor to the distress of the California dairy producers, evidenced by the decrease in the number of dairies and land devoted to dairies in California, and repeatedly testified to by California dairy farmers throughout this hearing.

Pursuant to their right under the Farm Bill, the Cooperatives have petitioned the Secretary for issuance of a California FMMO. The Farm Bill requires that upon petition and approval of California dairy producers, the California FMMO must recognize existing quota value. This state-specific carve-out explicitly grants California a right not granted any other FMMO under the supervision of the federal government. The Cooperatives' Proposal No. 1 is the only one which recognizes quota value in these terms, consistent with the language of the Farm Bill.

In addition to recognizing quota value, Proposal No. 1, marshalling the express authority of the AMAA (7 U.S.C. § 608c(5)(B)), brings FMMO minimum, uniform national prices for "**all**" milk uses to California, requiring "**all**" milk processors to pay these prices, and providing to "**all**" producers, the resulting pooled value "**irrespective of the use** to which" the individual producer's milk is put. (emphasis added.)

Furthermore, Proposal No. 1, as modified herein, allows non-California producers to participate in the California FMMO pool values without their return being diminished by the California quota program. The proposal provides a robust transportation credit program, applicable to milk from all locations, supporting the movement of milk for the higher-valued Class I and II uses from high production areas to high demand areas, thereby sharing the cost of supplying the pooled Class I and II values. All of the terms of the proposed order are expressly authorized by the AMAA and none violate the AMAA's proscription of trade barriers as there is no prohibition on the marketing of milk or limitation in the marketing of any milk products erected under the Proposal.

The Cooperatives urge adoption by the Secretary, pursuant to the authority granted by the AMAA and the Farm Bill, of a California FMMO incorporating the provisions of Proposal No. 1, with the modifications described in this brief.

II. THE RECORD OVERWHELMINGLY DEMONSTRATES THE NEED FOR A CALIFORNIA FMMO.

The California milk marketing system is deteriorating, and without intervention, the future of California producers is in peril. As the near unanimous testimony on the record shows, the system dysfunction is crippling California producers and fails to address their disadvantaged position in the national market place. The California system fails to regulate interstate transactions and is not uniform with national prices. The evidence is clear that California producers want and need a California FMMO.

A. California Dairy Farmers, Cooperatives, And Trade Associations Support A California FMMO.

1. California Dairy Regulatory History

California is the largest milk producing state in the U.S., with more than 20% of national production. (Exh. 19, p. 4.) According to United States Department of

Agriculture ("USDA") statistics, California is the country's leading dairy state. (*Id.*) In spite of its significance nationally, California has been the most important region in the country which has not been part of the FMMO system.

California has regulated milk producer pricing under its own statutory and regulatory scheme since its adoption of the Young Act in 1935. (Exh. 42, pp. 3-4.) However, until the adoption of the Gonsalves Milk Pooling Act in 1967 ("Pooling Act"), and its implementation in 1969, the California system did not provide for marketwide pooling of producer revenues. (Exh. 42, p. 5.) Mandatory pooling under the Pooling Act brought with it producer quota. Quota, ever since its original issuance, has constituted an important capitalized and marketable balance sheet asset and a reliable guaranteed income stream for California dairy farmers. (Exh. 42, p. 2.) Testimony by Mr. Lon Hatamiya ("Mr. Hatamiya") has established that as of January 2015 there were 2,215,977.6 pounds of quota solids-not-fat holdings at a value of $1,163,388,061 (Exh. 54, p. 14.) Under the Pooling Act and Pooling Plan Sections 500-504 ("Pooling Plan"), quota can be transferred, bought and sold. (Exh. 42, pp. 17-18.) From the outset of pooling, there has been an active market for selling and buying quota. Currently, a significant portion of quota held by California producers has been purchased by them and represents significant capitalized investment. (Exh. 42, pp. 20-22.)

In general, quota grants a right to a California producer to receive an enhanced price increment for "market milk" (virtually identical in definition to "Grade A" milk) sold that is covered by the amount of quota held by the producer over and above, and in addition to, the pool blend prices for such milk (hereinafter, the "quota premium"). (Exh. 42, p. 22.) The recognition of the importance of California's pooling and quota

system to California dairy farmers is emphasized by Pooling Act section 62712(e), which provides that the Pooling Plan can neither be substantively amended nor terminated without producer assent at a referendum by prescribed majorities. (Exh. 42, pp. 9-10, 22-23.)

For many decades, the California Department of Food and Agriculture ("CDFA") has administered a state order and has reasonably balanced industry interests to the satisfaction of California's dairy farmers. In recent years, however, U.S. milk markets have become more regional and national in scope, and FMMO regulations have evolved with those developments, while regulations in California have not responded to the shifts taking place in the national marketplace. (Exh. 19, p. 5.)

In 2014, Congress provided a necessary prerequisite for correcting this condition when it re-authorized the language in the 1996 Farm Bill allowing the USDA to promulgate a California FMMO while retaining the California state quota program. That Congressional authorization makes clear that a California FMMO will have all the benefits and characteristics of the other ten FMMOs, while maintaining the unique California system of sharing milk sales revenues through the state quota program. 7 U.S.C. § 7253.

2. Financial Dysfunction Impact On Producers.

As was made clear at the hearing, California dairy farmers are suffering significant and likely terminal financial burdens under the current California system. Linda Lopes of Turlock testified that the California dairy business "at this moment is disintegrating before [the dairy farmers'] eyes." (Lopes Tr. Vol. XXXIV, p. 6796 (Nov. 10, 2015).) Producer Joey Fernandes of Tulare explained that California producers already face challenges from "drought, regulation, and competing higher value crops," but

admitted that their "ability to compete is most hindered by [their] disparity in milk price." (Fernandes Tr. Vol. XVII, p. 3398 (Oct. 16, 2015).) And, several witnesses testified that the current pricing structure in California is not sustainable. (Kasbergen Tr. Vol. V, p. 960 (Sept. 28, 2015); Vanden Heuvel Tr. Vol. XXXII, p. 6558 (Nov. 6, 2015); C. Medeiros Tr. Vol. XXXVII, p. 7524 (Nov. 13, 2015).)

In fact, according to just about every producer who testified, the financial burdens of this dysfunctional system are leading to an unprecedented decline in dairy farms, milk production, and "the demise of an industry that was once the envy of the world." (Kasbergen Tr. Vol. V, p. 960 (Sept. 28, 2015).) According to the producers, California dairy farmers "have reached [their] limit," they are "no longer the most efficient kid on the block," and they "can't afford it anymore." (Vanden Heuvel Tr. Vol. XXXII, p. 6558 (Nov. 6, 2015).)

More troubling is the sheer volume of testimony about the rapid closure or abandonment of dairy farms in California due to the financial burdens placed on California producers. Antoinette Duarte of Elk Grove explained that the reason they have "lost a lot of dairies is the volatility. There's quite a few young dairymen who could not stay in business any longer. They did not see a light at the end of the tunnel." (Duarte Tr. Vol. XXXIV, p. 6805 (Nov. 10, 2015).) Other witnesses testified to "a huge amount, an exodus" of dairy farmers, maybe to the tune of "a dairy a week going out." (Tollenaar Tr. Vol. VI, p. 1209 (Sept. 29, 2015); Vanden Heuvel Tr. Vol. XXXII, p. 6561 (Nov. 6, 2015).) James Netto testified that "California has not had a new dairy built in five years," and all "the existing dairymen are just hanging on, fixing this, fixing that, and continuing to try to survive in the business." (Netto Tr. Vol. XXXV, p. 7174 (Nov. 11,

2015).) Joaquin Contente of Hanford testified that they have "lost already over 16 dairy farms that are gone forever." (Contente Tr. Vol. VI, p. 1300 (Sept. 29, 2015).) In fact, "they have had some very good top registered herds sold out, good operators that decided to throw in the chips, and they have seen a reduction in [their] milk production in this state." (Contente Tr. Vol. VI, p. 1301 (Sept. 29, 2015).) According to Case Van Steyn, California continues to have sales of dairies going out of business on a regular basis, there are shortages of milk in California with most processors, and it is likely to get worse." (Van Steyn Tr. Vol. XXXVIII, p. 7758 (Nov. 16, 2015).)

The demoralization of producers under this system is clear and nearly crippling. Dino Giacomazzi feels like a victim, while he sees the rest of the nation's producers empowered to manage their farms and industries. (Giacomazzi Tr. Vol. XXV, p. 4965 (Oct. 28, 2015).) Barbara Martin testified to the "scars, those wounds," of having to surrender to the financial burdens, and cling to small parcels of once large farms that could remain viable. (Martin Tr. Vol. XXIII, p. 4614 (Oct. 26, 2015).)

3. Need For National Market Level Playing Field.

One of several fundamental facts that the producers put forward in near unanimity was that the discrepancy between California prices and those of the FMMO system makes it impossible for them to compete, puts them at an unfair disadvantage in the marketplace, and must be addressed if California dairy farms are to survive.

George Mertens of Sonoma testified that "[it] is difficult to understand why the California 4b milk price is so much lower than the federal order Class III price, but not too hard to feel some of the impact. It is difficult to compete for milk production inputs with other dairies in other region of the country, when [California] prices are not in a reasonable relationship with theirs." (Mertens Tr. Vol. VI, p. 1174 (Sept. 29. 2015).)

The math on the discrepancy is not debatable; if the FMMO had been in place in California, dairy farmers would have been paid "at least a dollar more per hundredweight." (Lopes Tr. Vol. XXXIV, p. 6797 (Nov. 10. 2015); Adams Tr. Vol. XXXV, p. 7188 (Nov. 11, 2015); Verburg Tr. Vol. XXXI, p. 6211 (Nov. 5, 2015).) According to Geoffrey Vanden Heuvel, California dairy farmers can no longer live with California using its police power to discount California regulated prices relative to the federal prices; "it's inappropriate, it's always been inappropriate in my opinion, and now the whole producer sector has come to that point of view." (Vanden Heuvel Tr. Vol. XXXII, p. 6571 (Nov. 6, 2015).)

California producers do not want an advantage, just a level playing field with the nation's producers. The testimony is clear, the California producers simply want to be "in line with other producers throughout the federal system." (Lopes Tr. Vol. XXXIV, p. 6797 (Nov. 10, 2015).) According to Cornell Kasbergen, "being on a level playing field with the rest of the country is the answer." (Kasbergen Tr. Vol. V, p. 960 (Sept. 28, 2015).) No witness made the issue clearer than James Netto. Mr. Netto just wants a chance to compete: "I think every dairyman in California ought to be able to wake up in the morning and compete with everybody across the U.S. . . . We're not saying give us more money, we're saying, put us in the game, Coach, get us off the bench." (Netto Tr. Vol. XXXV, p. 7165 (Nov. 11, 2015).) The level playing field, as Michael Oosten testified, is "the foundation of what orderly marketing . . . should be." (Oosten Tr. Vol. XXXVIII, p. 7775 (Nov. 16, 2015).)

Jared Fernandes and Dino Giacomazzi further testified about the impossibility of using futures to hedge producer milk price risk under the California system as compared

to producers under FMMOs. (Fernandes Tr. Vol. V, p. 998 (Sept. 28, 2015); Giacomazzi Tr. Vol. XXV, p. 4962-3 (Oct. 28, 2015).) Mr. Fernandes enrolled into a two-year risk management class, and hired a risk management consultant to assist him in hedging. (*Id.* at 1002-1003.) The consultant works with dairies throughout the USA and has repeatedly indicated that hedging would be more straightforward with reduced basis risk if California could institute an FMMO. (*Id.* at 1003.) Mr. Giacomazzi sat on the Dairy Futures Task Force, and took two years of risk management courses, and still has abandoned futures hedging. (Giacomazzi Tr. Vol. XXV, p. 4960 (Oct. 28, 2015).)

As Mr. Fernandes and Mr. Giacomazzi testified, California dairy producers are at a disadvantage in terms of managing price risk due to an inherent basis difference regarding the hedging instrument, the Class III milk futures contracts, through the Chicago Mercantile Exchange ("CME"). (Fernandes Tr. Vol. V, p. 998 (Sept. 28, 2015).) One of the primary difficulties that California producers have faced in terms of managing the risk is their disconnection from the CME. (Giacomazzi Tr. Vol. XXV, p. 4962 (Oct. 28, 2015).) Unlike the more stable basis in the FMMOs for hedging and risk management purposes, the basis is highly volatile and unpredictable month to month in California. (Fernandes Tr. Vol. V, p. 999 (Sept. 28, 2015).) The transition from the California system to an FMMO will add another tool for California dairy farmers to manage their milk price risks. (*Id.* at 1002.)

Finally, the parity of California producers with producers nationwide under the FMMO system will also mean that they can avoid "ongoing difficulties with Interstate Commerce [that have] also been an issue between the California Order and Federal

Milk Marketing Order system over the years." (Maddox Tr. Vol. XVI, p. 3181 (Oct. 15, 2015).)

4. Necessity Of Preserving Quota In A California FMMO.

Unique to California dairy farmers is their unity of opinion on the need to preserve the California quota system. The foundational nature of quota to a California FMMO is clear; it gave and continues to give California producers "peace of mind to focus on the production of milk." (Doornenbal Tr. Vol. XXXII, pp. 6505-6506 (Nov. 6, 2015).)

Witnesses testified to the significant investments made in reliance on quota value and how devastated California dairy farmers will be by any Proposal that seeks to diminish or ignore quota value. Many producers have based their business decisions and company modeling on preserving their quota holding. Linda Lopes testified that people have spent a lot of money buying quota, and that must be compensated. (Lopez Tr. Vol. XXXIV, p. 6801 (Nov. 10, 2015).) James Netto and Cornell Kasbergen testified to the hundreds of millions and even a billion dollars of asset value currently tied to quota holdings. (Netto Tr. Vol. XXXV, p. 7169 (Nov. 11, 2015); Kasbergen Tr. Vol. V, p. 962 (Sept. 28, 2015).) Even Frank Otis, representing producer-handler Foster Farms, testified that Foster Farms has specifically structured its family-owned business to preserve its exempt quota holding, including the investment of hundreds of millions of dollars in capital spending in the dairy farms, processing facilities, and distribution centers over the last 50 years." (Otis Tr. Vol. XXXVI, p. 7305 (Nov. 12, 2015).)

And, regardless of the amount of quota held or the methods undertaken for preserving quota, the California producers agree that the quota system must be maintained in the FMMO. It would be unfair to ignore its value. (Lopez Tr. Vol. XXXIV, p. 6800 (Nov. 10, 2015).) Worse than the unfairness, the failure to maintain quota

"would be devastating to [Roger Fluegel] and a number of [his] fellow dairymen." (Fluegel Tr. Vol. XXV, p. 2978 (Oct. 14, 2015).) Joe Machado of Hanford does not own a single pound of quota, but still testified that "it is very important that we protect [quota]" (Machado Tr. Vol. VI, pp. 1312-1313 (Sept. 29, 2015).)

5. Pervasiveness of Desire for FMMO.

The near unanimity of California producers on their petition for an FMMO may be the strongest evidence of its necessity. Roger Fluegel, who has insight provided by owning a dairy in both Wisconsin and California, testified that the majority of [his] fellow dairymen support the petition for an FMMO and specifically Proposal No. 1. (Fluegel Tr. Vol. XXV, p. 2978 (Oct. 14, 2015).) In fact, over the course of the 40 days of testimony, all the following California producers, who are located in different counties, with different size farms, some with and some without quota, testified that they agree an FMMO must issue if California dairy farmers are to survive: Rien Doornenbal, Linda Lopes, Antoinette Duarte, James Netto, Lantz Adams, Michelle Adams, Rick Adams, Cornell Kasbergen, Xavier Avila, George Mertens, Sieste Tollenaar, Scott Magneson, Joaquin Contente, Joe Machado, Mark McAfee, Roger Fluegel, Simon Vander Woude, Stephen Maddox, Joey Fernandes, Jared Fernandes, Dino Giacomazzi, Noel Rosa, Barbara Martin, Jacob Verburg, Geoffrey Vanden Heuvel, Richard Shehadey, Melvin Medeiros, Christina Medeiros, Joseph Airoso, Case Van Steyn, Michael Oosten, and Tom Barcellos.

Support at the hearings was voiced not only by the dairy farmers themselves, but also by the Proponent Cooperatives, and by the three largest California dairy trade organizations – Western United Dairymen, Milk Producers Council, and California Dairy Campaign – that represent the vast majority of California dairy farmers.

If anything is clear from this show of evidence, it is that the producers of California know their system is broken, they want a California FMMO, and the future of milk supply and orderly market conditions hang on the issuance of that order.

B. Market Conditions Dictate The Issuance Of A California FMMO.

The need for an FMMO for California is also clear from the evidence before the Secretary regarding the inability of the California system to repair pricing disparity, to maintain market integrity and to address the complex issues resulting from nationalization of the market place.

1. Producer Prices Under The California System Fall Far Below Prevailing FMMO Prices.

Because the California dairy industry is regulated outside the national FMMO pricing and marketing grid, there is significant producer price misalignment with the USDA standard of uniformity and equity in both producer and handler prices. The Cooperatives presented evidence from Mr. Elvin Hollon ("Mr. Hollon") of this disparity in their comparison of the Mailbox Milk Price ("MMP") series published by the Agricultural Marketing Service ("AMS"). (Hollon Tr. Vol. IV, p. 803 (Sept. 25, 2015).) The MMP reflects the net pay prices received by dairy farmers for milk, and reflects all payments received for milk sold and all costs associated with the marketing the milk. (Hollon Tr. Vol. IV, pp. 804-5 (Sept. 25, 2015).)[3]

The Cooperatives isolated the three states (Wisconsin, Minnesota and Illinois) that comprise the majority of the upper Midwest Order marketing area with high

[3] Since the MMP is an at-test price, Mr. Hollon adjusted the price for components in each region to the FMMO standard for butterfat of 3.5%, for protein of 2.9915%, and for other solids of 5.6935% in order to arrive at a standard price for comparison.

production of cheese, butter and nonfat dry milk ("NFDM") and lower Class I utilization of milk. This region, as the DIC itself admitted, bears striking similarities with the California market. (Hollon Tr. Vol. IV, p. 804 (Sept. 25, 2015); Zolin Tr. Vol. XXVI, pp. 5214, 5233, 5256-7, 5791-6, 5911 (Oct. 29, 2015); Blaufuss Tr. Vol. XXVII, p. 5494 (Oct. 30, 2105); Steeneck Tr. Vol. I, p. 89 (September 22, 2015).) They also selected the Northwest States series composed of data from Oregon and Washington for comparison. Like Order 30 and the California market, the Northwest States have significant manufactured dairy product output, and are similarly situated geographically as Western states facing similar competitive situations in the marketing of manufactured dairy products to both eastern domestic markets and westward export markets. (Hollon Tr. Vol. IV, pp. 805-6 (Sept. 25, 2015).).

Despite the many similarities, these two marketing regions (upper Midwest and Northwest States) do not have a similar MMP to the California market. The Cooperatives presented evidence based on the most recent data available prior to the July 2015 hearing. (Hollon Tr. Vol. IV, p. 806 (Sept. 25, 2015).) For the recent period of August 2012 - May 2015, there were 34 monthly observations from the similar regions. (Hollon Tr. Vol. IV, pp. 807-8 (Sept. 25, 2015).) For the 34 months and the four MMP regions for comparison, in no month did California have a higher or even close to equal MMP to the two most similar regions. (Hollon Tr. Vol. IV, p. 808 (Sept. 25, 2015).). The average difference over all observations was $1.85 per hundredweight lower. (*Id.*) The single largest difference was minus $4.27 (Wisconsin 12/2012) and the narrowest was minus $.43 (Northwest States 03/2015.) (*Id.*) The California region averaged $2.12 per hundredweight lower than the Wisconsin region for the 34 months; it was $2.05 lower

than the Minnesota region; it was $2.22 lower than the Illinois region; and it was $1.01 lower than the Northwest region. (*Id.*) Using the MMP as a proxy for producer prices shows there are wide differences for farms in similarly situated regions of the U.S. (*Id.*)

The California system returns a different, lower, price to producers in the proposed marketing area than a California FMMO price under Proposal No. 1 will yield. (Hollon Tr. Vol. IV, p. 823 (Sept. 25, 2015).) These price differences reflect a marketing situation where milk buyers and producers in California are subject to different minimum pricing conditions than similarly situated producers and processors in other parts of the country, instead of a single uniform pricing grid. (*Id.*)

2. California Class Prices Do Not Conform To The Uniform National FMMO Prices.

The failure of California regulations to establish minimum prices to California producers which reflect national values for classified milk uses has cost California dairy farmers more than $1.5 billion since 2010. (Hollon Tr. Vol. IV, p. 796 (Sept. 25, 2015).). While both systems use classified prices, the class definitions are not identical, and those differences are a cause of disorderly marketing. The various underlying commodity price series, the effective dates for determining the prices used in the formulas, the yield constants, and the make allowances are not identical, and the flux is a cause of disorderly marketing. (Hollon Tr. Vol. IV, p. 8105 (Sept. 25, 2015).) The fact that minimum base class prices and resulting dairy ingredients prices use different underlying dairy product commodity prices and different periods to determine the base prices impacts milk marketing decisions, and causes disorderly marketing. (Hollon Tr. Vol. IV, pp. 810-811 (Sept. 25, 2015).)

Generally, Class I (1 in California) represents milk consumed in fluid form. (Hollon Tr. Vol. IV, p. 809 (Sept. 25, 2015).) The Class I price surface has a differentiated regional bias and not a uniform national surface. (Hollon Tr. Vol. IV, p. 8135 (Sept. 25, 2015).) The FMMO adopted Class I pricing structure utilized the United States Dairy Sector Simulator ("USDSS") model results adjusted for all known plant locations, and established differential levels that will generate sufficient revenue to assure adequate supply of milk, while maintaining equity from among handlers in the minimum prices they pay for milk bought from dairy farmers. (Hollon Tr. Vol. IV, p. 815 (Sept. 25, 2015).) In the higher population zones, the California system Class 1 price is below the FMMO grid for all years and periods measured. (Hollon Tr. Vol. IV, p. 821 (Sept. 25, 2015).) For the most recent period of August 2012 to July 2015, the shortfall is $.37 and $.27 per hundredweight. (*Id.*)

Class II (2 and 3 in California) represents milk products such as cream-based items, ice cream and ice cream mixes, yogurt, dips, cultured products, cottage cheese and milk used to produce items such as evaporated and condensed milks. (Hollon Tr. Vol. IV, p. 809 (Sept. 25, 2015).) The FMMO system includes all these products in a single class while the California system divides them into two classes. (*Id.*) While the California system Class 2 and Class 3 classifications include essentially the same products as the FMMO Class II classification, there are disorderly marketing implications resulting from regulatory differences which do not reflect market fundamentals. In the California system, announced Class 2 and 3 prices apply for two months at a time and are based on butter and milk powder commodity price averages from the prior two months. (Hollon Tr. Vol. IV, p. 828 (Sept. 25, 2015).) The FMMO

Class II price is announced monthly and is based on data from the prior month. (*Id.*) Market conditions can change swiftly, and, in some cases, noticeably, over the four-month period spanned by this calculation under the California system. (*Id.*) Cream, condensed skim milk, and sweetened condensed skim milk, are dairy ingredients commonly used in many products and product formulations which then carry Class II (2 or 3 in California) classifications. (Hollon Tr. Vol. IV, p. 829 (Sept. 25, 2015).) These Class II products are transported long distances in bulk tankers, and deliveries of hundreds or even thousands of miles are not uncommon. (*Id.*) Because of the bulk nature of these condensed products, they are more prone to opportunistic situations. (*Id.*) These FMMO versus California price differences can create disorderly market conditions when dairy ingredients enter distant markets, generally on a spot basis, to exploit short-term price disparities. (*Id.*)

Milk used to produce cheese and whey products is Class III (4b in California). (Hollon Tr. Vol. IV, p. 809 (Sept. 25, 2015).) Since 2007, the California system has changed the whey component pricing factor contained within the Class 4b formula three different times. (Hollon Tr. Vol. IV, p. 811 (Sept. 25, 2015).)[4] During this period, the Class III price has exceeded the Class 4b price 161 times. For the entire period, January 2000 to July 2015, the difference averages minus $.91 per hundredweight, but the range of difference has increased significantly in recent years. (Hollon Tr. Vol. IV, p.

[4] There was another price formula change that became effective August 1, 2015. (Hollon Tr. Vol. IV, p. 812 (Sept. 25, 2015).) That change was intended to increase the 4b price and increase producer mailbox prices but had very limited effect. That change is temporary and expires July 31, 2016. (*Id.*) As it is temporary and can only be extended through the result of another hearing, its long term impact is both tenuous and not known. (*Id.*)

835 (Sept. 25, 2015).) Between January 2000 and November 2007, the difference averaged minus $.39. Between December 2007 and August 2011, the difference was minus $.91. (*Id.*) Between September 2011 and July 2012, the average difference was minus $2.22. And between August 2012 and July 2015, the average difference was minus $1.89. (*Id.*) There were no years where on an annual basis the average California system price was greater than the FMMO price. (*Id.*) The widest single month difference was in November 2014 where the 4b price was $3.24 per hundredweight less than the FMMO Class III price. (*Id.*)

It is difficult to accept or explain class price differences of this magnitude for what amounts to deliveries to plants manufacturing identical products and sold into similarly situated markets. (Hollon Tr. Vol. IV, p. 838 (Sept. 25, 2015).) Cheese and whey products produced in California plants and priced using the California system prices are marketed and sold nationwide directly alongside similar products produced in FMMO areas priced under FMMO terms. (Hollon Tr. Vol. IV, p. 839 (Sept. 25, 2015).) The difference in pricing results solely from different regulations and not market fundamentals. (*Id.*) This clearly does not promote orderly marketing conditions. (Hollon Tr. Vol. IV, p. 839 (Sept. 25, 2015).)

3. The California System Has Not Kept Up With The Nationalization Of Dairy Markets.

In recent years, U.S. milk markets have become more regional and national in scope, and FMMO regulations have evolved with those developments. However, regulations in California have not responded to the shifts taking place in the national marketplace. (Hollon Tr. Vol. IV, p. 801 (Sept. 25, 2015).)

The FMMO manufacturing class prices are different from the California system prices, and the differences led, in part, to Proponents' petition because they are a source of disorderly marketing. (Hollon Tr. Vol. IV, p. 825 (Sept. 25, 2015).) The FMMO manufactured pricing grid results in uniform national prices. (Hollon Tr. Vol. IV, pp. 825-6 (Sept. 25, 2015).) There is only one monthly price for the entire grid. (Hollon Tr. Vol. IV, p. 826 (Sept. 25, 2015).) The FMMO prices are national prices because the markets they compete in are national in nature, even though there are clear regional differences where dairy products are produced. (*Id.*) Notably, regional population density does not match production density, and thus product must move between regions to satisfy demand. (*Id.*)

Manufactured dairy products can easily be produced in one region of the U.S. and marketed in other regions. (Hollon Tr. Vol. IV, p. 827 (Sept. 25, 2015).) Examples are many and product brand names include Tillamook cheese, Blue Bunny ice cream, Yoplait, Chobani or Dannon yogurt, Eagle Brand sweetened condensed milk, Crystal Farms cheese, Ben and Jerry's ice cream and Land O'Lakes, Challenge, and Plugra butter. (*Id.*) The fact of a national supply and demand relationship is clearly articulated in the Reform Final Decision when the manufacturing class prices were discussed. *Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders*, 64 Fed. Reg. 16026, 16026-16296 (April 2, 1999) ("Reform Final Decision")[5]. The formulas in the Reform Final Decision used national

[5] Proponents have concurrently filed a Request For Official Notice for documents and materials cited in and replied upon in this Brief, which can be found at Appendix Exhibit 1, and ask that official notice be taken of the documents and materials identified therein.

commodity price series thereby reflecting the national supply and demand of dairy products and the national demand for milk. *Id.*

4. The California System's Failure To Regulate Interstate Transactions Has Created Market Disorder.

There are additional disorderly marketing conditions present in the California market that cannot be cured by a state order, and in fact, are caused by the state order. (Hollon Tr. Vol. IV, p. 824 (Sept. 25, 2015).) The Cooperatives initiated this proceeding to regulate all milk that competes in the marketing area, including interstate transactions, transactions which are currently wholly unregulated as to the California marketplace. Since January 2009, data published by the CDFA indicate an average of 54.5 million pounds of milk per month came from farms located outside of the proposed marketing area, and were marketed to processing plants located inside the proposed Order boundaries. (Hollon Tr. Vol. XXXVIII, p. 7659 (Nov. 16, 2015)(emphasis added).) Regulating this milk in a California FMMO would have resulted in an average blend price improvement of $.029 per hundredweight for the period January 2009 through July 2015. (Hollon Tr. Vol. XXXVIII, p. 7664 (Nov. 16, 2015).)

The same data series indicates that an average of 36 million pounds of milk per month is produced inside the marketing area and sold to plants located outside the marketing area. (Hollon Tr. Vol. XXXVIII, p. 7659 (Nov. 16, 2015)(emphasis added).) For example, producer milk regularly leaves the California market and is delivered to a plant or plants pooled by FMMO 131; they in turn market the milk back into California. (Hollon Tr. Vol. IV, p. 825 (Sept. 25, 2015).) This practice removes Class I revenues from the California system as well as lowers the price for the purchasing handler who would not make the purchase if it cost more than the California system minimum.

(Hollon Tr. Vol. IV, p. 824 (Sept. 25, 2015).) Including such volumes in the California FMMO pool would result in an average blend price improvement of $.011 per hundredweight. The average monthly increase in pool revenue from these interstate transactions would be $3,429,333. (Hollon Tr. Vol. XXXVIII, p. 7667 (Nov. 16, 2015).)

The California system does not effectively regulate these interstate transactions because of Commerce Clause concerns. Currently, the out-of-state producers delivering to California plants are able to extract a higher plant blend price than in-state producers serving the same market, who receive the California blend price. (Hollon Tr. Vol. XXXVIII, p. 7667 (Nov. 16, 2015).) Additionally, the costs of serving and balancing the market are shifted to the in-state producers who are regulated by the California system. (*Id.*) Similarly, processors who receive these milk supplies are able to pay lower prices than their competitors. (*Id.*) The issuance of an FMMO will bring all these transactions into the pool, adding an estimated average of $.04 per hundredweight to the blend price, and resulting in a more orderly market. As the Secretary has found, when "the impact on the marketing area's blend price" per month due to unregulated transactions exceeds $0.01, this level is "significant and disruptive to orderly marketing." *Milk in the Pacific Northwest and Arizona-Las Vegas Marketing Areas, Final Decision*, 70 Fed. Reg. 74166, 7418 (Dec. 14, 2005).

This voluminous record supports, beyond the shadow of any doubt, the promulgation of an FMMO for the state of California, the largest milk producing state in the nation. The California system is simply no longer a satisfactory regulatory framework for the participation of California dairy producers and California dairy processors in the national dairy marketplace. The dysfunctional California system's

misaligned pricing for all classes of milk has led to widespread financial distress at the farm level. At the same time, the prices to processors, which are out-of-line with the national price grid for all classes of milk, foster disorderly marketing patterns in interstate transactions, which the state refrains from trying to regulate because of constitutional concerns. Congress in 1996 and again in 2014 directed the Secretary to act upon the petition of California dairy farmers and utilize the AMAA in furtherance of its stated purposes of enhancing producer income while establishing and maintaining orderly marketing. This record provides the basis for that action to be taken.

III. PROPONENTS HAVE SATISFIED ALL LEGAL PREREQUISITES UNDER THE AMAA FOR ISSUANCE OF A CALIFORNIA FMMO.

A. Proponents Have Met Their Burden Of Going Forward.

As an initial matter, the Cooperatives address the issue of the burden of proof under 5 U.S.C. section 556 for issuance of an FMMO covering California. Section 556 requires that "the proponent of a rule or order has the burden of proof."

The U.S. Supreme Court has most recently defined the section 556 burden in individualized, adjudicative administrative proceedings as the "burden of persuasion," where the standard is only that of a preponderance of the evidence. *Dir., Office of Workers' Comp. Programs, Dep't of Labor v. Greenwich Collieries*, 512 U.S. 267, 276 (1994)("*Greenwich Collieries*.")(emphasis added.) The present proceedings are quasi-legislative hearings on proposed rule-making, and no case has applied the higher standard to quasi-legislative proceedings. As Mr. Vetne confirmed during his testimony, the current proceeding is quasi-legislative because it concerns the adoption of "a rule that is of general application." (Vetne Tr. Vol. XXVI, p. 5156 (Oct. 29, 2015).)

A distinction has been and must be drawn between provisions involving quasi-judicial proceedings and those involving quasi-legislative proceedings, regarding the practicality, effectiveness or desirability of an Order, or whether the Order effectuates the declared policy of the Act. *See, In Re H. Naraghi*, 40 Agric. Dec. 1688, 1690 (USDA, May 19, 1981). In furtherance of this distinction, in quasi-legislative proceedings, the USDA has found that the burden is more accurately likened to the burden of "going forward." *In Re: Midway Farms, Inc.*, 56 Agric. Dec. 102 (USDA, Apr. 18, 1997), quoting The *Attorney General's Manual on the Administrative Procedure Act* 75 (1947) ("There is some indication that the term 'burden of proof' was not employed in any strict sense, but rather as synonymous with the "burden of going forward"). In this quasi-legislative rule-making, the Cooperatives' burden is that of "going forward," not the greater burden of a preponderance of the evidence. The Cooperatives have met their burden.

Even under the more formal standard for individualized adjudicative administrative proceedings that is not applicable here, the proponent of a rule or order need only produce evidence which is in any qualitative single measure greater than that of its opposition to prevail. As long as the "scales tip, however slightly, in favor of the party with this burden of proof, that element has been proved by a preponderance of evidence. *In Re: Bitstreams, Inc.*, SBA No. BDP-122 (July 2, 1999). The record shows, as has been and will be highlighted herein, that the Cooperatives have met this burden as well, although they are not required to do so.[6]

[6] The Cooperatives remind the Secretary that the burden of proof applicable to its proposed order is likewise applicable to any orders counter-proposed by other parties: (footnote continued)

Moreover, at the end of the day, the Secretary's action will be upheld if it is supported by "substantial evidence on the record." *Bowman Transp., Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 284 (1974).[7] Barring a showing that substantial evidence for the agency's decisions does not exist, the rules promulgated by the agency will not be second-guessed by the Courts. *Id.*

B. The Issuance Of A California FMMO Is Required Under The AMAA And The Farm Bill.

1. The Farm Bill Requires Adoption Of A California FMMO Solely Upon Petition And Approval By Producers.

The provisions of the 2014 Farm Bill are unique, expressing a strong Congressional intent that California, with the nation's largest dairy production, be brought into the federal milk regulatory system. Accordingly, Congress, in enacting the Farm Bill, made the issuance of a California FMMO mandatory solely upon petition and approval by the producers. It included no requirements about showings or burdens regarding the state of the industry. The Farm Bill is clear that "[u]pon the petition and approval of California dairy producers" the Secretary "shall designate the State of California as a separate Federal milk marketing order." 7 U.S.C.§ 7253(2). The only additional term, and the only reference to the AMAA, is that the producers approve the FMMO via the voting process outlined in the AMAA.

". . . other parties, who are proponents of some different result, also for that purpose have a burden to maintain." *Greenwich Collieries*, *supra*, 512 U.S. at 278-279, quoting S.Rep. No. 752, 79th Cong., 1st Sess., 22 (1945), and H.R.Rep. No. 1980, 79th Cong., 2d Sess., 36 (1946). As such, any counter-proposed orders must fail if the evidence the proponents place into the record does not meet their separate and distinct burden of proof.

[7] Substantial evidence means only "more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Universal Camera Corp. v. N.L.R.B.*, 340 U.S. 474, 477 (1951).

In addition, the use of *shall* in a statutory provision is deemed to be a directive by Congress that the related provision is mandatory rather than permissive. *FDIC v. Meyer*, 510 U.S. 471, 476 (1994). The imposition of a showing of any kind for the designation of a California FMMO is nowhere to be found and has no statutory basis.

2. Even Apart From The Farm Bill, Under The AMAA, Enhancing Producer Income And Establishing And Maintaining Orderly Market Conditions Are The Bases For Adoption Of An FMMO – A Showing Of Disorderly Market Conditions Is Not Required.

Even if the Secretary finds that the producers must make a showing to justify promulgation of a California FMMO, the only inquiry should be whether or not the issuance of the order tends to effectuate (1) the establishment and maintenance of "such orderly marketing conditions" as will protect the interests of producers and consumers and (2) the enhancement of producer income. If it does, the Secretary must issue the order.

The purposes of the AMAA are clear from a plain reading of its text, which begins, and in this case ends, where all such inquires do: "with the language of the statute itself." *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989); *United States Ass'n of Reptile Keepers, Inc. v. Jewe*l, No. CV 13-2007 (RDM), 2015 WL 2207603, at *7 (D.D.C. May 12, 2015). Section 7 U.S.C. 602 is quite clear as to the purposes of the AMAA. As regards these proceedings, the two essential purposes of the AMAA are enhancement of producer income and establishment and maintenance of orderly market conditions. Section 602 provides:

> It is declared to be the policy of Congress –
>
> (1) Through the exercise of the powers conferred upon the Secretary of Agriculture under this chapter, to establish and maintain such orderly marketing conditions for agricultural commodities in interstate

> commerce as will establish, as the prices to farmers, parity prices as defined by section 1301(a)(1) of this title.
>
> ….
>
> ….
>
> (4) Through the exercise of the powers conferred upon the Secretary of Agriculture under this chapter, to establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in section 608c(2) of this title as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.

With respect to the enhancement of the producer pricing prong of the AMAA, the U.S. Supreme Court has specifically recognized that one of the intentions of Congress in enacting the AMAA was to enhance producer prices, stating in *Block v. Community Nutrition Institute*, 467 U.S. 340, 342 (1984):

> [The] essential purpose [of this milk market order scheme] is to raise producer prices (internal citations omitted), and thereby to insure that the benefits and burdens of the milk market are fairly and proportionately shared by all dairy farmers.

The Dairy Institute of California ("DIC")'s opposition to Proposal No. 1 has chosen to completely ignore this purpose of the AMAA and instead focuses solely on its erroneous assumption that under the AMAA, no FMMO can ever be adopted unless there is a showing of disorderly marketing conditions. The express language of the statute and its regulatory history show that this assumption is simply wrong and wholly without merit.

Since the DIC's opposition focuses only on the marketing conditions prong, the following discussion will concentrate on that issue only. However, in so doing, the

Cooperatives at the same time strongly submit that, in deciding on the need for a California FMMO under the AMAA, the goal of enhancement of producer prices must be given equal weight.

With respect to the matter of marketing conditions, as indicated above, the express goal of the AMAA is "to establish and maintain such orderly marketing conditions" for milk and "an orderly flow of the supply" of milk. 7 U.S.C. § 602 (1-4). Likewise, the Courts have confirmed that the purposes of the AMAA are to "maintain orderly marketing conditions that will result in parity prices for farmers and will protect consumers." *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 411 (3rd Cir. 1987). The Secretary shall issue the order if he finds that the issuance of the order will tend to effectuate the declared purposes of the AMAA. 7 U.S.C. § 608c(4)(emphasis added).

When the plain meaning is clear, as is the case here, further inquiry must be abandoned. *Demarest v. Manspeaker,* 498 U.S. 184, 190 (1991). The language of the statute indicates that efforts to "maintain" orderly conditions are sufficient bases for issuance of an order. The Secretary has before argued and the Court of Appeals agreed that he "is not required under the Act to find more than that the expansion of the federal orders would tend to support the goals of the statute." *Lehigh*, *supra*, 829 F.2d at 415. Thus, if a showing is required at all, proponents of a California FMMO need only show that the issuance of the order will tend to maintain orderly market conditions. As discussed below, the record before the Secretary satisfies this obligation.

The DIC's argument that the AMAA requires a showing of disorderly conditions hinges on several faulty assumptions about the plain meaning of the AMAA and the basis for the exercise of the Secretary's regulatory powers.

First, the DIC's position will require the Secretary to "depart from the plain meaning of the statute" and infer an obligation that is not identified in the statute's express terms – a departure any agency or court would be loath to make. *Uniroyal Chem. Co. v. Deltech Corp.*, 160 F.3d 238, 250 (5th Cir. 1998), as *modified on reh'g* (Jan. 8, 1999). Congress would have chosen to require a showing of disorder if it meant to put such a limitation on an order's issuance. However, it did not do so. Nowhere in section 602 or elsewhere is there any requirement that there must be a showing of the existence of disorderly market conditions. Indeed, nowhere in the statute do the words *disorder* or *disorderly* even appear.[8]

Further, nothing in the AMAA requires the Secretary to wait for chaotic or disorderly market conditions to occur. In issuing its decision on the proposed changes to the Middle – Atlantic and New York – New Jersey Marketing Order, the USDA stressed, in the face of contentions that there were "no disorderly marking conditions in the 23-county area," that what was important was that the change "[was] necessary for the **maintenance** of orderly marketing under current marketing conditions." 50 Fed. Reg. 32716, 32718-32719 (August 14, 1985)(emphasis added).

The Secretary can regulate to "cope with potential threats to a then-existing orderly market." *In Re Independent Milk Producer-Distributors*, 20 Agric. Dec. 1, 24-25 (1961). It would be absurd to imagine that Congress enacted a complex scheme of marketing regulations, only to require that the Secretary "stand powerless or shut his eyes to possible disruptive factors or eventualities in a regulated market." (*Id.*) In fact, section 608c(3) of the AMAA requires that the Secretary give notice and hold a hearing,

[8] (Christ Tr. Vol. XII, pp. 2439-2473 (Oct. 7, 2015); Exh. 58.)

if he even "has reason to believe" that the issuance of an order will tend to effectuate the declared policy the AMAA. The reasonable belief that an order would tend to effectuate the AMAA's purpose is sufficient for the Secretary to act, and the issuance of an order in response to that initial action requires only a finding that the order will "establish and maintain" orderly marketing conditions.

In fact, the Secretary is obligated to follow the plain meaning of a statute unless it would lead to a result "so bizarre that Congress could not have intended it." *Johnson v. Sawyer*, 120 F.3d 1307, 1319 (5th Cir. 1997). The DIC cannot reasonably suggest that application of the plain meaning of "maintain[ing] such orderly marketing conditions" would lead to a result so bizarre that Congress did not intend it. Rather, it is the DIC's reading of additional, non-existent requirements into the text that will lead to a bizarre result; under the DIC's position, which is a clear departure from the plain language analysis, the AMAA would require that not until actual chaos ensues can the Secretary issue an FMMO. Given the time and processes required for rule-making, and the express terms of the statute, anything short of a preemptive proposal to maintain market order would be, to use the Fifth Circuit's term, *bizarre*.

3. Prior Administrative Interpretations Do Not Change The Scope Of The AMAA.

Because the AMAA is clear on its face on this issue, despite the DIC's protestations to the contrary, the Secretary need not turn to prior interpretations of the threshold for issuing an order under the AMAA. Deferring to the agency's prior interpretations is limited to instances where the statute is ambiguous. *Haggar Co. v. Helvering*, 308 U.S. 389 (1940); *Combs v. Chapal Zenray, Inc.*, 357 S.W.3d 751 (Tex. App. Austin 2011), *reh'g overruled*, (Jan. 25, 2012) and *review denied*, (Dec. 14, 2012).

The unambiguous and express purpose of the AMAA is "to establish and maintain . . . orderly marketing conditions" for milk and "an orderly flow of the supply" of milk. (1-4). Because no showing of disorder is required or even contemplated by the statute, the statute's plain meaning controls. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984); *Scialabba v. Cuellar de Osorio*, 134 S. Ct. 2191, 2203, *reh'g denied*.

Even were the Secretary to defer to prior USDA interpretations of the AMAA, they cannot be read to advance positions or terms contrary to the statute's plain language. *Demarest*, *supra,* 498 U.S. at 190. As an example, in *Demarest*, where the Court was being asked to approve a longstanding administrative practice of withholding witness fees from prisoners, the Court held the agency's interpretation – though plausible – was entitled to no deference because it was in conflict with the plain language of the statutes at issue. *Id.* The DIC's contention that USDA has required the presence of disorder in prior decisions under the AMAA, even if plausible – which it is not – is contrary to the language of the AMAA, and thus deserves no deference by the Secretary.

Moreover, even were the Secretary to find the AMAA sufficiently ambiguous on this threshold issue to merit potential deference to USDA's prior interpretations, he need only defer to an interpretation that is reasonable. *Chevron, supra*, 467 U.S. at 843. To be considered in the assessment, an agency's interpretation must be based on a permissible construction of the statute. *Id.* Ambiguity anywhere in a statute is not a license to the interpreting agency to roam about that statute looking for other provisions to narrow or expand through the process of definition; rather, the delegated authority to

interpret an ambiguous statutory term extends only to the specific subject matter covered by the ambiguous term. *Bower v. Federal Exp. Corp.*, 96 F.3d 200 (6th Cir. 1996). In *Chevron*, the Court held that ambiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in reasonable fashion. *Nat'l Cable & Telecommunications Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 980(2005) ("*Brand X*")(emphasis added).

The DIC's claim that USDA's prior interpretations of the AMAA require proof of the existence of disorderly market conditions is not accurate nor reasonable, and therefore not subject to deference. Indeed, the Cooperatives dispute that the USDA has interpreted the AMAA as requiring such a showing. The fact that other regions allowed their markets to suffer disorder and uncertainty before seeking a marketing order does not prohibit the California dairy industry from seeking a California FMMO to maintain an orderly market as permitted by the AMAA. For example, in the USDA's decision regarding an order for Southwestern Idaho-Eastern Oregon, the opinion noted that "disorderly marketing conditions that **often** precede an order" were not present. 44 Fed. Reg. 48128, 48130 (August 16, 1979)(emphasis added). The decision is telling in that, while such conditions **often** precede an order, they are not required. The statute, not the worst case scenarios allowed to occur in other regions, sets the threshold.

If, however, the Secretary finds that the USDA has in the past interpreted the AMAA to require a showing of a disorderly market before issuance of a milk marketing order, the Cooperatives believe that interpretation is unreasonable, and thus not entitled to any reliance or deference. The stated goals of the AMAA are to enhance producer income and maintain orderly marketing conditions in order to protect the market

process, milk producers, and thus the milk supply; the increased standard advanced by the DIC's interpretation will be too little, too late, to be of any benefit to the people, regions, and markets the AMAA purports to protect. It will render the provision moot, in that by the time most regions are able to seek a federal order or amendment, their regions and producers will have already suffered immensely. The DIC's alleged disorder requirement cannot be a reasonable, nor therefore reliable interpretation of the AMAA.

Finally, the mere fact that the USDA may have previously cited the existence of a disorderly market when issuing a milk marketing order does not require it to do so in this case. Change in application of policy "is not invalidating, since the whole point of *Chevron* is to leave the discretion provided by the ambiguities of a statute with the implementing agency." *Smiley v. Citibank (South Dakota), N. A.*, 517 U.S. 735, 742 (1996); *Barnhart v. Walton*, 535 U.S. 212, 226 (2002) (Scalia, J., concurring in part and concurring in judgment). Though the Cooperatives dispute that the USDA has made any such prior binding interpretation, they note that any perceived interpretation to that effect is not carved in stone. In fact, agencies must consider "varying interpretations and the wisdom of its policy on a continuing basis." *Brand X*, *supra*, 545 U.S. at 981-982. The Secretary must "be free to react to changes in market conditions to effectuate the purposes of the statutes." *Lehigh*, *supra*, 829 F.2d at 413. Thus, even if the prior invocations were based on USDA policy favoring a showing of disorder, there is nothing to prohibit the USDA from an evaluation of the reasonableness of that application here.

There is no conflict to resolve, no ambiguity to sort out, and no deference to wade through. The plain language of the AMAA controls the Secretary's consideration

of a California FMMO. The Cooperatives have requested issuance of an order to enhance producer incomes and "establish and maintain . . . orderly marketing conditions" and "an orderly flow of the supply" of milk to market. 7 U.S.C. § 602(1-4). Under the express terms of the AMAA, the Cooperatives need only show that the order will effectuate these goals. The Secretary cannot and should not consider any purported ambiguities fabricated by the DIC to muddy the waters of this straightforward assessment. The clamoring by the DIC for deference owed to its version of USDA's prior decisions, and for any heightened showing for issuance of a California FMMO is unreasonable from every angle. The Cooperatives' request for a California FMMO for the purpose of maintaining an orderly market is exactly what was intended by Congress when it enacted the statute, and exactly what the statutes says it requires.

4. Even If A Showing Of Disorderly Market Conditions Were Necessary, The Record Shows That Such Conditions Exist In California.

However, even if some showing of disorder were required, which it is not, the Cooperatives have made such a showing. The price inequity of the California system versus the FMMO system has been a significant contributor to the distress of the California dairy producers, evidenced by the decrease in the number of dairies and land devoted to dairies in California. As detailed in Section II (A and B), *supra*, the market in California is in disorder, and the producers are desperate for the stability and parity that an FMMO will provide them.

IV. THE FARM BILL REQUIRES RECOGNITION OF QUOTA VALUE IN A CALIFORNIA FMMO.

Under the Farm Bill, the California FMMO "shall have the right to reblend and distribute order receipts to recognize quota value." 7 U.S.C. § 7253(2). This state-

specific carve out explicitly grants California a right not granted any other FMMOs under the supervision of the federal government, the recognition of quota value.

A. Recognition Of The Value Of Quota Is Mandatory.

Through its use of the imperative *shall*, the Farm Bill prohibits the Secretary from denying that right. As previously noted, the use of *shall* in the provision is deemed to be a directive by Congress that the provision is mandatory rather than permissive. *Meyer*, *supra*, 510 U.S. at 476. An unambiguous statute may not be supplemented or altered in the guise of interpretation. *Cullinan v. McColgan*, 80 Cal.App.2d 976, 183 (3d Dist. 1947); *Helvering v. Sabine Transp. Co.*, 318 U.S. 306 (1943); *In re Loeb's Estate*, 400 Pa. 368 (1960). There is no ambiguity in this provision.

The argument by the DIC that the right to recognize quota value rests in the discretion of the Secretary is unfounded. To so interpret the statute would render it meaningless. If the statute is clear, the agency charged with administering the statute must give effect to the unambiguously expressed will of the legislature. *American Federation of Government Employees v. Rumsfeld*, 262 F.3d 649 (7th Cir. 2001); *Haug v. Bank of America, N.A.*, 317 F.3d 832 (8th Cir. 2003). The statute itself is clear that the recognition of quota is a right which cannot be denied. Clearly Congress was telling the Secretary he must recognize quota value in any California FMMO, and not that he can recognize it if he felt like it. In fact, the DIC's own Proposal No. 2 includes a provision that unsuccessfully attempts to recognize quota value. Thus, even in their opposition to the mandatory nature of the recognition of quota value, the DIC included it in their proposed order, unfortunately in a manner that will destroy quota value in a short period of time.

In the 2014 Committee Report on the Farm Bill, the Committee notes indicate that the Secretary has discretion to recognize the longstanding California quota system "in whatever manner is appropriate." Federal Agriculture Reform and Risk Management Act of 2013, FD H.B. (NS), p. 389 (Jan. 27, 2014). The notes make clear that it is the *manner* of recognition, and not the fact of recognition, that may be subject to the Secretary's discretion. To make a mandatory right's existence subject to discretion of the Secretary will effectuate a nullity. The Secretary should apply a construction which will fulfill the intent over one which defeats its manifest object. *Stuart v. Weisflog's Showroom Gallery, Inc.*, 2008 WI 22, 308 Wis.2d 103 (2008). Only recognition of quota value by the Secretary satisfies the mandate of the Farm Bill.

B. The Obligation To Meaningfully Recognize Quota Value Is Clear.

Likewise, the meaning of the provision requiring the order to "blend and redistribute" receipts to "recognize quota value" is clear and unambiguous. When the words of a statute are unambiguous, the primary principle of construction is both the first and last consulted by the Court: the "inquiry is complete." *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (citations omitted); *see also*, *Desert Palace, Inc. v. Costa,* 539 U.S. 90, 99 (2003) (finding that the evidentiary standard for an employment suit were clear from the face of the statute). In *Connecticut Nat'l Bank*, the Court was clear that the purported legislative history of the bankruptcy statutes at issue need not be assessed, because the inquiry began and ended with what the text did and did not say. *Supra*, 503 U.S. at 254. The *Connecticut Nat'l Bank* Court reiterated the obligation to assume that the "legislature says in a statute what it means and means in a statute what it says." *Id.* Here, the 2014 Farm Bill says that quota value must be recognized; it means what it says.

Looking beyond the plain meaning occurs only in "rare and exceptional circumstances." *Rubin v. United States*, 449 U.S. 424, 430 (1981) (declining to look outside a banking statute to define the terms *sale* and *offer*). In *Velez v. Cuyahoga Metro. Hous. Auth.*, the Sixth Circuit refused to look outside the plain meaning of the text to define the term *rent* in a housing provision, even where the Court acknowledged that the fee at issue was differently defined than a standard rental fee. 795 F.3d 578, 583 (6th Cir. 2015).

Recognize is a term of ordinary meaning. Words that are not terms of art and that are not statutorily defined are to be given their ordinary meanings. *Meyer*, *supra*, 510 U.S. at 476. To recognize quota value is " to give formal acknowledgment of the status" of quota value. *Collins English Dictionary*, 2016. As such, section 7253 requires that, upon petition and approval of California dairy producers, the California FMMO must acknowledge the existence, validity, or legality of existing quota value. The Cooperatives' Proposal No. 1 is the only one which recognizes quota value in these terms, consistent with the language of the Farm Bill. The proposal advanced by the DIC will destroy the value of quota, as predicted by the USDA's Preliminary Regulatory Impact Analysis of Proposals to Establish a California Federal Milk Marketing Order, August, 2015 ("Preliminary Impact Analysis") and the testimony of expert witness Mr. Hatamiya, and conceded in the testimony of Dr. William Schiek ("Dr. Schiek"), the DIC's economist and chief witness. (Steeneck Tr. Vol. I, pp. 71-72 (September 22, 2015); Hatamiya Tr. Vol. XI, p. 2283 (Oct. 6, 2015); Schiek Tr. Vol. XXXIII, p. 6690 (Nov. 9, 2015).) Any Proposal which either destroys or diminishes the value of quota cannot, under any meaning of the term *recognize*, be valid. Furthermore, the DIC's proposed

annuity and buyout methods of recognition do not fall within the parameters of the Farm Bill, which requires that recognition of quota value be accomplished by the blending and redistribution of receipts, not to mention that the USDA has never had, nor is there currently, a mechanism to provide for the proposed annuity. Both labored options suggested by the DIC diminish the value of quota, and neither is consistent with the Farm Bill or within the purview of the USDA.[9] In short, the Cooperatives' Proposal is the only one presented in this hearing that recognizes quota value in any meaningful way as required by the Legislature.

C. Recognition Of Quota Value Is Not A Trade Barrier.

In analyzing trade barrier issues, it is important to note that AMAA's proscription of trade barriers, while bearing some similarities to the negative or dormant Commerce Clause of the U.S. Constitution, is considerably narrower. Indeed one of the benefits of FMMOs is that they can effectively address issues arising from the interstate shipment of milk that might be barred, or perceived by state regulators to be barred, by the Constitution.

Out-of-state producers, such as Ponderosa[10], have taken advantage of the lack of a California FMMO. They ship milk from Nevada to California Class I plants and apparently receive the plant blend price which, except for rare occasions, exceeds the California regulated blend price. (Degroot Tr. Vol. XXXVII, pp. 7591-4 (Nov. 13, 2015).)

[9] Remarkably, the ill-conceived DIC suggestion for an annuity calls for that annuity to be funded from pool revenues. In effect, quota holders would be compelled to buy themselves out with their own money. Moreover, non-quota holders would be paying to buy out quota holders. A bizarre proposition at best.

[10] Ponderosa Dairy which, is a Nevada producer, has historically sent almost all of its milk to Rockview Dairy, which is a plant in California. (Hancock Tr. Vol. V, p. 873 (Sept. 28, 2015).)

The California handlers can afford these purchases because, with no applicable state order, they do not have to account for these Class 1 usages to the California pool. As will be demonstrated infra, these out-of-state producers, taking advantage of the California system, find themselves in a better position than California producers. Only a California FMMO can effectively deal with this inequity.

Section 608c(5)(G) of the AMAA provides:

> No marketing agreement or order applicable to milk and its products in any marketing area shall prohibit or in any manner limit, in the case of products of milk, the marketing in that area of any milk or product thereof produced in any production area in the United States.

With respect to milk, section 608c(5)(G) provides only that a marketing agreement or order may not prohibit the marketing of milk in a marketing area that is produced in any production area of the U.S. With respect to the products of milk, there is a further prohibition against limiting such marketing: mere differences in treatment between in-state and out-of-state producers are not enough, in themselves, to constitute a trade barrier.

In conjunction with this brief, the Proponents of Proposal No. 1 have modified its provisions regarding recognition of quota value to provide that the minimum price to be received by producers located outside California for milk delivered to plants regulated under the California FMMO will not be diminished by payments of the quota premium. The modified proposal will also grant the identical proposed transportation credits to milk produced outside California as granted to milk produced in California.

Even before amendment, Proposal No. 1's method of recognizing quota value did not constitute a trade barrier. Under the original Proposal No. 1, marketing of out-of-state milk in California was in no way prohibited. Out-of-state and in-state

producers who hold no quota will be paid the same blend price.[11] As was true in *Sterling Davis Dairy v. Freeman*, 253 F.Supp. 80, 86 (D.N.J. 1965), a provision engendering no inherent rate discrimination, where pool or non-pool participants make or receive identical payments, reveals no attempt to "control or restrict the flow of outside milk" into the region. There is no disparate treatment, and so there can be no negative impact on the flow of milk into California under Proposal No. 1.

The fact that some California producers receive the benefit of the quota premium on some of their milk does not prohibit out-of-state producers from marketing milk in California, just as California producers holding no quota (or producing some milk not covered by quota) are not prohibited from marketing in California. Out-of-state producers cannot claim that the fact that they cannot acquire quota constitutes a prohibition against marketing their milk in California. It does not.

Moreover, quota is a creature of California state law designed for California producers. Even under the increased scrutiny of the Commerce Clause, a state is not prohibited from "action designed to give its residents an advantage in the market place…." *New Energy Co. v. Lombach,* 486 U.S. 269, 278 (1988). And "(d)irect subsidization of domestic industry does not ordinarily run afoul of that prohibition." *Id.; See also Bacchus Industries v. Dias,* 468 U.S. 263, 271 (1984). This is also true, *a fortiori*, under the narrower proscription of section 608c(5)(G).

The modifications to Proposal No. 1 that will pay out-of-state producers a minimum price undiminished by payment of quota premiums, and additionally allow

[11] Under the original Proposal No. 1, out-of-state producers would also be paid the identical blend price as received by California quota holders as to their production not covered by quota.

identical transportation credits with respect to milk delivered from out-of-state, drives the final nail into the coffin of the DIC's trade barrier claims. In essence, under the amendment, out-of-state producers will fare better than California producers without quota, and even better than California producers who hold quota with respect to their production not covered by their quota holdings. As such, out-of-state producers have no factual basis to claim that the recognition of quota value prohibits them from marketing their milk in California and effects a trade barrier.

And, significantly, as was the case for the differentials in *Dairylea Cooperative, Inc. v. Butz*, 504 F.2d 80, 88 (2nd Cir. 1974), *Schepps Dairy, Inc. v. Bergland*, 628 F.2d 11, 20 (D.C. Cir. 1980) and *Sunnyhill Farms Dairy Co., Inc. v. Hardin*, 442 F.2d 1124, 1131 (8th Cir. 1971), the recognition of quota value is "specifically" and "expressly" authorized by the Farm Bill, and assigned to the power of the Secretary to administer. As long as the provision is not a prohibition against the flow of milk into the market, it does not run afoul of 7 U.S.C. 608c(5)(G). In *Sunnyhill*, the Court held that though the differential in the proposed order did make it less profitable to sell into the St. Louis market, the differential was not an impermissible trade barrier because it did not prohibit out of area milk marketing, was specifically authorized statute, and was reasonable under the circumstances. *Id.* Certainly the same is true here. Recognition of quota value, and any resulting differential, in the California FMMO is expressly authorized by the Farm Bill. Because out-of-state producers will be paid above the blend price paid to California producers, there can be no prohibition on the flow of milk into the marketing area. Finally, given clear Congressional intent, the investment made by California quota

holders, and the value all stakeholder place on quota, its recognition is more than reasonable; it is in fact, necessary.

The opponents of Proposal No. 1 hang their hat on the decision in *Lehigh Valley Cooperative Farmers, Inc. v. United States,* 370 U.S. 76 (1962). But *Lehigh* provides no peg on which to hang their trade barrier hat.

In *Lehigh*, the Secretary attempted to achieve competitive parity between pool milk under the New York – New Jersey FMMO and non-pool (*i.e.*, out-of-area) milk by requiring a handler of non-pool milk to make a "compensatory payment" to the pool. Farmers in the New York – New Jersey system received a uniform minimum blend price, rather than the minimum classified prices. Nonetheless, the Secretary imposed on processors that purchased non-pool milk a "compensatory payment" in an amount equal to the difference between the minimum prices for the highest and for the lowest use classifications, *i.e.*, Class I and Class III prices, under the New York – New Jersey FMMO. *Supra*, 370 U.S. at 83.

The Supreme Court struck down the Secretary's regulation as erecting an impermissible "trade barrier" because it will "in all but rare instances, nullify any competitive advantage that non-pool milk could have," since a handler will have an incentive to bring non-pool milk in the area only where its cost was less than the minimum price for the lowest use, Class III. *Id.* at 84. In striking down the compensatory payment in *Lehigh*, however, the Supreme Court suggested that, to achieve competitive parity between pool milk and non-pool milk, a payment equal to the difference between the Class I price and the blend price would be acceptable. *Id.* at 86-87 n. 13.

Subsequent cases conclusively demonstrate that the *Lehigh* holding is confined to fact situations where out-of-area milk is expressly prohibited from being marketed in the area, or, as in *Lehigh*, are in practical operational effect so prohibited. For example, in *County Line Cheese Co. v. Lyng,* 823 F.2d 1127 (7th Cir. 1987), the Seventh Circuit upheld a provision of the Indiana FMMO that required a Class 1 processor to account to the pool for the difference between the Class 1 price and the uniform blend price actually paid to the pool producers. The Court determined that the payments for non-pool milk required under the Indiana FMMO "do not present a trade barrier," but simply "erase an artificial advantage gained by the way of the price supports work." 823 F.2d at 1334; s*ee also Lewes Dairy, Inc. v. Freeman,* 401 F.2d 208 (3rd Cir. 1968); *Sunny Hills Dairy Co., Inc. v. Hardin, supra*, 442 F.2d 1124 (8th Cir. 1971); *Dairylea Cooperative, Inc. v. Butz,* 504 F.2d 80 (2d Cir. 1974); *Borden v. Butz,* 628 F.2d 11 (D.C. Cir. 1980).[12]

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[12] Some witnesses seemed to imply that the U.S. Supreme Court in *Hillside Dairy Inc. et al. v. Lyons, Secretary, California Department of Food and Agriculture, et al.,* 539 U.S. 59 (2003) ("*Hillside*") struck down on Commerce Clause grounds a California state order provision relating to out-of-state milk shipped to California plants. The Court did no such thing. It merely reversed a District Court that dismissed the case on grounds other than the Commerce and the Privileges and Immunities Clauses of the U.S. Constitution, and remanded the case back to the District Court. As to the Constitutional claims, the Supreme Court expressly stated that "we do not reach the merits of either constitutional claim and that "we express no opinion on the merits." *Id.* at 61, 62. In any event, *Hillside* was not a trade barrier case.

It is true that on remand, the District Court ruled that the California regulation violated the Commerce Clause. The cooperatives assert that the District Court was dead wrong and decry the fact that CDFA declined to carry forward an appeal. At any rate, that decision is neither binding or precedential. The doctrine of *stare decisis* does not even compel one district court judge to follow the decision of another. *Cactus Corner, LLC v. U.S. Dep't. of Agric.,* 346 F.Supp. 2d 1075, 1105-06 (E.D. Cal. 2004) aff'd, 450 F.3d 428 (9th Cir. 2006); *Starbuck v. City of San Francisco,* 446 F.2d 450, 457, n. 13 (9th Cir. 1977). Rather, "[s]uch decisions will normally be entitled to no more weight than their (footnote continued)

In summary, Proposal No. 1, as modified, does not in any manner erect a trade barrier under section 608c(5)(G).

D. There Is No Merit To The DIC's Position That The Farm Bill's Failure To Expressly Amend The AMAA Invalidates Its Mandatory Recognition Of Quota Value.

1. Prices Under Proposal One Are Uniform, So The Statutes Can Be Harmonized.

At the outset, the Cooperatives assert that Proposal No. 1 allows the Farm Bill and the AMAA to be read in harmony. While Congress can make explicit its intent that a statutory scheme amends a prior one, conflicts may still arise between the operation of related federal statutes that are silent as to their relationship, as is the case here. In such case, the Secretary must try to harmonize the two so that both can "be given effect while preserving their sense and purpose." *Watt v. Alaska*, 451 U.S. 259, 267 (1981). The AMAA principle of uniform pricing is honored in the Cooperatives' Proposal No. 1. All California producers' non-quota milk is uniformly paid, and all quota milk is uniformly paid. There is no inconsistency, as the two sets of producers are differently situated. Payment of a quota premium on quota milk is uniform as to all milk covered by quota and payment of the blend price after deduction of quota value is uniform as to all California milk not covered by quota. Non-California milk is not impacted by quota at all.

No such harmony is possible under the DIC's Proposal No. 2. The DIC's proposal purports to allow the uniform pricing provision of the AMAA and the mandatory recognition of quota value in the Farm Bill to both be given effect. However, the DIC's

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intrinsic persuasiveness [on the] merits … because the responsibility for maintaining the law's uniformity is a responsibility of the appellate rather than trial judges…" *Cactus Corner, supra,* 346 F. Supp. 2d at 1106.

proposal is only harmonizing in theory. The proposal advanced by the DIC will destroy the value of quota, as predicted by the USDA's Preliminary Impact Analysis and the testimony of expert witness Mr. Hatamiya. (Steeneck Tr. Vol. I, pp. 71-72 (September 22, 2015); Hatamiya Tr. Vol. XI, p. 2283 (Oct. 6, 2015); Schiek Tr. Vol. XXXIII, p. 6690 (Nov. 9, 2015).)

2. The AMAA Already Creates Allowable Exceptions To Uniformity, The Farm Bill Merely Creates Another – The Recognition Of The Value Of Quota.

Even if a price structure recognizing the value of quota was deemed to establish non-uniform prices, uniform producer prices under the AMAA are subject to authorized adjustments from absolute price uniformity as allowed for under 7 U.S.C. 608c(5)(B):

> subject, in either case, only to adjustments for (a) volume, market, and production differentials customarily applied by the handlers subject to such order, (b) the grade or quality of the milk delivered, (c) the locations at which delivery of such milk is made, and (d) a further adjustment, equitably to apportion the total value of the milk purchased by any handler, or by all handlers, among producers and associations of producers, on the basis of their marketings of milk during a representative period of time., 2 [(e) omitted] and (f) a further adjustment, equitably to apportion the total value of milk purchased by any handler or by all handlers among producers on the basis of the milk components contained in their marketings of milk.

With adoption of the Farm Bill, payment for California quota was added to this list of permitted deviations from uniformity. This was confirmed by Dr. Schiek upon cross-examination:

> Q: And prior to this legislation, would a California Federal Order have had the right to distribute pool funds to recognize quota value?
>
> A: I don't believe so.
>
> Q: But now it does?

A: "Has the right" is what the language says. It has the right.

Q: Now, so now a California Federal Order can do something that it was not authorized to do under the Agricultural Marketing Agreement Act before the 1996 Farm Bill was passed; isn't that correct, Dr. Schiek?

A: It has the right to do something it could not do before the Act was passed.

Q: Right. It has the right to distribute order receipts to recognize quota value, which it could not do before the Act was passed; isn't that correct?

A: Yes.

(Schiek Tr. Vol. XXXIII, pp. 6730-31 (Nov. 9, 2015).)

Thus, even the DIC's chief witness and economist conceded that the provisions of the Farm Bill are a statutory exception to the AMAA's principle of uniform prices. The AMAA mandates producer price uniformity, subject to enumerated exceptions to which quota has been now added as an exception. The legislation fits logically and legally into the structure of the AMAA.

3. The Later, More Specific Farm Bill Impliedly Amends Or Controls The Earlier, More Generalized AMAA.

If the Secretary nevertheless were to finds harmony impossible, because the provisions of these two different federal statutes are "irreconcilably conflicting," the Secretary must apply the rule that the later of the two prevails. *Watt, supra*, 451 U.S. at 267. It is established that the last enacted statute prevails because it is the latest expression of the legislative intent. *Argentine Republic v. Amerada Hess Shipping Corp.,* 488 U.S. 428, 438 (1989); *Harding v. Dep't of Veterans Affairs,* 448 F.3d 1373, 1376 (Fed. Cir. 2006). The amendment or repeal is to be implied to make the (later enacted law) work, but only to the extent necessary. *United States Ass'n of Reptile*

Keepers, Inc. v. Jewell, No. CV 13-2007 (RDM), 2015 WL 2207603, at *15 (D.D.C. May 12, 2015). Furthermore, where provisions of two acts are in conflict, standard statutory construction requires the provision more closely associated with the specific substance of the controversy to control. *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 153 (1976) (holding a specific provision of the Banking Act applied when in conflict with a more generalized provision of the Securities Exchange Act); *Townsend v. Little,* 109 U.S. 504, 512 (1883)(holding the more specific requirement for witnesses of deeds prevailed over a more general requirement of non-specific conveyances). A limited scope amendment, by the more issue-specific, later in time Farm Bill, is exactly what the Secretary has before him here.

If the Secretary finds that the AMAA requirement of "uniform prices" is inconsistent with the Farm Bill's requirement of reblending and distributing order receipts to recognize quota value, under *Reptile Keepers* and *Bowman,* the later, more specific enactment of the Farm Bill for mandatory quota recognition implicitly modifies, or amends, the older, more generic terms of the AMAA as to the narrow issue of a single exception to the uniform pricing scheme. The most fundamental presumption in statutory construction is that the Legislature intended to enact an effective law. *Imperial Production Corp. v. City of Sweetwater* , 210 F.2d 917 (1954). The DIC's position turns logic on its head, advocating that the earlier in time and more general provisions of the AMAA somehow trump the more specific and later enacted provisions of the Farm Bill. This interpretation is wholly inconsistent with the canons of statutory interpretation. To prohibit recognition of quota value because of the uniform pricing language of the AMAA will make the Farm Bill recognition of quota value meaningless. Instead, consistent with

the canons of interpretation, this limited scope implied amendment, by a Congress well aware of the broad strokes of the AMAA, makes both statutes effective.

The rules of statutory construction require that the provisions be read together if possible, that they be read so as to give both provisions meaning, and that if no coordinated reading is possible, the later in time, more specific provision be deemed to prevail. Under all such tenets, the more specific enactment of the Farm Bill requiring quota recognition implicitly modifies, or amends and prevails over the older, more generic terms of the AMAA. As such, the Cooperatives' Proposal No. 1, and not the DIC's[13], satisfies the relevant requirements of the Farm Bill, to the extent it amends the AMAA in requiring the recognition of quota value.

V. THE BASIC ADMINISTRATIVE AND OPERATING TERMS OF THE ORDER IN PROPOSAL ONE ARE UNDISPUTED AND SHOULD BE ADOPTED.

Proponents have shown in Section II. A and B, *supra*, that there is overwhelming support for a California FMMO and that marketing conditions require it. Proponents will now detail the appropriate terms for that order, discussed in three subject groupings: First, the essentially undisputed administrative terms for the order, drawn from the uniform terms for federal orders in 7 Code of Federal Regulations ("C.F.R.") 1000; second, the pricing provisions of the order; and, third, the pooling and producer payment terms. Proposal No. 1 builds a California FMMO from the uniform provisions for all federal orders in 7 C.F.R. 1000. The great majority of those proposed terms are not in dispute in this hearing and should be adopted as proposed. Proponents will

[13] Interestingly, although the DIC has argued that the AMAA's uniform pricing provision controls the Farm Bill's language concerning quota, its own Proposal 2 contemplates different pricing between quota holders and non-quota holders and between quota holders holding different amounts of quota.

discuss these basic federal order building blocks in three parts: (1) basic order definitions; (2) Market Administrator administrative provisions; and (3) uniform provisions relating to classification and pricing.

A. Basic Order Definitions.

Sections 1-19 of Proposal No. 1 cover the "General Provisions" and "Definitions" portions of the proposed order. Of these 19 provisions, 13 draw upon the uniform provisions in Part 1000 and are not disputed. In addition, there are portions of the 6 other provisions which are identical in Proposal Nos. 1 and 2 and not disputed in other testimony.

The thirteen definitional sections which are not in dispute, and a brief description of each, are:

1051.1 – General Provisions: regulatory preamble.

1051.2 – California Marketing Area: definition of the territory of the State of California as the marketing area for the order.

1051.3 – Route Disposition: uniform definition of fluid milk product movements tracked and priced under the order.

1051.4 – Plant: uniform definition for physical facilities potentially subject to having their receipt and disposition of milk regulated under the order.

1051.5 – Distributing Plant: uniform definition for a fluid milk product processing facility which may be subject to regulation under the order.

1051.6 – Supply Plant: uniform definition for a facility which receives milk directly from farms and either manufactures it or transfers (or diverts) it to another plant.

1051.8 – Nonpool Plant: uniform definition of categories of plants excluded from regulation under this federal order.

1051.9 – Handler: uniform definition for the person or entity accountable to the Market Administrator of the federal order for the receipt and disposition of fluid milk products and milk from producers subject to the order.

1051.14 – Other Source Milk: uniform definition for skim milk and butterfat received or handled by regulated handlers which is not pool milk.

1051.15 – Fluid Milk Product: uniform definition for milk products used as beverages and, generally, classified as Class I products for pricing purposes under the order. The definition contains precise component criteria for butterfat and nonfat solids.

1051.16 – Fluid Cream Product: uniform definition for high butterfat content fluid products which are generally Class II products under the federal orders.

1051.18 – Cooperative Association: uniform definition for producer cooperative associations, qualified under the provisions of the Capper-Volstead Act, which are engaged in collective marketing of producer milk under the order. The definition includes a federation of associations, all of which are qualified cooperatives.

1051.19 – Commercial Food Processing Establishment: uniform definition for a facility which is not a milk plant but to which fluid milk and cream products are disposed of for use as ingredients in food products.

Each of these sections is in Title 7 of the C.F.R. Part 1000 and in both Proposal Nos. 1 and 2. There was no testimony at the hearing in opposition to the language in any of these sections and they should be adopted for the California FMMO.

B. Uniform Market Administrator And Administrative Provisions.

There are ten proposed order provisions which together involve establishing the basic administrative structure of the FMMO and stipulating the fundamental ground rules for operation of the order. These are all uniform federal order provisions in 7

C.F.R. 1000; all are in both Proposal Nos. 1 and 2 and were not disputed by any witness or party on the hearing record. They are:

1051.25 – Market Administrator: uniform job description for the person, appointed by the Secretary, who is delegated authority and responsibility responsible for supervising the administration of the FMMO.

1051.26 – Continuity and Separability of Provisions: uniform provision for implementation, suspension, and termination of order provisions, including the rules for settlement of financial accounts between the Market Administrator and regulated parties in the event of termination of an order.

1051.27 – Handler Responsibility For Records and Facilities: uniform requirements for handler record keeping necessary for administration of the order. The requirements include description of records which must be kept, accessibility of the handler's records and facilities to the Market Administrator and his agents, and retention requirements for those records.

1051.28 – Termination of Obligations: uniform provision providing that except in instances of handler fraud or intentional concealment, a handler's obligation to pay pursuant to the Order ends two years after the Market Administrator receives the handler's records of receipts and utilization supporting the obligation, unless the Market Administrator gives the handler written notice of his failure to pay the obligation.

1051.70 – Producer Settlement Fund: uniform provision directing the Market Administrator to create a producer-settlement fund for payments pursuant to the order and payments due to a handler shall be offset by payments due from that handler.

1051.77 – Adjustment of Accounts: uniform provision requiring routine audit of handlers' records. If the Market Administrator's audit reveals an error, the Market Administrator shall notify the handler, and payment of the amount of the error must be made before the next date for making payments.

1051.78 – Charges on Overdue Accounts: uniform provision requiring a 1% per month charge added to unpaid amounts a handler owes that were not paid timely.

1051.85 – Assessment for Order Administration: uniform provision directing handlers to pay to the Market Administrator, on or before the order's payment due date, the handler's pro rata share of the cost of administering the order.

1051.86 – Deduction for Marketing Services: uniform provision directing certain handlers to deduct an amount set by the Market Administrator from payments to producers and submit that amount to enable the Market Administrator to verify or establish weights, samples, and tests of producer milk.

1051.90 – Dates: uniform provision requiring payments scheduled for weekends or holidays to be paid on the next day the Market Administrator's office is open.

Each of these sections is in 7 C.F.R. Part 1000 and in both Proposal Nos. 1 and 2. There was no testimony at the hearing in opposition to the language in these sections and they should be adopted for the California FMMO.

C. Uniform Provisions Relating To Classification And Pricing.

Proposal No. 1 further requests the adoption of nine uniform (or uniformly proposed) provisions which relate to the classification and pricing of milk in all FMMOs. These provisions, all part of 7 C.F.R. Part 1000 or in Proposal Nos. 1 and 2, are subject to very limited and narrow dispute. They are:

1051.40 – Classes of Utilization: uniform provision specifying the classes of utilization used in all FMMOs. Class I (fluid milk and shrinkage); Class II (fluid milk in containers larger than one gallon and cottage cheese; ricotta, and similar soft, high-moisture cheese; milkshake and ice milk mixes; sour cream, yogurt, etc.; custards, puddings, pancake mixes and similar products, buttermilk biscuit mixes and other buttermilk for baking; products especially prepared for infant feeding or dietary use; candy, soup, bakery products and other prepared foods; and other fluid cream products); Class III (milk used to produce cream cheese and other spreadable cheese, hard cheese, plastic milk, etc.; and shrinkage); Class IV (milk used to make butter, evaporated milk, sweetened condensed milk, any milk product in dry form, or shrinkage).

1051.42 – Classification of Transfers and Diversions: uniform provision prescribing the classification transferred or diverted by handlers.

1051.43 – General Classification Rules: uniform provision requiring the Market Administrator to, *inter alia*, correct obvious reporting errors monthly and to determine shrinkage and overage for pool plants and specified handlers.

1051.44 – Classification of Producer Milk: uniform provision requiring the Market Administrator, on a monthly basis, to determine for each specified handler the classification of producer milk by allocating the handler's receipts of skim milk and butterfat to the handler's gross utilization of such receipts according to the formulae set forth.

1051. 50(a)-(k) – Class Prices, Component Prices, and Advanced Pricing Factors: uniform provision containing the formulas for and method of setting all Class prices and advance pricing factors in all Federal Orders.[14]

1051.51 – Reserved.

1051.52 – Adjusted Class I Differentials: uniform provision providing for price adjustments for all locations as set forth in the table in paragraph 1051.52.

1051.53 – Announcement of Class Prices, Component Process and Advanced Pricing Factors: uniform provision requiring the Market Administrator, by the 5th day of the month, to announce class and component prices for products and components in Classes I-IV for the preceding month, and by the 23rd day of the month, announce prices for the upcoming month for the following: Class I products, Class I skim milk, Class I butterfat, Class II skim milk, Class II nonfat solids, and advanced pricing factors.

1051.54 – Equivalent Price: uniform provision directing the Market Administrator, when lacking information necessary to calculate prices, to use a price or pricing constituent provided by the Deputy Administrator, Dairy Programs, Agricultural Marketing Service, which is deemed to be equivalent to the necessary price or pricing constituent.

VI. THE CALIFORNIA FMMO SHOULD ADOPT THE UNIFORM CLASS PRICES WHICH PRESENTLY PREVAIL IN ALL FMMOS.

The California FMMO should bring California dairy farmers and the California dairy industry into the national milk marketing system by adopting the class prices and component pricing formulas embodied in the uniform provisions for FMMOs, 7 C.F.R.

[14] Subparts (a)-(k) of Section 1051.50 appear in Proposal Nos. 1 and 2. Only subparts (l)-(q) are contested by the DIC.

Sections 1000.50 and 1000.52. These uniform national provisions include in Section 1000.50 the uniform national Class II, III, and IV prices, and the Class I price, adjusted for the plant location by the national Class I differential grid in Section 1000.52. The parochial opposition of the DIC to California becoming part of the national marketplace should not outweigh the chorus of producer testimony urging the Secretary to bring the nation's largest milk producing state into the uniform national class price system.

The single appeal heard more than any other in this hearing was that of California dairy farmers urgently requesting that the Secretary exercise his authority under the AMAA and allow California producers the ability to compete with the same minimum class prices as the rest of the country. This was succinctly summed up by producer Melvin Medeiros, who testified: "Our milk needs to be valued just like it is across the country, so I, as a producer in California, can compete at an equal playing field." (Medeiros Tr. Vol. XXXVII, p. 7509 (Nov. 13, 2015).) Dairy farmer James Netto put it this way, contrasting the CDFA prices with federal order prices: "[E]very dairyman in California ought to be able to wake up in the morning and compete with everybody across the U.S. . . . The CDFA continues to send us to a gunfight with a knife . . . Nobody's asking for more, we're asking to give us a chance, you know, let us compete." (Netto Tr. Vol. XXXV, pp. 7164-7165 (Nov. 11, 2015).) Many other dairymen and women expressed the same sentiment (*see supra,* Section II.A); and the Secretary should heed this request and adopt the uniform national price system as requested in Proposal No. 1.

A. The Uniform Class Prices In Part 1000, First Adopted Through The Federal Order Reform Process Effective January 1, 2000, Were Formulated In Contemplation Of A California FMMO.

The uniform prices for all FMMOS resulting from Federal Order Reform[15] expressly included prices for the entire country, including California, because a California FMMO was expressly authorized in the 1996 Farm Bill. In the very first paragraph of the Director of the Dairy Division's May 2, 1996 announcement to all "Interested Parties" of the procedures to be utilized in the then just-starting 3 year process, he notified all that a potential California FMMO was part of the task, stating that this "enormous undertaking" involved a mandate to consolidate the then-existing 33 federal orders to 10 to 14, as well as to "designate the State of California as a Federal milk order if California dairy producers petition for and approve such an order." McKee Letter, Appendix A to Price Structure Committee, AMS, Dairy Division, Preliminary Report (November 1, 1996), *see* Request for Official Notice). With that directive from Congress, the reform process went forward and promulgated minimum class prices for Classes I, II, III, and IV, which recognized the place of California in the national system.

The USDA adopted uniform Class II, III, and IV prices and a national Class I price grid with a price for every county including all counties in California in its Final Decision of April 2, 1999. *See Milk in the New England and Other Marketing Areas,*

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[15] *Milk in the New England and Other Marketing Areas; Proposed Rule and Opportunity to File Comments, Including Written Exceptions, on Proposed Amendments to Marketing Agreements and Orders*, 63 Fed. Reg. 4802-5095 (January 30, 1998) ("Reform Proposed Rule"); *Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders*, 64 Fed. Reg. 16026-16296 (April 2, 1999) ("Reform Final Decision"). The term "Federal Order Reform" refers to these orders specifically, and more generally to the informal rulemaking process mandated by the 1996 Farm Bill which took place from the time of enactment of the 1996 Farm Bill through September 1999.

supra, 64 Fed. Reg. at 16026-16296. The language of that decision made clear the USDA's contemplation of a California FMMO when it stated, "The Secretary of Agriculture (Secretary) is also directed to designate the State of California as a Federal milk order if California dairy producers petition for and approve such an order." *Supra*, 64 Fed. Reg. at 16027 (emphasis added). Furthermore, the USDA received and considered input from California interests throughout Federal Order Reform. For example, the DIC, citing its concern that producers would petition for a California FMMO, submitted 29 pages of comments to AMS on April 29, 1998, in response to the recommended decision. (Schad Tr. Vol. XV, pp. 3154-55 (Oct. 14, 2015); Exh. 70, p. 33.) The USDA noted that the DIC recommended increasing cheese make allowances over those set forth in the recommended decision. *Supra*, 64 Fed. Reg. at 16098. Also, as the DIC urged, the USDA included Las Vegas with Arizona to eliminate competitive distortions between those areas and California. *See id.* at 16078. California was in the eye of the USDA as it crafted the national FMMO system which exists today, with its uniform national Class II, III, and IV prices and its single, all-states-encompassing national Class I price grid.

B. The Uniform Class Prices, Component Prices, Advanced Pricing Factors, And Adjusted Class I Differentials In Part 1000 Should Be Adopted For The California FMMO.

The uniform provisions of 7 C.F.R. Parts 1050 and 1052, which are in all existing FMMOs, should be adopted for the California FMMO. Section 1000.50 contains 17 uniform definitions, subparts (a) through (q) which in aggregate (and including Section 1000.52 for Class I) establish the minimum values for prices to handlers for skim milk, butterfat, protein, and other solids in Class I (subparts (a) - (c) and (q)) plus 1000.52, Class II (subparts (d) - (g) and (q)), Class III (subparts (h), (i), (l), (n), (o), and (p)), and

Class IV (subparts (j), (k) and (l)). Adoption of all of these uniform pricing provisions is appropriate for the California FMMO. Proponents will discuss them in order by Class.

1. The National Class I Price Grid In Uniform Sections 1000.50 And 1000.52 Should Be Adopted In The California Order.

Both Proposal Nos. 1 and 2 in the Hearing Notice endorse adoption of the uniform national base price and adjusted Class I differential grid for Class I prices.[16] The uniform national grid in Part 1000 was adopted in the Reform Final Decision (and refined in Congressional action in November 1999)[17] and has remained in place ever since.[18] This uniform Class I base price and differential grid should be adopted for the California FMMO.

On behalf of the Cooperatives, Dennis Schad ("Mr. Schad") of LOL reviewed in detail the background and evolution of the uniform national integrated system of Class I prices in FMMOs. When orders have different Class I prices, the potential for disorder arises when distributing plants change regulatory status from one order to another. Federal Order Reform eliminated this possibility with adoption of uniform Class I differentials applicable to all orders. If a California FMMO has Class I prices different than those of adjoining orders, or any other orders in the system, it will create the unacceptable possibility for a plant in Arizona, for instance, to shift regulation and obtain

[16] Proposal No. 2 would fractionate the uniform Class I skim price into Class I nonfat solids (76%) and Class I fluid carrier (24%) components. This fractionation of the skim milk price does not change, however, the uniform skim milk price level itself, or affect the applicable differentials in Part 1000.52.

[17] *The Consolidated Appropriations Act*, 2000, (P.L. 106-113, 115 Stat. 1501).

[18] Adjustments to some differentials in the Southeast FMMOs did not change the Part 1000 grid.

a competitive advantage. This is precisely what federal price uniformity has prevented and what the California FMMO should avoid.

In addition to the Reform Final Decision which established the basis and rationale for the basic Class I price level and the county-by-county differentials, Mr. Schad detailed the historical and present basis for the base Class I differential added to the base manufacturing values which make up the advanced pricing factors for Class I skim and butterfat prices. 7 C.F.R. Part 1000.50(q). The base Class I price, with a minimum differential of $1.60, is supported by the quality and services required for producing Grade A milk and servicing the Class I market. Mr. Schad detailed how the additional costs associated with Grade A milk are greater than the $1.60 differential. (Schad Tr. XVI, pp. 3146-54 (Oct. 15, 2015); Exh. 70, pp. 30-32.) The additional production costs that a farmer incurs to earn Grade A status include: (1) the cost of obtaining and maintaining an approved water system and supply; (2) the cost of facility construction and compliance with appearance requirements; (3) the cost of meeting plumbing requirements; and (4) the cost of procuring and maintaining specific equipment. (Schad Tr. Vol. XVI, p. 3148 (Oct. 15, 2015); Exh. 70, p. 31.) Furthermore, maintaining Grade A status requires additional labor and utility expense. (*Id.*; s*ee also,* Exh. 71, Dairy Farms Scorecard, State of California Department of Food and Agriculture (listing out most things a dairy farmer must do to maintain Grade A status), *see* Request for Official Notice.) In 1999, the USDA estimated the additional cost to produce Grade A milk to be $.60 per hundredweight. (Schad Tr. Vol. XVI, p. 3148 (Oct. 15, 2015); Exh. 70, p. 31, citing *Milk in the New England and Other Marketing Areas; Proposed Rule and Opportunity to File Comments, Including Written Exceptions, on Proposed*

Amendments to Marketing Agreements and Orders, 63 Fed. Reg. 4802, 4908 (January 30, 1998).)

In addition to increased production costs, farmers incur additional marketing costs for Grade A milk. The Secretary has determined that additional marketing costs include, "seasonal and daily reserve balancing of milk supplies, transportation to more distant processing plants, shrinkage, administrative costs, and the opportunity for 'give-up' charges at manufacturing milk plants that service the fluid Class I market." (Schad Tr. Vol. XVI, p. 3152 (Oct. 15, 2015); Exh. 70, p. 31, citing *Milk in the New England and Other Marketing Areas, etc., supra,* 63 Fed. Reg. at 4909.) The Secretary estimated these additional marketing costs to total $.60 per hundredweight. *Milk in the New England and Other Marketing Areas, etc., supra,* 63 Fed. Reg. at 4908; s*ee also* Schad Tr. Vol. XVI, p. 3152 (Oct. 15, 2015); Exh. 70, p. 31.

Furthermore, in the upper Midwest, Class I handlers compete for milk with processors of manufactured milk, and two-thirds of the competitive premium is $.60 per hundredweight. *Milk in the New England and Other Marketing Areas, etc., supra,* 63 Fed. Reg. at 4909; Schad Tr. Vol. XVI, p. 3152 (Oct. 15, 2015); Exh. 70, p. 31. Finally, the proposed transportation credit program in Proposal No. 1, which costs about $.60 per hundredweight of Class I volume further justifies the need for the $1.60 minimum differential. (Schad Tr. Vol. XVI, pp. 3152-53 (Oct. 15, 2015); Exh. 70, p. 31-32.)

The sum total of cost factors discussed above which support the minimum Class I differential of $1.60 add up to $2.40, or 50% more than necessary to justify the $1.60. There is more than adequate evidence in this record to adopt this uniform minimum national Class I value in the California FMMO.

The Class I prices in the California FMMO should also be based on the higher of the Class III or IV advance price mover, as calculated under Section 1000.50(q) and applied uniformly throughout the FMMO system. Any deviation from use of the "higher of" mover will create the same type of price differences and resulting distortions between FMMOs as will different Class I base prices, or different Class I differentials.

No participant in the hearing, including the DIC, testified in opposition to adoption of the uniform FMMO Class I price grid. As noted above, the DIC supported a Class I skim fluid carrier which will be discussed in reply, but did not challenge the price level when advancing that modification to uniform provisions. The national Class I grid will further orderly marketing in the California marketing area and should be adopted.

2. The Uniform National Class II Price Should Be Adopted For The California FMMO.

Uniform national pricing for Class II products in the FMMO system was adopted at a national hearing in 1991. At the time of Federal Order Reform, only Order 2, the New York – New Jersey Order had a slightly different price for Class II uses linked to its then-existing farm point pricing program. (Schad Tr. XV, pp. 3095-96 (Oct. 14, 2015); Exh. 70 pp. 12-13.) This Order 2 anomaly was eliminated with Federal Order Reform and since 2000 all FMMOs price Class II milk in accordance with the uniform provisions of Section 1000.50. These specific terms for components, and for advance pricing are:

> (d) The Class II price per hundredweight, rounded to the nearest cent, shall be .965 times the Class II skim milk price plus 3.5 times the Class II butterfat price.
>
> (e) Class II skim milk price. The Class II skim milk price per hundredweight shall be the advanced Class IV skim milk price computed in paragraph (q)(2) of this section plus 70 cents.

(f) Class II nonfat solids price. The Class II nonfat solids price per pound, rounded to the nearest one-hundredth cent, shall be the Class II skim milk price divided by 9.

(g) Class II butterfat price. The Class II butterfat price per pound shall be the butterfat price plus $0.007.

. . .

(q) Advanced pricing factors. For the purpose of computing the Class I skim milk price, the Class II skim milk price, the Class II nonfat solids price, and the Class I butterfat price for the following month, the following pricing factors shall be computed using the weighted average of the 2 most recent NASS U.S. average weekly survey prices announced before the 24th day of the month:

. . .

(2) An advanced Class IV skim milk price per hundredweight, rounded to the nearest cent, shall be computed as follows:

(i) Following the procedure set forth in paragraph (m) of this section, but using the weighted average of the 2 most recent NASS U.S. average weekly survey prices announced before the 24th day of the month, compute a nonfat solids price; and

(ii) Multiply the nonfat solids price computed in paragraph (q)(2)(i) of this section by 9.

The importance of a uniform national price for Class II products was underscored by the hearing testimony which revealed the national competition in, and distribution of, Class II products. The witness for Nestlé testified to the locations of Nestlé's U.S. plants, their products, and their distribution. (Kluesner Tr. Vol. XXXI, pp. 6296-6307 (Nov. 5, 2015).) Nestlé has three California plants, two of which produce Class II products, including ice cream and novelties. (*Id.* at 6297.) Both California Class II plants distribute nationally, competing with plants throughout the country. (*Id.* at 6299.) The

Nestlé Tulare plant's distribution was described as national on pretty much everything they make. Outside California, Nestlé's Class II plants also distribute over a wide regional, if not national, geographic area. Its newest plant in Anderson, Indiana, a fully regulated Order 33 pool plant, for instance, distributes coffee creamers and nutritional beverages nationally. (*Id.* at 6305.) Their Wisconsin nutritional beverage and confectionary plants also distribute nationally. (*Id.* at 6306.) The Nestlé witness underscored the importance of their nationwide competition with processors in the FMMO system, arguing, somewhat ironically, that Nestlé wants to have the same pooling rules, but not the same prices, in a California FMMO as its competitors experience in the rest of the country. (*Id.* at 6293-94; Exh. 136.) There was also other testimony at the hearing confirming the national marketing of Class II products, including Mr. Hollon's testimony to the long-distance movement of bulk Class II condensed milk from California. (Hollon Tr. Vol. IV, pp. 829-31 (Sept. 25, 2015 and 911-12 (Sept. 28, 2015).) The fact that Class II products compete in a national market has been a fundamental tenet of FMMO Class II pricing for several decades; that principle was reaffirmed and applied in Federal Order Reform, and it is confirmed by the testimony in this record. In short, the fact that the Class II market is a national market is not subject to dispute.

The basis for the $.70 Class II differential over the Class IV price is fully explained and supported in the Reform Final Decision. *See Milk in the New England and Other Marketing Areas, supra*, 64 Fed. Reg. at 16093-94. Since it is possible to rehydrate dry milk powder and use it as an alternative to fresh "wet" nonfat milk solids, NFDM or condensed milk are alternative ingredients to fresh milk in the manufacture of

many Class II products including ice cream, cottage cheese, and yogurt. Therefore, the Class II price has been linked to the cost of condensing or drying and rehydrating milk solids. In the Reform Final Decision, the Secretary found that $.70 is the best "estimate of the cost of drying condensed milk and rewetting the solids to be used in Class II products." (*Id.* at 16104.) Of that figure, $.57 represents the cost of drying condensed milk." (*Id.*) The cost of using NFDM could be as much as $.27 per hundredweight. (*Id.*) When combined with the $.57 per hundredweight cost for drying condensed milk, it is clear that the cost could be greater than $.70. Therefore, $.70 per hundredweight continues to be an appropriate and reasonable amount to reflect the value of fresh milk in the production of Class II products

The uniform national price for Class II milk of Class IV plus $.70 should be adopted for the California FMMO.

3. The Uniform National Class III Price Should Be Adopted For The California FMMO.

a. History shows the USDA's deliberate adoption of uniform national pricing.

The history of federal order pricing for milk used to produce hard manufactured products – cheese, butter and NFDM – traces an inexorable journey from a scrabble board proliferation of local and regional prices[19] to one, uniform national price. The evolution from local and regional class prices for manufacturing milk to a uniform national price began in earnest in the 1960's, as has been reported: "[S]ince the early 1960's USDA policy has been to move toward the establishment of essentially uniform

[19] In 1961, when the M-W was first adopted, there were 86 orders with more than a dozen different prices or price formulas for the lowest class milk, which was either class II, III, or IV depending on the order. 7 C.F.R. 1000-1137 (January 1, 1962).

prices for reserve milk supplies in all markets . . . ." *Research Bulletin 1105: Pricing Grade A Milk Used in Manufactured Dairy Products*, Jacobson, Robert E., et al. (Ohio Agriculture Research and Development Center, Wooster, Ohio (1978), *see* Request for Official Notice. The 1961 adoption in the Chicago federal order of the Minnesota-Wisconsin ("M-W") price series as the basis for pricing milk used for manufacturing was a key development in this process.[20] The USDA obtained the M-W price from a base-month survey of manufacturing plants in Minnesota and Wisconsin that paid producers of Grade B (manufacturing grade) milk. (Schad Tr. Vol. Vol. XV, p. 3063 (Oct. 14, 2015).) In this context, manufacturing grade milk was used for all products which did not require Grade A milk, including butter, NFDM powder and all forms and varieties of cheese. (*Id.* at 3064.) The USDA updated the base monthly M-W price via a survey of a smaller number of plants' pay prices for the succeeding month. (*Id.* at 3063.) By October 1967, 30 of the then-existing 74 orders had adopted the M-W price as their single uniform price for reserve milk. The Secretary explained the national character of the M-W price in the following terms:

> The M-W price is a competitive price that represents an estimate of the average of prices paid for Grade B milk in Minnesota and Wisconsin by plants that manufacture butter, nonfat dry milk, and cheese. These products are sold in a national market in competition with such products made from Grade A milk that is in excess of fluid milk needs. Month-to-month changes in the M-W price reflect changes in overall supply and demand conditions for milk and its products nationally.

[20] *See Milk in Chicago Illinois Marketing Area, Decision on Proposed Amendments to Tentative Marketing Agreement and to Order*, 26 Fed. Reg. 7134 (Aug. 9, 1961).

Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Tentative Marketing Agreements and Order, 60 Fed. Reg. 7290, 7292 (Feb. 7, 1995).

At the time of first adoption of the M-W price series, there were more than 80 federal orders, with many and varied reserve milk pricing provisions.[21] Price Structure Committee, AMS, Dairy Division, Preliminary Report, p. 3 (November 1, 1996), *see* Request for Official Notice. With the implementation of USDA's national pricing policy, all FMMOs adopted the M-W price series as the uniform Class III price by the mid-1970s. *Milk in the Northeast and Other Marketing Areas; Decision on Proposed Amendments to Tentative Marketing Agreement and to Order,* 67 Fed. Reg. 67906, 67937 (Nov. 7, 2002).

With the recognition of national markets and the importance of a uniform national price policy, the USDA resisted requested inroads into this price grid when new orders came into the program. In 1989, for example, the USDA rejected requests in the Carolina FMMO to deviate from federal butterfat pricing standards (applicable to all classes of milk) and adhere to a state butterfat pricing factor, stating: "If such a modification were adopted, the value of butterfat and skim milk in the Carolina market will not be aligned with such values under the neighboring Federal order markets" and citing the difference between the states' pricing and federal pricing as a factor in "disorderly marketing."[22] *Milk in the Carolina Marketing Area; Final Decision on*

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[21] More than a dozen different prices, at least. See note 16, *supra*.

[22] Mr. Vetne asked Mr. Schad, on cross examination, "whether the words disorderly marketing are words used by the Secretary" in the decision cited. Mr. Schad responded by reading the following passage from the decision:

(footnote continued)

Proposed Amendments to Marketing Agreement and to Order, 55 Fed. Reg. 25618, 25643 (June 22, 1990).

The retention of uniform national pricing for Class III milk was again demonstrated when multiple component pricing ("MCP") was introduced in several FMMOs in the late 1980s and early 1990s prior to Federal Order Reform. The USDA held a separate hearing for each order involved and made decisions based on the evidence adduced at each hearing. After those hearings, which resulted in several somewhat different MCP programs, regardless of the formula ultimately adopted, the Class III price, which was the national Basic Formula Price ("BFP"), was retained. Thus, at standard test, the Class III price in all FMMOs was the uniform national price at the time of federal order reform.

On another occasion, while seasonal Class III adjusters had been "grandfathered" into the Northeastern orders through the 1990s, the Secretary declined the invitation to incorporate seasonal adjusters into other orders, thereby further reinforcing the drive toward national pricing. *See, e.g., Milk in the Georgia and Certain Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Order,* 60 Fed. Reg. 25014, 25036 (May 10, 1995).

The operation of the M-W price itself did change in the 1980s and 1990s pre-reform with the adoption of the BFP. When the USDA first developed the M-W price,

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> The disparity [in] . . . pay prices [caused] . . . by individual handler pools and individual base plans have contributed to disorderly marketing in North Carolina and South Carolina.
>
> . . . another factor contributing to disorderly marketing . . . in this two state area is the butterfat differential used in paying producers.

(Schad Tr. Vol. XVI, p. 3201 (October 10, 2015).)

approximately 50% of the total U.S. Grade B milk was produced in Wisconsin and Minnesota. (Schad Tr. Vol. XV, p. 3063 (Oct. 14, 2015).) As the number of Grade B producers and the number of plants that accepted Grade B milk declined, the USDA established the BFP in 1989 to reflect that change. (*Id.* at 3064.) The BFP is a commodity price update to the M-W competitive price survey. (Schad, Tr. Vol. XV, p. 3064, October 14, 2015) The products surveyed in the updated formulae were butter, non-fat dry milk, cheddar cheese, and whey powder. The Secretary has described the process to determine the Basic Formula Price as follows:

> It [BFP] would be computed by increasing or decreasing the M-W price of the second preceding month by an amount that reflects changes in the value of the gross value of milk used to produce cheddar cheese (including whey fat and whey solids non-fat), butter, non-fat dry milk and edible whey powder of the first fifteen days of the preceding month compared to the first fifteen days during the second preceding month. The gross value of milk used to produce these products would be determined by multiplying the price of each product by a yield factor which represents the pounds of product that results from the manufacture of a hundredweight of milk. The yield factors used in the formula adopted herein would be those that are used under the Dairy Price Support Program for determining similar gross values.

Milk in the Carolina Marketing Area, supra, 55 Fed. Reg. at 25641.[23]

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[23] Although the 1985 Farm Bill changed the calculation of the cheese support price by deleting whey from the formula, the Secretary continued to use whey values, make allowances, and yields to compute the BFP. Within the Secretary's decision to report an equivalent price, he wrote:

> It is therefore ordered that a whey processing cost of 12.5 cents per pound and a yield factor of 5.5 pounds continue to be used as equivalent factors determining any positive whey value in computing the basic Class III formula price under the above named orders, effective upon issuance of this

(footnote continued)

The USDA changed the calculation of BFP in 1995, prior to Federal Order Reform. The 1995 BFP decision redefined the calculation by deleting the whey factor, but, for the first time, including a dry buttermilk factor. The newly configured BFP remained the base national price. *Milk in New England and Other Marketing Areas, supra,* 60 Fed. Reg. at 7301.[24]

The 1996 Farm Bill directed the Secretary to consolidate the existing 33 Federal orders to a maximum of 14 and a minimum of 10 and authorized the Secretary to address all issues related to milk pricing. As noted in the Conference Committee Report on the 1996 Farm Bill: "There is no limitation to the number of issues the Secretary may consider when consolidating the orders." *Conference Report to Accompany H.R. 2854*, p. 338 (March 25, 1996). Congress also directed the Secretary to implement the Farm Bill's mandates through the streamlined procedures of informal rulemaking.[25]

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determination. *Milk in the Carolina Marketing Area, supra,* 55 Fed. Reg. at 25642.

[24] While the politics of the 1985 Farm Bill ultimately changed the calculation of the BFP by deleting whey from the formula, the value of whey continued to be implicitly included in the base BFP through the base month M-W price. Consequently, ever since 1961, the value of whey has always been included in the FMMO price for manufacturing milk.

[25] Informal rulemaking allowed the Secretary to request information and recommendations from USDA staff and other sources which normally would not be provided in the formal hearing process. Thus, AMS established five committees composed of AMS and Market Administrator staff. Those committees were Price Structure, Basic Formula Price, Identical Provisions, Classifications and a Regional Committee, composed of Mideast, Northeast, Southeast and Western regions. In addition to utilizing USDA personnel, partnerships were established with two university consortia to provide expert analysis on issues relating to price structure and basic formula price options.

The broad authorization and informal rulemaking procedures granted in the 1996 Farm Bill allowed AMS to standardize milk classifications, pricing, and procedures into a full national system, which the USDA first set out in its 1998 Proposed Rule for Federal Order Reform. *Milk in New England and Other Marketing Areas, supra,* 63 Fed. Reg. at 4877. In the course of that Proposed Rule, prior to the ultimate Final Decision, the USDA made clear its intention to establish a national price formula with uniform application across the country. The Secretary stated, *inter alia*,

> The new basic formula price should be simple to derive and easy for the dairy industry to understand, since it would be used in **all Federal milk orders**. The BFP also should be transparent. That is, it should be possible to see and understand the derivation of the BFP, even if a complex formula is used to determine the price. Further, the new basic formula price should **be applied uniformly within orders and on a national basis**.
>
> The most important criterion is sound economics--the ability of the BFP to reflect the supply and demand for raw milk. Currently, the BFP is intended to represent the interaction of supply and demand for manufacturing milk and thereby, the supply and demand for fluid milk at a minimum level. A replacement that fits this traditional role suggests that the supply and demand for manufacturing milk should be reflected in the new price.
>
> Sound economics also implies that minimum prices for milk used in manufactured products will be market-clearing. The use of two classes to price milk used in traditional "surplus" products of butter, nonfat dry milk, and cheese (that is, milk in excess of that amount needed to fill fluid demand), helps assure that only one product will have to be priced at a level that clears the market. The market-clearing product in most cases is butter/nonfat dry milk.

Milk in New England and Other Marketing Areas, supra, 63 Fed. Reg. at 4877 (emphasis added). Thus, Federal Order Reform enacted pursuant to the 1996 Farm Bill

was the culmination of the price nationalization efforts which began in 1961 with the first adoption of the M-W price.[26]

In 1999, all FMMOs except the three Northeastern orders (1, 2 and 4) charged the same Class III price. The average Class III price for milk pooled on Order 2 was $0.09 higher than the national average price; Order 4, $0.03 higher and Order 1, $.01 greater. (Federal Milk Order Market Statistics, 1999 Annual Summary, Table 30, *see* Request for Official Notice.) These deviations from the national price for milk used to produce Class III products were the result of each order's seasonal adjuster. These adjusters had factored into the orders' milk pricing for 30 years and predated the national adoption of the M-W price series in all orders. *See Milk in the New England and Other Marketing Areas, supra,* 64 Fed. Reg. at 16149.

In the course of implementing Federal Order Reform, the Secretary replaced the BFP with an MCP system that derived component values from surveyed prices of manufactured dairy products. The adopted pricing system determines butterfat prices for milk used in Class II, Class III and Class IV products from a butter price; protein and other solids prices for milk used in Class III products from cheese and whey prices; and nonfat solids prices for milk used in Class II and Class IV products from NFDM product prices. To translate prices of dairy commodities into uniform class prices for milk, three factors are needed: (1) a price discovery vehicle for butter, NFDM, cheddar cheese and

[26] Class II prices have followed the same path as Class III prices. As a result of a national hearing held in 1991, the Class II price was established in all FMMOs as the Class III price plus $0.30 per hundredweight. At the time of Federal Order Reform, all FMMOs, except the New York – New Jersey order charged the same price for milk used to produce Class II products. Only Order 2, which included farm point pricing, maintained a location adjuster on Class II volumes. On average the Order 2 price was $0.08 higher than other FMMOs.

whey; (2) the cost of processing milk into the finished product commodities; and, (3) the yield of finished product from a hundredweight of milk. These factors were adopted for component prices in all MCP orders.

The Secretary has long recognized, as noted above, that national competition for dairy products sales requires prices for milk used in those products to be uniform across all FMMOs. Uniform pricing promotes fair competition based on manufacturers' relative advantages and the market place, rather than based on the price of milk, while disparate pricing formulas can result in substantial price differences among proximate manufacturing plants, depending upon where the dividing line is for different prices. *See, e.g., Milk in the New England and Certain Other Marketing Areas; Decision on Proposed Amendments to Tentative Marketing Agreements and to Orders,* 58 Fed. Reg. 58112, 58124 (October 29, 1993). In other words, the Secretary does not want the USDA to be in the business of favoring some manufacturers and disadvantaging others. Similarly, the Secretary has recognized that deviations from a uniform national price cause price misalignments in adjacent markets and would be inconsistent with national policy. *See id.* at 58114-15. In that decision, the Secretary further explained that while there may be *some* location value associated with NFDM, as there is with manufactured dairy products such as cheese and butter, that value **does not outweigh** the value of a uniform national price:

> [M]anufacturers of these finished products compete with each other for sales throughout the nation. Thus currently, the minimum price used for these products is uniform throughout the country, with some minor exceptions. This insures that all processors of these products have the same starting point in terms of minimum price for milk. They are then left to compete for sales with each other for sales throughout the country. In some places the processors would have a location advantage over competitors and in some areas a disadvantage. However, the

> marketplace and not differences in the minimum price for milk would determine the relative advantages in order to allow competitive forces to continue to operate. The recommended decision concluded that the Class III-A price should be uniform among the Federal order markets as is currently the case with the Class III price. Using different power prices in the Class III-A formulas could result in substantial price differences among nearby manufacturing plants, depending upon where the dividing line is established for using different prices that recommended decision concluded. Establishing different price levels would not be consistent with the price support program and the national market nature of the NFDM market, the recommended decision further concluded.

Id. at 58124.[27]

Uniform national pricing of milk used in dairy products, other than fluid milk, is critical because the market for manufactured dairy products is national in scope. For more than 50 years, the Secretary has recognized that "butter, nonfat dry milk, and cheese . . . are sold in a national market in competition with such products made from Grade A milk that is in excess of fluid milk needs. *Milk in the New England and Other Marketing Areas, supra,* 60 Fed. Reg. at 7292. Since adoption of the M-W price series, the Secretary has consistently concluded that Class III and Class IV products compete in a national market. The Secretary has continued to recognize the national scope of the market for Class III and Class IV dairy products after Federal Order Reform. In the 2002 post-Reform Final Decision on Class III and IV prices, the Secretary expressly rejected price requests for lower prices in the Western U.S. reasoning and finding:

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[27] The 1993 final decision in the III-A proceeding represented a brief hiccup in the USDA's longstanding drive towards national pricing in that it retained certain Western regional NFDM prices. However, as explained in the testimony of Mr. Schad, the probable reason for this change was the unavailability of robust data sets regarding national NFDM prices. (Exh. 70, p. 10-12.) By 2000, when adequate data became available, use of regional NFDM data was discontinued and regional prices were eliminated. *See Milk in the New England and Other Marketing Areas, supra*, 64 Fed. Reg. at 16296.

> . . . Class III and Class IV prices established under Federal milk orders are based on national dairy product prices which reflect the national supply and demand conditions of milk used in these two classes. . . . .
>
> **Class III and Class IV dairy products compete in a national market. Because of this, Class III and Class IV milk prices established for all Federal milk marketing order areas are the same.** The Federal milk order program gradually adopted the Minnesota-Wisconsin (M-W) price as the Class III price in all Federal milk marketing orders. Although the M-W was first adopted in 1963, it was not until the mid 1970's that the M-W established a uniform class price for milk used in Class III products in all Federal milk orders. Observations of the market place for cheese, butter, and nonfat dry milk provided the basis for concluding that these products compete in a market that is national in scope. Such findings were upheld with the adoption of the Basic Formula Price (BFP), which provided an interim pricing method for milk (due largely to the declining statistical reliability of the M-W price series) until a more long-term pricing method could be developed.
>
> The implementation of milk order reform in 2000 continued finding that Class III and Class IV dairy products compete in a national marketplace. However, a competitive price for milk, as represented by the M-W and BFP prices, was no longer viable. As an intended long-term method, the Federal milk order program has adopted end-product price formulas, valuing Class III and Class IV milk on the basis of the value of Class III and Class IV end-products in the marketplace. The NASS price survey for dairy products used as a basis for establishing Class III and Class IV prices includes all dairy product prices and sales volumes in all regions of the country, including California. In this regard, the Federal order program has and will continue to reflect California's impact on dairy product prices while establishing Class III and Class IV prices that are reflective of national supply and demand conditions.

Milk in the Northeast and Other Marketing Areas, supra, 67 Fed. Reg. at 67937 (emphasis added).

The USDA's decades-long, deliberated, implemented, and settled policy of uniform national pricing of milk used to produce manufactured milk products should be continued in the California FMMO.

b. California cheese is part of the national cheese marketplace.

The testimony of California cheese processors makes clear, if there were ever any doubt, that California cheese competes in the national marketplace of cheese sales, confirming the longstanding USDA policy predicate that the market for manufactured products be national. The testimony of the witnesses for Saputo, Leprino, Hilmar, Marquez Brothers, and Cacique paint a vivid picture of this national trade and nationwide competition.

Saputo is a national Class II and III processor, the second or third largest cheese processor in the country. Exhibit 94 depicts the locations of its 16 plants from coast to coast, five of which are in California. With nationwide distribution, the plants are concentrated in California and the upper Midwest, primarily Wisconsin. (Dryer Tr. Vol. XXI, pp. 4248-61 (Oct. 22, 2015).) Saputo, among other products and product lines, has the number one brand of string cheese in the country. (*Id.* at 4251.) It services its national accounts from both its California and Wisconsin cheese plants.

Leprino is one of the three largest cheese processors in the country. It has nine plants, three in California and the other six in Colorado (2), New Mexico, Michigan (2), and Pennsylvania. Its plants, products and distribution were described by Sue Taylor of Leprino. The California plants represent 33-50% of Leprino's total volume. (Taylor Tr. Vol. XXXI, pp. 6188-6202 (Nov. 5, 2015).) The Leprino plants in California distribute products throughout the United States and as far as Florida. (*Id.*) Leprino's production and distribution system operates with the individual plants specializing in production of various products all of which are distributed to Leprino customers nationally and internationally. (*Id.*) The non-California plants all purchase milk regulated by FMMOs

and all pay the minimum federal class price plus a premium. (Taylor Tr. Vol. XXXI, p. 5317 (Nov. 5, 2015).)

Hilmar has plants in California and Texas. (De Jong Tr. Vol. XXII, p. 4383 (Oct. 23, 2015).) The Hilmar California plant is said to be the largest cheese plant in the nation, processing 12% of California's milk production. (*Id.*) It manufactures a variety of cheese (and whey) products and distributes them nationally. (*Id.*) Unlike Saputo and Leprino which have sales to consumers and end-users, Hilmar markets its products in bulk, primarily to "converters," companies which buy bulk quantities of cheese and process it by cutting and wrapping it into smaller packages for resale. (*Id.* at 4456-61.) Hilmar's sales are apparently nearly all to out-of-state converters. (*Id.*) It identified the locations of its major converter customers, none of which were in California. (*Id.*)

California produces 50% of the Hispanic cheese in the country. (Hollon Tr. Vol. IV p. 799 (Sept. 25, 2015).) The two Hispanic cheese processors who testified both market over a very broad geographic area. (Maldonado Tr. Vol. XXIII, p. 4646 (Oct. 26, 2015); De Cardenas Tr. Vol. XXIV, p. 4881 (Oct. 27, 2015).) Cacique Cheese, located in Industry, California, markets its Hispanic cheeses nationally, to customers including Walmart stores which carry Cacique products from coast to coast. Marquez Brothers, based in Hanford, California, markets its cheeses nationwide as well, with major distribution in the Midwestern states. (Maldonado Tr. Vol. XXIII, p. 4646 (Oct. 26, 2015).) Hispanic cheeses for the entire country are thus produced in California under the California system's lower prices, posing a serious competitive issue for would-be manufacturers and sellers of Hispanic cheese elsewhere in the country. (Hollon Tr. Vol. V, p. 918 (Sept. 28, 2015).) The record further establishes that cheesemakers in the

Midwest, and even in the Northeast, market in California. Two Wisconsin cheesemakers testified and acknowledged that sales of their products cover a wide geography from their Wisconsin base, including sales reaching the West Coast. (Buholzer Tr. Vol. XXIV, pp. 5772-73 (Nov. 3, 2015); Stettler Tr. Vol. XXIV, p. 5763 (Nov. 3, 2015).) In addition, witnesses noted that Vermont-based Cabot brand cheddar cheese was available in California grocery stores. (De Cardenas/Moore Tr. Vol. XXIV, p. 4884 (Oct. 27, 2015).)

There is no genuine dispute that cheesemakers in California compete with cheesemakers throughout the country, and vice-versa. As Federal Order Reform held, the market for sales of Class III products is a national market.

c. Whey pricing is not a basis for a California deviation from the national Class III price.

The other solids, or whey, factor in the Class III price provides no basis for the California FMMO price to deviate from the national price formula. The large California cheese plants, which process the lion's share of the Class III products in California, process their whey in the same manner and to the same extent as cheese processors in the rest of the country. Leprino, Saputo, and Hilmar, the three largest cheese processors in California, all process their whey. (Taylor Tr. Vol. XXVI, p. 5294 (Oct. 29, 2015); Dryer Tr. Vol. XXI, pp. 4255-56 (Oct. 22, 2015); De Jong Tr. Vol. XXII, p. 4383 (Oct. 23, 2015).) Gallo Cheese, a smaller California cheesemaker also processes its whey and purchases whey from some other cheesemakers. (Paris Tr. Vol. XXX, pp. 6080-81 (Nov. 4, 2015).) Farmdale processes its whey, as do Marquez and Cacique. (Hofferber Tr. Vol. XXIV, p. 4762 (Oct. 27, 2015); De Cardenas/Moore Tr. Vol. XXIV, pp. 4888-89 (Oct. 27, 2015); Maldonado Tr. Vol. XXIII, p. 4624 (Oct. 26, 2015).) There is

nothing in the record to establish that whey processing in California is any different than the rest of the country.

Exhibit 96 provides an overview of California cheesemakers and whey processing during the first quarter of 2015. A review of that data is quite enlightening. Prepared by CDFA, Exhibit 96 groups the 57 California plants processing cheese into nine groups by volume, with at least three plants in each group. (Exh. 96.) The three largest plants in the state all process whey and represent 56.4% of the volume of milk processed into cheese. (Exh. 96.) Those plants processed just under an average of 10 million pounds of milk per plant per day. (Exh. 96.) At the other end of the volume spectrum is a grouping of 17 plants, which together had monthly average usage of 561,232 pounds of milk, just over 1000 pounds per day per plant. (Exh. 96.) Incredibly, each of these plants is about 1/10,000 the size of each of the three largest plants. All of these 17 plants will be exempt from regulation under Proposal No. 1.

The four smallest, by volume, groups of plants in Exhibit 96 include 36 of the 57 plants but together they represent only 1.1% of the aggregate volume. (Exh. 96.) None of these plants processes whey. (Exh. 96.) However, of the 21 plants in the five largest groups by volume, 13 process whey. (Dryer Tr. Vol. XXI, pp. 4248-61 (Oct. 22, 2015).) If one makes the reasonable assumption that the plants which process whey in each group have group average volume, 85.8% of the state's cheese is produced at plants which process whey. In addition, some plants which do not process whey sell their whey to plants which do process it. (Paris Tr. Vol. XXX, pp. 6081-82 (Nov. 4, 2015); Wegner Tr. Vol. VIII, p. 1658 (Oct. 1, 2015).) One of the major cheese producers in the state, Saputo, consolidated all its whey processing at one location, although it has four

plants which process milk into cheese. (Dryer Tr. Vol. XXII, pp. 4301-03 (Oct. 23, 2015).) The three Saputo plants whose whey processing has been consolidated to one plant will show up as non-processing plants in Exhibit 96. Those Saputo non-whey-processing plants are of substantial size, according to Saputo's witness, who would not reveal volumes but said at any plant "you need to be able to process quite a bit of milk." (*Id.* at 4251.) If one assumes that the non-whey-processing Saputo plants are the non-whey processing plants in Groups 8 and 9 of Exhibit 96, 94.7% of the cheese producing capacity in California processes its whey. When LOL and DFA plant volumes[28] are added, as well as Gallo's purchased volume, well in excess of 95% of whey in California is processed. It is noteworthy that there were no California cheese plant operators who testified at the hearing who did not process their whey.

These California whey usage data compare favorably to those reflected in the Wisconsin cheese industry whey study, introduced in Dr. Schiek's testimony as Exhibit 123. That study reported that "[a]pproximately half" the cheese plants in Wisconsin "do not process their whey at any level" accounting for "about one-tenth of the total volume of whey generated." (Exh. 123, p. 25.)

There is simply no factual basis to support pricing whey in California any differently than it is priced in Wisconsin or any other FMMO. There is no data series available to implement the new whey pricing program which Proposal No. 2 will foist

[28] Liquid whey from both the DFA Turlock, California mozzarella cheese plant and LOL Orland, California process cheese plant is sold to other California processors. (Murphy Tr. Vol. XXVII, p. 5373 (Oct. XX, 2015); *see also* Wegner Tr. Vol. VIII p. 1658 (Oct. 1, 2015).)

upon the California dairy industry. The uniform national price for milk used to produce cheese should be adopted for the California FMMO.

d. California plants can afford to pay the same minimum price for Class III milk as applies in the rest of the FMMO system.

The contention has been made that California cheese plants cannot afford to pay minimum FMMO Class III prices. This contention simply does not withstand scrutiny. Mr. Paul Christ ("Mr. Christ") addressed it directly in his testimony. (Christ Tr. Vol. XII, pp. 2457-70 (Oct. 7, 2015); Exh. 58, pp. 8-12.) Mr. Christ, a witness whose breadth of experience in the dairy industry and FMMO system was unequaled by any other witness in the hearing, carefully evaluated this contention and identified seven factors which lead him to conclude: "It is not likely that the proposed prices for manufacturing milk in California will be too high." (Christ Tr. Vol. XII, p. 2470 (Oct. 7, 2015); Exh. 58, p. 12.) The factors Mr. Christ identified are:

1. Cheese production in FMMO areas of the Western U.S. have expanded at a faster rate than production in California during the years from 2000 to 2014, since Federal Order Reform.

2. Cheese processors throughout the FMMO system pay substantial premiums over the minimum Class III price for milk used to produce cheese. Mr. Christ relied on a data series prepared for him by the Market Administrators throughout the FMMO system. (Exh. 60.) The fact and extent of the premiums prevailing throughout the federal order system was confirmed by many, many witnesses and in multiple data sets. It is not subject to good faith dispute.

3. California plants have substantial advantages in economies of scale, in comparison with plants in the rest of the country. The average cheese plant in California is twice the size of the average plant in the rest of the country. The average California butter plant is 2.6 times that of non-California competitors.

4. California plants have cost advantages in milk procurement because of the larger size of California farms, which in 2014 had average production of 28.5 million pounds versus the national average of 4.5 million pounds.

5. California's low Class I utilization provides manufacturing plants with lower balancing expenses than competitive plants in most FMMO markets.

6. Proximity to Asian export markets gives California plants an advantage in capturing those sales when export demand is strong. The revenue opportunities from these sales would be expected to be greater than the cost reflected in FMMO manufacturing class prices.

7. California cheese manufacturers have the opportunity to process non-commodity products and capture the value added. It appears, in fact, that the California industry has seen and taken advantage of this opportunity already. California does not even produce enough cheddar cheese to meet its domestic consumption needs.

The evidence in the hearing record overwhelmingly demonstrates that cheese manufacturers throughout the FMMO system routinely pay more than minimum federal order value, demonstrating that the FMMO prices are, in fact, minimum prices. Consequently, requiring California cheese plants to pay the minimum Class III price does not place them at a competitive disadvantage. First, Mr. Hollon's mailbox milk price comparison shows the lack of competitive disadvantage. (*See, supra,* Section II.B.1.) Mr. Hollon's comparisons of mailbox prices in California, Wisconsin, Illinois, Minnesota and the Pacific Northwest were particularly refined because he adjusted the published prices for component values. The comparisons with pay prices in the upper Midwest are especially illuminating because at least 80% of the milk production in the upper Midwest states is used for the production of cheese. *Order 30 Market*

Administrator Reports, *see* Request for Official Notice (List of Handlers, Plants, and Cooperative Associations 2014-2016 Federal Market Administrator, Upper Midwest Marketing Area) and (List of Supply Plant Systems 2014-2016, Federal Market Administrator, Upper Midwest Marketing Area). The three upper Midwest states' producers received an average of $2.05 to $2.22 per hundredweight more for milk than California producers during the 34 months from August 2012 to May 2015. Mr. Dryer of Saputo, which manufactures cheese at multiple plants in California and the upper Midwest, confirmed that the mailbox prices reflect the difference in the cost of milk for cheese in California and the upper Midwest. (Dryer Tr. Vol. XXI, pp. 4261, 4338 (Oct. 22, 2015).) The cheese manufacturers from Wisconsin who testified confirmed the routine payment of substantial premiums for Class III milk.

Second, the record is replete with evidence of premiums paid by manufacturers. Mr. Christ presented data compiled by the Market Administrators which further documented the substantial premiums above federal minimums paid to producers pooled throughout the system, including in the upper Midwest. Prices charged for Class III milk in the major federal cheese producing orders were documented by Mr. Hollon to average more than $1.00 per hundredweight above minimum for the full year of 2014. All California manufacturers of cheese with operations in FMMO markets confirmed the payment of Class III plus premiums for full supplies of milk. There is simply no basis in this record to support a contention that being required to pay the minimum national uniform Class III price will place California cheese plants at an unfair competitive disadvantage; it will simply eliminate a portion the competitive advantage they now have.

The cost of doing business in California also provides no basis for the creation of a California discount in the Class III price. First of all, California costs of manufacturing cheese are already part of the FMMO price through USDA's use of CDFA manufacturing cost data. Moreover, Mr. Hatamiya documented the general baselessness of this argument in his rebuttal testimony. Using a highly reputable database of national costs-of-doing business, Mr. Hatamiya compared the costs in the cheese-producing regions of California with apples-to-apples costs in other parts of the country with major cheese production. California was competitive in all comparisons. (Hatamiya Tr. Vol. XXXIX, pp. 7924-7945 (Nov. 17, 2015); Exh. 188.) The DIC witnesses who cited California costs, cherry-picked some factors (such as workers compensation insurance and utilities) which they said were higher in California, ignoring the actual portion of total costs those line items represented. (*Id.*) Mr. Hatamiya's comparison was broad-based in costs compared, and comprehensive in geographic comparisons.

e. One national price does not create an impermissible trade barrier.

Proposal No. 1 properly provides the same Class III prices under a California FMMO as in all other FMMOs. Contrary to the arguments made by Hilmar's consultant Mr. John Vetne ("Mr. Vetne") on the witness stand, this uniformity does not result in a trade barrier. In his testimony, Mr. Vetne argued that milk products manufactured in California (particularly cheese) have a lower locational value with respect to the demand markets in the Midwest and other more distant locations because of the cost of

transportation of the products to those markets.[29] In effect, he disagreed with long established USDA policy declaring that the market for milk products is national, and establishing uniform minimum prices for milk used to manufacture those products. Focused on that disagreement, he asserted, without factual proof in the record,[30] that providing in a California FMMO that California produced milk used for cheese receive the same Class III price as in other FMMOs will limit the marketing of California cheese in those more distant markets and constitute a trade barrier under the AMAA. 7 U.S.C. § 608c(5)(G).

Boiled down to their essence, Mr. Vetne's argument (as well as Mr. Stephenson's position) would establish regional pricing of milk used for manufacturing purposes, at least for milk produced in the California marketing area. This concept was specifically rejected during Federal Order Reform. The argument defies longstanding USDA policy recognizing that, as the market for milk products is national, the pricing of milk used for those products must be uniform across all FMMOs. The current uniform pricing formulae were developed through Federal Order Reform (and amended by several subsequent national hearings). But even before Federal Order Reform, antecedent

[29] Mr. Vetne's testimony would adopt as policy the data generated by the Stephenson/Nicholson calculation, which the USDA had before it in the Federal Order Reform and rejected for Class III and IV prices. Mr. Vetne's testimony should be rejected here, along with that data, for the same reasons the USDA rejected the data previously.

[30] To the extent the DIC attempts to invoke the doctrine of negative inference, a complete opposition to the DIC's Memorandum on this issue can be found at Appendix Exhibit 5. In any event, Dr. Stephenson, while not directly testifying as to the report, did testify in full as to his views.

federal orders pointed the way toward uniform national pricing for milk used to produce dairy products.[31]

The comments of the Secretary clearly articulate the uniform national pricing policy. In addressing comments pertaining to regional milk pricing, the Secretary stated, "This decision replaces the current BFP with a national Class III and a national Class IV price." *See Milk in the New England and Other Marketing Areas, supra*, 64 Fed. Reg. at 16100. The Secretary further stated, Class III and Class IV dairy products compete in a national market. *Id.* at 16046. Because of this, Class III and Class IV milk prices established for all FMMO areas are the same. *Milk in the Northeast and Other Marketing Areas, supra*, 67 Fed. Reg. at 67937.

Carried to its logical conclusion, if the locational value of milk argument dictated that California FMMO prices be different from, and lower than, those established in all other FMMOs for milk used for manufactured products, so too should the prices be regionally adjusted for milk produced in other marketing areas where products are sold in more distant marketing areas, *e.g.*, products from the Pacific Northwest. This Pandora's box, once opened, will doom the national uniform price standard that has evolved, and been repeatedly affirmed by the USDA, over decades.

And if a lower, non-uniform California FMMO minimum producer price for milk used for milk products was established in order to reflect the cost to transport milk to more distant markets, will that lower minimum price also apply to California milk utilized to manufacture the very substantial amount of California cheese marketed in California

[31] (Schad Tr. Vol. XV, p. 3059-74 (Oct. 14, 2015); Exh. 70, p. 5-19)(tracing the evolution of national prices for milk used for manufacturing purposes).)

itself? And if there were different prices established, depending on where the cheese was marketed, how will such prices even be administered? In any event, the DIC's trade barrier argument, unsupported by any evidentiary showing, is totally without merit.

Contrary to the DIC's arguments, establishing the same Class III price in a California FMMO for milk used for cheese does not limit California cheesemakers from marketing their product in the Midwest and other more distant markets. California cheese plants are among the most efficient in the country. As clearly demonstrated in the testimony of Mr. Hatamiya, California costs of doing business in the major California milk producing counties are amongst the lowest of all major milk producing areas in the nation. (Tr. Vol. XXXIX, pp. 7924-7945 (Nov. 17, 2015); Exh. 188.) For years, California cheesemakers have used the lower California regulated prices as a means of maximizing profits, in effect shifting the cost of transporting cheese to the more distant markets onto the backs of producers. Paying a higher uniform FMMO Class III price may reduce profits, but it will not limit the marketing of California cheese in the more distant markets. *See Sunnyhill Farm Dairy, Inc. v. Hardin,* 442 F.2d 1124, 1131 (8th Cir. 1971) *cert. den*. 405 U.S. 917.[32]

That an enhanced California minimum price for milk used for cheese will not limit marketing in other areas is demonstrated by the fact that finished milk products from out-of-state have been and continue to be marketed in California, particularly cheddar cheese where California consumption is greater than its production of cheddar. (Schad Tr. Vol., XXXVIII pp. 7829-31; Exh. 185 (Nov. 16, 2015).) The regulated minimum

[32] While no case has been found that interprets the word "limit" as used in section 608c(5)(G), surely it cannot mean merely a reduction in profits.

prices in these out-of-state production areas are higher than California's 4b price, and, additionally cheese plants in these areas are able to pay and do pay significant premiums to procure their milk supply. (*See*, *e.g.*, Christ Tr. Vol. XII, pp. 2457-70 (Oct. 7, 2015); Exh. 60; Dryer Tr. Vol. XXI, pp. 4256-61 (Oct. 22, 2015); Hollon Tr. Vol. XXXX, pp. 8080-82 (Nov. 18, 2015); Schad, Tr. Vol. XXXVIII, pp. 7789-94 (Nov. 16, 2015).) Yet these plants still are able to market cheese in California.

California produces approximately 21% of the nation's milk. Approximately 65% of total national milk product was in 2014 priced under the uniform pricing formulae of the FMMO system. And if California production were excluded, approximately 82% of milk production outside of California was priced under those uniform formulae.[33] The time has come for California's 21% of national milk production be priced under the same national uniform prices.

4. The Uniform National Class IV Prices And Formulae Should Be Adopted For The California Federal Order.

Unlike the voluminous testimony from the multiple parties regarding the Class III price, there was limited testimony (essentially only Dr. Schiek) regarding Class IV pricing. Proposal No. 2 rejects the national prices, which are based substantially upon California products and transactions, and recommends California-centric or Western U.S. based price reductions in the Class IV butterfat and nonfat solids prices.[34] Because uniformity of price in the national market for NFDM and butter is as important as in the markets for cheese and Class II products, the USDA should reject Proposal

[33] (Schad Tr. Vol. XV, pp. 3059-60 (Oct. 14, 2015); Exh. 70.)

[34] The DIC's proposed prices have numerous data challenges. The price series in the Hearing Notice are not available. Therefore, a "Western adjuster," constructed from non-current data, has been devised and proposed by the DIC. (Exh. 122, p. 5.)

No. 2, maintain its policy of national price uniformity, and adopt the uniform Class IV price formulas in Section 1000.50(k), (l), and (m), as recommended in Proposal No. 1.

The uniform national Class IV price consists of: (1) the butterfat price (which is the same as the Class III butterfat price); and (2) the Class IV skim milk price. The components of the product price formulas in each case are: a product price; a yield factor; and a make allowance. These current formulae are the product of the Federal Order Reform and three national hearings held in 2000, 2006 and 2007. Proposal No. 1 will adopt the uniform, national terms for all elements of the Class IV price. Proposal No. 2 will substitute formulas intended to reflect California-only prices for the national average data used for the product prices of butter and NFDM, as well as California-only data for the make allowances. Since it is clear that California butter and NFDM compete in the national marketplace for sales of these products, national prices and make allowances should be used to establish the minimum class price values in the California FMMO.

There appear to be two contentions offered in support of the DIC position that California Class IV processors should have their own local, California-specific prices, irrespective of their competing in the national markets for manufactured dairy products and regardless of the minimum milk prices applicable to their competitors in the rest of the country. The first contention is that the relevant market for determining the milk price is the "local market," not the national market since "[t]he markets for finished dairy products clear nationally, but the market for milk clears locally." (*E.g.*, Schiek Tr. Vol. XXXVIII, p. 5557 (Nov. 2, 2015); Exh. 122, p. 4.) From this premise, the DIC would derive the minimum price for Class IV components from product sales occurring in

California through use of its devised "Western value adjuster." The second premise of its pricing thesis is that the minimum price can never be too low; and must avoid at all costs being too high. Neither of these points should be given any validity as against the continued implementation of evolved, vetted, tried and tested national uniform prices.

The milk-markets-clear-locally assertion, repeated numerous times in the hearing, has no basis as a price policy premise in any USDA decisions. (Schiek Tr. Vol. XXI, pp. 4163-64 (Oct. 22, 2015).) It is nothing more than a "conceptual observation" of Dr. Schiek. (*Id.* at 4161.) Dr. Schiek has no definition of what "locally" means; it also is a "conceptual idea." (*Id.* at 4163.) The DIC asks the USDA to leverage this conceptual idea to justify the use of only local product prices as the basis for the Proposal No. 2 minimum class prices. This concept is incompatible with the premise of end-product pricing for minimum raw milk prices which bases the minimum milk price on the market-clearing prices of the products in the market where the products compete. There is no dispute that the national marketplace is the market in which butter and NFDM manufactured in California competes. Basing the California plants' price on local California product sales would give California plants a raw milk cost advantage over their national competitors. Dr. Schiek's "conceptual idea" provides no basis for this deviation from the national price uniformity policy.

The further assertion that use of the national Class IV price for milk in California is inappropriate because it will be too high, and not a market-clearing price, should be rejected. First, the great majority of butter and NFDM in California is produced by the Cooperatives which are the Proponents of Proposal No. 1. Among witnesses opposing Proposal No. 1, only Hilmar which is building a powder plant in California, is a Class IV

processor of any significance. Thus, the great majority of California Class IV production is supportive of Proposal No. 1 and, therefore, of the view that the uniform national prices are not too high for California.

The point which cannot be emphasized too often in regard to the level of Class III and IV prices is that: **the uniform and minimum class prices in the FMMO system are based upon national market-clearing product prices**. This fact was made clear from the very beginning of the hearing in the testimony of Amanda Steeneck, the USDA economist who presented the economic impact analysis. She testified: "The market-clearing prices are the national product prices." (Steeneck Tr. Vol. I, pp. 174-75 (September 22, 2015).) California prices are a very, very substantial part of these prices: based on total production volumes, California represents 33% of butter and 40% of NFDM nationally. (Schad Tr. Vol. XVI, p. 3113 (Oct. 15, 2015.); Exh. 70, p. 19.) The DIC is not satisfied with average product prices to which California contributes approximately 33-40% of total transactions. DIC wants only California prices. The DIC's self-serving invitation to keep California pricing separate from the rest of the country should be rejected.

C. Changes To Uniform National Prices In 7 C.F.R. Part 1000 Are Not Appropriate For Consideration In A Hearing Concerning Adoption Of A California FMMO.

Changing the whey factor in the Class III formula is a matter of national concern, and if considered at all, it should be the subject of a national hearing, not a hearing considering only adoption of a California FMMO.[35] To make a change in the whey

[35] Over the Cooperatives' strenuous objection, the DIC was permitted to add a proposal not contained in the Notice of Hearing that would change the manner of valuing whey in the Class III formula for California only. The Cooperatives continue to object to (footnote continued)

factor in a California FMMO that differs from uniform national Class III pricing prevailing in every other FMMO will exacerbate the very economic turmoil that led California dairy farmers to request a California FMMO, and will perpetuate, rather than prevent, market instability.

The USDA's explicit rejection of regional prices for Class II, III, and IV products in the Reform Final Decision, the express finding that the markets for manufactured products are national in nature, and the indisputable impact that non-uniform prices in a California FMMO will have on participants throughout the federal system, mandates that any re-consideration of regional pricing of milk for Classes II/III/IV should be done, if at all, in a national hearing when all impacted parties and orders are participating. The California FMMO should not be held hostage to the convening and resolution of any such hearing. Uniform prices for the California market should be adopted now.

VII. ALL GRADE A MILK PRODUCED AND MARKETED IN CALIFORNIA SHOULD BE POOLED SUBJECT ONLY TO EXEMPTION FOR SMALL PLANTS.

The California FMMO should provide for the inclusive pooling of all California plants buying milk from California producers and incorporate the California quota program in the distribution of pool funds. These two characteristics are indispensable pillars of a California FMMO which accomplishes the objective of bringing California dairy farmers into the national dairy marketplace. Proposal No. 1 provides a detailed, precise set of regulations to accomplish this objective. Proponents will discuss first the buildup of the proposed pool: which distributing and non-distributing plants are in and

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permitting this proposal to be considered and maintain that it is improper for this hearing and should be stricken.

must therefore account for the minimum classified use value of their pool milk receipts; what obligation non-distributing plants and handlers have to provide milk to distributing plants; which plants are exempt or otherwise not in; and the California order specific adjustments for transportation credits, which are reflected in pool handlers' obligations to the pool. The discussion of the buildup of the pool also involves the corollary description of which producers and which producer milk are, and which producers and which producer milk are not, in. Furthermore, Proponents will address the absolute need for the inclusive terms of the California pool and respond to various objections which have been raised to inclusive pooling. Finally, Proponents will detail the proposed pool distribution: the necessary recognition of California quota value; the basis of payment for non-quota milk of both California and non-California producers; and the timing and mechanics of payments to all producers.

A. Inclusive Pooling: All Non-Exempt California Plants Should Be Pooled.

1. The AMAA Specifically Authorizes Inclusive Pooling; Nothing In The AMAA Limits Mandatory Pooling To Class I Milk.

In assessing the permissible breadth and scope of a California FMMO, the starting point must be the language of the AMAA itself. Section 7 U.S.C. 608c(5)(B) provides specific authorization for an FMMO to provide: "for the payment to all producers and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered, irrespective of the uses made of such milk by the individual handler to whom it is delivered."

The AMAA neither specifies what milk can be included in the pool nor limits mandatory pooling to Class I. The AMAA expressly authorizes mandatory pooling of "**all milk** so delivered [by **all producers** to **all handlers**], **irrespective of the uses**

made of such milk" and payment of a uniform producer price from such pool. *Id.* (emphasis added.) This is exactly what Proposal No. 1 accomplishes (excepting only very small exempt entities and size-limited producer handlers) and subject only to price differences otherwise authorized by the AMAA and Farm Bill.

Thus, the DIC's objections to inclusive pooling in California are not founded upon any proscriptions or limitations imposed by the AMAA. They are grounded instead upon the assumption that the California FMMO must operate exactly as other orders in other parts of the country with other marketing conditions have operated. The DIC's reference to other orders for guidance with respect to a California FMMO is both myopic in the scope of its observations and misguided in the application of what it observes.

The AMAA expressly authorizes inclusive pooling, and a review of the history of pooling demonstrates that when economic conditions justify it, pooling beyond milk utilized for Class I purposes has been implemented. The very earliest milk orders were essentially all inclusive of fluid handlers in the market and milk which those handlers were using or can use. The early orders covered single metropolitan areas, the milk dealers marketing in those areas, and all producers supplying or eligible to supply those handlers. Over time, as more milk became Grade A and therefore eligible to be marketed to the fluid handlers, the dominant issue regarding pooling in orders was how much milk to allow to share in the pool's blend price. (Christ Tr. Vol. XII, pp. 2449-52 (Oct. 7, 2015); Exh. 58, pp. 3-5.) Ultimately, as Mr. Christ testified in reviewing some of the history of FMMO pooling, all milk eligible for the fluid market and available to serve that market has been pooled. (*Id.*) In other words, "all" milk, irrespective of use, was accommodated in the system.

There have been significant changes over time in the economic drivers that relate to pooling. During the years pre-Federal Order Reform, the predominant economic pooling issue leading to opening up the orders to the pooling of additional milk was determining when to allow lower-valued uses to share in the pool with the higher-valued uses. The orders confronted circumstances where parties wanted to pool when advantageous, but not pool when that sharing involved giving, rather than receiving. The resolution of the issue was the creation of provisions such as Order 1's dairy farmer for other markets provision, which essentially requires a producer who has voluntarily depooled to retain higher valued uses for himself to be out of the pool for a year. 7 C.F.R. 1001.12(b). The effect of this provision has been to make depooling essentially non-existent in Order 1. (Schad Tr. Vol. XXXIX, p. 7918 (Nov. 17, 2015).) In other words, it has resulted in *de facto* inclusive pooling.

Post-Federal Order Reform, the disorder created by an increasing incidence of opportunistic depooling was addressed in multiple hearings for Orders 30, 32, and 33 with results custom-tailored to the conditions in each order.[36] The principle applied in each decision was that unlimited depooling was not acceptable. The orders make clear that the limitations adopted should address the particular circumstances of the market involved.

Depooling has become an issue in FMMOs in 2016 because of the change in relationship of class prices and percentage utilization between Class I and

[36] *Milk in the Upper Midwest Marketing Area, Final Decision*, 71 Fed. Reg. 54136 (Sept. 13, 2006); *Milk in the Central Marketing Area, Final Decision*, 71 Fed. Reg. 54152 (Sept. 13, 2006); *Milk in the Mideast Marketing Area, Final Decision*, 71 Fed. Reg. 54172 (Sept. 13, 2006).

manufacturing uses in the 80 years since the first order was promulgated under the AMAA. Whereas in 1950, the Class I utilization in the order system was 59%, today it is less than 40%. *Measures of Growth in Federal Milk Orders*, AMS, USDA (June 15, 2015), *see* Request for Official Notice. By the same token, whereas the difference between the Class price and non Class I value was 31% in 1950, in 2015 it was 17% on an annual basis. *Id.*; *see also* "Federal Milk Order Marketing and Utilization Summary, Annual 2015," AMS, Dairy Market News (February 8-12, 2016), *see* Request for Official Notice. Whereas, pre-1990 FMMO blend prices less than manufacturing class prices were virtually unknown, in 2015 manufacturing class prices greater than order blend prices are commonplace in the system and routine in some orders. Thus, the simple arithmetic of pooling has changed greatly over the years, and with it the equities of pooling all milk "irrespective of use" have tilted away from consideration of Class I only to consideration of all class values. The bottom line is that whereas for many years essentially the only value added to marketwide pools was Class I value, today the value of all uses is important to marketwide producer values. For California producers, given the characteristics of their market, inclusive pooling of all milk and all use values is essential.

2. Without Inclusive Pooling, California Producers Will Not Receive The Benefit Of National FMMO Prices.

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

basis. If opportunistic depooling by California's large cheese processing handlers is permitted, the benefits to producers of a California FMMO will be illusory and the purpose of having a California FMMO will be defeated.

3. The Pooling Provisions Of FMMOs Are Crafted For The Marketing Conditions In Each Individual Marketing Area.

A key element of the genius of Federal Order Reform was its establishment of a broad base of uniform order provisions for all FMMOs from coast to coast, while at the same time allowing other necessary order provisions to be customized and crafted to the unique market conditions in each order's marketing area. In addition, the Market Administrators were given the ability to make changes in shipping and performance requirements which had previously required either Dairy Division action or formal hearings. Bringing California into this system involves, as discussed above, implementing the uniform order provisions for order administration and pricing. Pooling, or "performance," standards are the key order characteristics necessary in all FMMOs but markedly different from order to order as they are tailored to fit the unique marketing characteristics of each area. Mr. Hollon noted just a few of the differences in pooling provisions in the system:

> [T]he Southeastern Orders have a high number of touch base days per month while the Upper Midwest Order has "once per ever," so long as the farm does not get pooled on another Order. Several Orders prevent pooling a diversion of a producer's milk "until" that producer has "touched base" while other Orders prevent pooling a diversion "unless" there has been a touch base delivery. The result of this language is very different for the pooling handler. The Northeast, Central, Mideast and Upper Midwest Orders have special pooling provisions which apply solely to milk supplies located outside the marketing area.

(Hollon Tr. Vol. XIII, pp. 2737-38 (Oct. 16, 2015); Exh. 63, p. 9.)

While the performance requirements of each order define the linkage to the pool of the pool plants and producer milk, it has proved essential in the majority of orders to also define the terms of '"de-linkage" or "depooling" since there is a consensus in the industry that completely unrestrained depooling destabilizes the market, is not orderly, and should not be allowed. There are a variety of these provisions in the system as also referenced by Mr. Hollon:

> Some examples . . . include dairy-farmer-for-other-markets provisions in Orders 1, 124 and 131 as well as the state unit pooling provisions of Order 1. Orders 30, 32 and 33 have percentages limiting the amount of milk that can be pooled in any given month to a percentage of the milk pooled in the previous month. Additionally these same Orders have provisions (different from all the other Orders) that further govern the ability of an out of area plant to pool milk by requiring the deliveries for the qualifying volumes associated with that plant be delivered directly from the supply plant attempting to qualify producer milk and not allow any 1000 (9) (c) diversions to be included in the calculations qualifying the plant. Order 124 [has a] percentage limitation provision to increase the touch base days for regaining pool status for a producer's whose milk was depooled.

(*Id.* at 2738-39; Exh. 63, p. 10.)

For the California FMMO, the market characteristics need to be fully understood to determine the appropriate pooling and performance parameters for the establishment and maintenance of orderly marketing.

4. Because Of The Unique Marketing Conditions In The California Marketing Area, Market Stability Requires Pooling Stability.

The California market differs markedly from any other FMMO in its utilization, average plant size, average producer size, concentration of supplying/pooling handlers, and, of course, it is the only order with a quota program. These characteristics all need to be taken into account in determining the pooling and performance provisions, just as

each other existing order's unique characteristics have been considered for the provisions in place in those orders. Proponents will review each of these characteristics of the California FMMO in turn.

California's Class I utilization, at 12.5% in 2015 (through July) is close to Order 30's 2015 annual average of 11.6%. (Exh. 64, Table 5.c.6.) The next lowest orders are Arizona at 27.4% and the Pacific Northwest Order at 29.8% for 2015. *Measures of Growth in Federal Milk Orders*, AMS, USDA (June 15, 2015); "Federal Milk Order Marketing and Utilization Summary, Annual 2015," AMS, Dairy Market News (February 8-12, 2016), *see* Request for Official Notice. While California is close to Order 30 in Class I utilization, the similarity essentially stops there. California's manufacturing class (III and IV) utilization for 2015 (to July) was 45.8% Class III and 33.4% Class IV. (Exh. 64, Table 5.C.6.) Order 30 on the other hand was 79.2% Class III and only 3.5% Class IV. (*Id.*) Average plant sizes are vastly different between the upper Midwest and California. Mr. Christ detailed this contrast in size between California cheese and butter plants in 2014 in comparison to those in the rest of the country. (Tr. Vol. XII, pp. 2465-67 (Oct. 7, 2015); Exh 58, p. 10.) California cheese plants are twice the size of the average in the rest of the country and its butter plants are 2.6 times those in the rest of the country. NASS, "Dairy Products Annual," (Annual Reports 2000-2014); *see also* Christ Tr. Vol. XII, pp. 2465-67 (Oct. 7, 2015), *see* Request for Official Notice; Exh 58, p. 10. Looking just at cheese plants in California and Wisconsin, in 2014 the 15 California plants on average produced 3.3 times the volume of cheese per plant as the 50 plants in Wisconsin. *Id.* at p. 33. For butter, no Wisconsin-only comparison is available, but comparing California plants to those in the

Central area of the U.S., the same 3.3 times average production occurs at California plants. (*Id.*) There is an abundance of other data in the record disclosing the massive economies of scale in the California manufacturing sector. For instance, the Hilmar plant, standing alone, at 400 million pounds of milk processed per month is about 1.5 times the size of the entire Florida order, as large as the entire Arizona order (compared to the average monthly pool value for 2015); 80% or greater in comparison to the size of Order 5 or Order 7, and about two-thirds the size of the total Pacific Northwest Order. *Measures of Growth in Federal Milk Orders*, AMS, USDA (June 15, 2015); "Federal Milk Order Marketing and Utilization Summary, Annual 2015," AMS, Dairy Market News (February 8-12, 2016), *see* Request for Official Notice.

Comparing the number of handlers and cooperatives further distinguishes California from Order 30, which is the primary comparison order proposed by the DIC. Order 30 in December 2015 had 54 handlers operating pool plants; 46 qualified cooperatives; and 13 cooperatives acting as handlers that month. In California, in December 2015, there were only a total of seven supply handlers available to be called upon for milk supplies per the CDFA "Designated Supply Handlers" listing. *Designated Supply Handlers for Procurement Regions 1 and 2*, (2015-2016), *see* Request for Official Notice.[37] The Cooperatives here represent approximately 75% of the state's producers and production. (Hollon Tr. Vol. IV, p. 794 (Sept. 25, 2015); Exh. 19, p. 2.) Hilmar represents another 12% or more. (De Jong Tr. Vol. XXII, p. 4385 (Oct. 23, 2015).) Thus, the California market has far fewer and much larger players than

[37] https://www.cdfa.ca.gov/dairy/pdf/Call%20Provisions/2015-2016/S_CA_Call_Provisions_2015-16.pdf

Order 30 or any other FMMO for that matter. This has important implications for the pooling provisions of the order. Fewer and larger pooling entities means every depooling/repooling transaction has greater financial impact upon the depooling handler, as well as on the pool and affected producers. The depooling of a single plant can have far more deleterious impact on the pool than depooling by a plant, for example, in Wisconsin. Whereas smaller players may have limited incentive and lack the resources to commit to gaming-the-pool activities, larger players have every resource and every incentive to maximize their use of opportunistic loopholes in order regulations.[38] The structure of the California marketplace requires inclusive pooling.

In addition, the California quota program is an extremely important financial element in the pool calculations which does not exist in any other order. The quota premium is about $.34 – $.37 per hundredweight of the pool value. (Hollon Tr. Vol. XIII, p. 2733; Exh. 64, Table 5.E (Oct. 8, 2015).) This is an amount which exceeds the producer price differential ("PPD") in Order 30 about 90% of the time. When the transportation credit system in Proposal No. 1 is taken into account at a rate of $.09 per hundredweight, there is an additional impact to the non-quota blend price. (*Id.*) The result is that California pool producer returns will be extremely sensitive to additional reductions in blend prices which will occur via depooling.

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

These market characteristics reveal a market in which orderly marketing conditions can only be established and maintained with pooling stability achieved through Proposal No. 1's inclusive pooling. If provisions allow depooling along the lines of that allowed in Order 30 and under Proposal No. 2, major disorder and constant disruption are inevitable. This inevitably flows from the toxic mix of market characteristics discussed above, namely: (1) very high utilization in both Class III and IV; (2) very large plants and few handlers in a highly concentrated market; and (3) the California quota program.

As Mr. Hollon detailed in Exh. 64, Table 5.D, and his accompanying testimony, there are less than 10% of the months since 2000 when there would be no reason to depool either Class III or Class IV from the FMMO pool. Only 16 of the 187 months tracked result in the non-quota blend exceeding both the Class III and IV price. If one assumes there will be re-pooling limitations such as those under Proposal No. 2, it is likely, perhaps inevitable, that there will never be full pooling of all the milk in California under the FMMO. If only small volumes of depoolings will be expected to be involved, this might be tolerable, but with the large handlers and large plants in California, it is inevitable that if depooling is profitable, very large volumes of milk will be depooled routinely, at significant impact to all producers. Looking at Exhibit 64, Table 5.E.8, for the first seven months in 2015, the incentive to depool Class III milk averaged $1.05. Being conservative, if just 80% of the Class III milk (45.8% of the pool) were depooled with this incentive, the balance of producers in the pool will experience a blend price reduction of more than $.38 per hundredweight every month. Perhaps ironically, this

loss will fall most directly on the producers supplying Class I plants who will always be pooled.

What makes the California market even more unstable if depooling is allowed is the fact that a handler with both Class III and Class IV utilization can keep a steady volume of milk off the pool, taking advantage of the price swings, when the pooling/depooling advantage switched from Class III to IV or vice versa. Exhibit 64, Table 5.E.8 shows just that type of price swing between the summer and fall of 2014 when the pool disadvantage for Class IV varied from $.91 to $1.23 in June-August and then Class III had the disadvantage of $.74-$1.25 from September to November. The same handler can reap those price advantages in every month by depooling the same volume of milk in both months from the most advantageous usage. The depooling incentive not only exists with Class III and IV. Class II, while only representing 8-9% of the California market, will have a near-permanent incentive to depool: there was a financial incentive to do so about 70% of the time during the 187 month period from January 2000 to July 2015. (Exh. 64, Table 5.E.8.) The instability in this scenario cannot be overstated. Pool volumes will predictably fluctuate in large quantities to the unique advantage of some producers and handlers, and to the permanent detriment of marketing stability and price uniformity in the California FMMO.

Moreover, allowing depooling in the California FMMO will deny to California producers the primary goal of their request for an FMMO: the ability to experience the minimum price values provided under the FMMO program to the rest of the country. If Class III values generated in the California marketplace are not pooled in the California

FMMO, those values will be denied to California producers on a uniform basis. For California dairy farmers, this will essentially defeat the purpose of having an FMMO.

5. The Objections To Inclusive Pooling Raised At The Hearing Are Not Valid.

In response to a question from Mr. Richmond as to what "portion of the Cooperative proposal [is it] that the Dairy Institute was the most opposed to," the DIC's primary spokesperson, Dr. Schiek, identified inclusive pooling as at the top of their list. (Schiek Tr. Vol. XXI, pp. 4165, 4166 (Oct. 22, 2015).) However, while the DIC made clear that inclusive pooling is its priority issue, the reasons for opposition were somewhat less comprehensible. Dr. Schiek had some difficulty articulating why this is the DIC's most important issue, indicating: "I don't know quite how to express [the opposition to inclusive pooling] . . . But it kind of wraps regulatory arms around the entire milk supply in a way that doesn't happen in other Federal Orders." (*Id.* at 4166.) For several other DIC witnesses, the bare fact that Proposal No. 1's inclusive pooling is different from other FMMOs was cited as the problem, without much further elucidation. (*See*, *e.g.*, Exhs. 136 and 107; DeJong Tr. Vol. XXII, p. 4445 (Oct. 25, 2015); Suever Tr. Vol. XXI, p. 4179 (Oct. 22, 2015).) Moreover, in spite of inclusive pooling being its single greatest concern with Proposal No. 1, the DIC has done no studies, and presented no calculations of what it asserts would be the financial impact of inclusive pooling (referred to as "mandatory pooling" by the DIC witnesses) versus the type of permissive, when-I-want-to pooling reflected in Proposal No. 2. (*See* Suever Tr. Vol. XXI, pp. 4193-95 (Oct. 22, 2015); Paris Tr. Vol. XXX, p. 6111 (Nov. 4, 2015); Kluesner Tr. Vol. XXXI, pp. 6309-10 (Nov. 5, 2015).) In short, other than unsupported claims,

there is absolutely no documented evidence in the record to support the DIC's contentions regarding the supposed impact of inclusive pooling.[39]

Notwithstanding the lack of precision and clarity in articulating its position, the primary objection raised by opponents of inclusive pooling was that since this pooling will be different than that under other FMMOs, it will place California Class III processors at a competitive disadvantage to the plants in other orders. (*E.g.*, Exh. 136.) The claimed disadvantage appeared to be in two respects: First, when markets are soft (*i.e.*, when supply is perceived to exceed demand), pool plants will still be required to pay the minimum class price for milk, presumably more than the soft, spot market price. Secondly, when there are market distortions (*i.e.*, when, for example, the Class III price is greater than the pool blend), inclusively-pooled plants will not be able to take advantage of the situation by depooling and thereby keeping some, or all, of the class value in excess of the producer blend for themselves.[40] Basically, the ability to game-the-pool through depooling when advantageous will be lost in the inclusive pooling system. The underlying assumption of this objection – that their competitors in other FMMOs derive a substantial advantage by non-pooling or depooling – was never

[39] In contrast, the DIC presented detailed and voluminous information quantifying the difference between Proposal No. 2's proposed prices and those of Proposal No. 1. (Exh. 161.) The revealed differences in those prices was summarized by Dr. Erba in Exhibit 162A: The class prices proposed by the DIC in Proposal No. 2 would result in annual aggregate class prices $521.73 million <u>below</u> current FMMO prices.

[40] It was also notable that the DIC witnesses were operating with some basic misunderstandings concerning the economics of pooling and depooling in FMMOs. (Suever Tr. Vol. XXI, pp. 4200-02 (Oct. 22, 2015).) Voluntary depooling is not done when prices are low in order to take advantage of market gluts; it is done when price aberrations allow the handler to avoid pooling the use value of his milk which is higher than the pool blend. When prices are low, there is every reason for the marketer of the milk to pool it. (Dryer Tr. Vol. XXI, pp. 4289-90 (Oct. 22, 2015); Suever Tr. Vol. XXI, pp. 4200-02 (Oct. 22, 2015).)

quantified by the objectors, and the evidence in the record shows conclusively that there is, in fact, no such substantial disadvantage imposed upon California processors under inclusive pooling in Proposal No. 1. (Schad Tr. Vol. XXXIX, p. 7919 (Nov. 17, 2015).) Again, the failure of the opponents to quantify their bluster of opposition – when they had the resources to do so – reveals the emptiness of their objections.

The DIC proposes to control potential market instability that would arise from the decision of larger handlers to freely depool by investing in the Market Administrator the discretion to assess the intent and nature of the depooling. This suggestion is totally unworkable and impractical. It will be wholly unpredictable and place an enormous burden on the Market Administrator to make subjective decisions about a handler's intent. Prevention of instability must flow, instead, from clear regulatory provision that are understandable, predictable, reliable and effective. Under the unique marketing conditions that prevail in California, only inclusive pooling can achieve this result and prevent such instability. Moreover, the DIC's suggested provisions deals only with fraudulent collusion between handlers and not the major instability that will result from allowing large scale handlers a basically free right to depool.

Conversely, the Proponents of inclusive pooling demonstrated and documented in their rebuttal testimony that there is no material price advantage in other FMMO markets by having either the ability to be a nonpool plant, not bound by order minimum prices, or to depool at will. Both Mr. Hollon and Mr. Schad provided detailed information about the experience of their national cooperatives in marketing in FMMOs throughout the country. (Hollon Tr. Vol. XL, pp. 8074-91 (Nov. 18, 2015); Schad Tr. Vol. XXXVIII, pp. 7787-7815 (Nov. 16-, 2015) and Vol. XXXIX, pp. 7829-49, 7870-76 (Nov. 17, 2015);

Exh. 185, pp. 2-6.) Their testimony, along with other data and testimony of record, established clearly that cheese manufacturers in the rest of the country pay in excess, and most far in excess, of minimum FMMO prices for milk used to produce cheese. (Christ Tr. Vol. XII, pp. 2458-66; Exh. 58, pp. 9-10; Exh. 60 (Oct. 7, 2015).) Members of the DIC themselves with plants in other parts of the country buying in the FMMO system acknowledged this. (Dryer Tr. Vol. XXI, pp. 4258-61 (Oct. 22, 2015); Taylor Tr. Vol. XXXVI, p. 5217 (Oct. 29, 2015).) The DFA's average price for Class III milk to buyers in Orders 32, 30, 33, and 1 during the full year of 2014 ranged from $1.20-$2.08 per hundredweight over the minimum FMMO price. (Hollon Tr. Vol. XXXX, pp. 8080-82; (Nov. 18, 2015).)

Even in the Southwest, the area of the FMMO system with the lowest mailbox prices, the large buyers of milk for Class III pay order price plus. And, the prices in the major cheese production region of the upper Midwest are substantially over the minimum FMMO values. Importantly, these prices are effective irrespective of the buyer's pool status. This is confirmed by the testimony of both Proponent and DIC witnesses. (Buholzer Tr. Vol. XXXIV, pp. 5727-28, 5750-51 (Nov. 3, 2015)(stating that Klondike Cheese, purchasing both Grade A and B milk, has **never** paid below Class III price in Mr. Buholzer's more than 40 years in the business); Hollon Tr. Vol. XL, pp. 8074-91 (Nov. 18, 2015); Schad Tr. Vol. XXXVIII, pp. 7787-7815 (Nov. 16-, 2015) and Vol. XXXIX, pp. 7829-49, 7870-76 (Nov. 17, 2015); Exh. 185, pp. 2-6.) Whatever volumes of spot milk may be available from time to time at less than order prices do not nearly offset the year-round prevailing premiums paid for milk in the FMMO areas throughout the country, pool or nonpool. (Hollon Tr. Vol. XL, pp. 8074-91 (Nov. 18,

2015); Schad Tr. Vol. XXXVIII, pp. 7787-7815 (Nov. 16, 2015) and Vol. XXXIX, pp. 7829-49, 7870-76 (Nov. 17, 2015); Exh. 185, pp. 2-6.) In sum, the argument that being required to pay minimum FMMO class values will place California plants at a cost disadvantage because of inclusive pooling is completely unsupported.

Likewise, the implicit contention that losing the advantage of riding the pool blend price when the Class III price is higher than blend, does not translate into any substantial price gain, even were it possible to accomplish. Mr. Schad quantified the possible gains reflected in depooling Class III milk in Orders 30, 32, 33, and 124. (Exhs. 185, 186.) The calculated gains for the calendar year 2014 were $.015 to $.055 per hundredweight in the major cheese producing areas of Orders 30, 32, and 33.[41] Exh. 185 at pp. 5-6; Exh. 186. C-F.) In Order 124, the gain for the year was $.237. (Exh. 186.C.) Clearly, these gains – even if achieved and retained by the handlers, which is not assured – are nowhere near an amount that offsets the prevailing premiums in those markets so as to put California plants at a competitive disadvantage.

The most frequently cited reason for objecting to inclusive pooling is that FMMO minimum prices in California, combined with inclusive pooling, will not allow the market to clear, creating disorder. Opponents claim that inclusive pooling will interfere with plants' ability to buy for less than minimum order prices and, therefore, hamper the ability of the market to clear raw milk supplies. (Schiek Tr. Vol. XXXVI, p. 5186 (Oct. 29, 2015); Exh. 113, p. 7; Exh. 116[42]; Hofferber Tr. Vol. XXIV, pp. 4722-23 (Oct. 27,

[41] Note that Order 1, which has substantial cheese production, has no depooling.

[42] The primary thrust of Ms. Taylor's testimony (Exh. 116) in objecting to mandatory pooling was an academic, economics theory: that in order to achieve the most efficient allocation of milk and resources between various uses, there should be a single (footnote continued)

2015); Exh. 107, pp. 8-9.) The assertion that minimum FMMO prices are not "market clearing" prices, is simply incorrect. This point was clearly articulated by USDA Economist Amanda Steeneck at the very beginning of the hearing. She explained that **federal order Class III and IV minimum prices are, by the very fact of how they are derived, market clearing prices.** (Steeneck Tr. Vol. I, pp. 174-76 (Sept. 22, 2015) (emphasis added).) The prices are calculated after, not before, milk sales transactions take place and reflect sales, including large volumes of California product sales, during the preceding month of the lowest-valued commodity products – cheddar blocks for Class III and bulk butter and NFDM for Class IV. Thus, there is a fatal error in the logic of the non-market-clearing objection to FMMO minimum prices.

There are also several further reasons why this market-clearing concern should not lead to the rejection of inclusive pooling. First, California has been operating with mandatory pooling for more than 40 years. Mandatory pooling does not mean mandatory buying. (Dryer Tr. Vol. XXII, p. 4284 (Oct. 23, 2015).) The cheese industry, the primary objectors to Proposal No. 1, are demand buyers, as testified to in detail by Mr. Hollon, not market balancers. (Hollon Tr. Vol. XXXX, pp. 8082-84 (Nov. 18, 2015) ("Class III customers are described by demand sales.").) They do not "clear the market" in California now, as the record plainly reveals. In spite of California's low class 4b price for milk used to produce cheese, the cheese plants have not used existing capacity to

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manufacturing class, and therefore one price, for milk used to make cheese, butter, and NFDM, rather than the two separate classes, and two separate prices, which prevail in both the California and the FMMO system. This ivory-tower policy position has obviously been rejected by USDA, most recently in the Federal Order Reform, and is not even on the table in this hearing. Consequently, the argument does not provide any basis for rejecting inclusive pooling in this hearing.

acquire milk looking for a home in times of surplus. (Schad Tr. Vol. XXXVIII, pp. 7798-99 (Nov. 16, 2015); Exh. 185, pp. 4-5; .) The market is cleared by the cooperative-owned butter and powder balancing plants. (Hollon Tr. Vol. XXXX, pp. 8082-86 (Nov. 18, 2015); Exh. 193.) The situation will be no different under Proposal No. 1 – except that the minimum Class III prices will now be the minimum, national, uniform FMMO prices. Furthermore, as Mr. Schad and Mr. Hollon detailed, the proportion of transactions in FMMO markets which take place at less than minimum class prices is in the single digit percentages of market volumes and is in fact a very small part of transactions in the FMMO system. (Hollon Tr. Vol. XXXX, pp. 8076-78 (Nov. 18, 2015); Schad Tr. Vol. XXXVIII, pp. 7795-7800 (Nov. 16, 2015); Exh. 185, pp. 3-4.) DFA and LOL provided information for the full 2014 calendar year with respect to their sales in FMMOs throughout the country. For LOL, the below-class volumes were less than 1% of third party sales, with an aggregate price impact of $.02, assuming very low pricing. (Schad Tr. Vol. XXXVIII, pp. 7795-7800 (Nov. 16, 2015); Exh. 185, pp. 3-4.) For DFA, the transactions were similar. (Hollon Tr. Vol. XXXX, pp. 8076-78 (Nov. 18, 2015).) Furthermore, when the market for milk is long, it is quite possible, particularly in a market dominated by very large plants like California, for intra-month prices for manufacturing milk volumes to be adjusted by seller and buyer for market-clearing purposes without violating minimum order pricing. (Schad Tr. Vol. XXXVIII, pp. 7799-7800 (Nov. 16, 2015); Exh. 185, pp. 4-5.) The record reflects that premiums in California are in the range of "[P]lus or minus 50 cents a hundredweight" both at the farm and plant (DeGroot Tr. Vol. XXXVII, p. 7589 (Nov. 13, 2015) to "in excess of 75 cents on the average per hundredweight." (Paris Tr. Vol. XXX, p. 6095 (Nov. 4, 2015).

Consequently, Mr. Schad's illustration using a premium of $.25 is very, very conservative with respect to the ability to provide intra-month price concessions to clear the market. Clearly, the most detailed, in-depth testimony in this record which analyzes and quantifies the purported challenges that will be present under Proposal No. 1, presented by Mr. Hollon and Mr. Schad on rebuttal, demonstrates that inclusive pooling is both necessary and viable.

Finally, the underlying assumption of the DIC argument seems to be that FMMO prices should be so low that there is never a circumstance where any substantial volume of milk leaves the local marketplace to find a home. There is absolutely no basis for this assumption. The FMMO program has never invoked a pricing principle that all milk must find a home within some arbitrary distance of the point of production. As testimony in this hearing established, there are FMMO areas of the country where milk routinely travels significant distances out of the marketing area to find a home. (Hollon Tr. Vol. XL, pp. 8076-78 (Nov. 18, 2015).) This may be on a seasonal basis, or more regularly where local plant capacity is simply insufficient. (*Id.*) The FMMO minimum class prices are determined by the national market-clearing prices of manufactured dairy products. The pooling provisions of Proposal No. 1 will not keep the California FMMO market from clearing.

In sum, inclusive pooling is necessary for orderly marketing in the California FMMO and will not place California handlers at a competitive disadvantage.

B. The Plant And Producer Milk Definitions Under Proposal No. 1 For The California FMMO Should Be Adopted.

Defining which milk is priced under the FMMO, and the producers whose milk is subject to, and entitled to, the minimum pool price is addressed in the provisions of Sections 1051.7–1051.13. These provisions are reviewed in sequence.

1. Plant definitions – Section 1051.7.

a. Distributing plant(s) – Sections 1051.7(a) and (b).

Proposal No. 1's two categories of pool distributing plants are near-uniform definitions in the FMMO system. The 1051.7(a) plant is a fluid milk processing plant packaging traditional shelf-life fluid milk products. The 1051.7(b) plant is a fluid milk processing plant located in the marketing area which processes and packages long-shelf life ultra-pasteurized or aseptically-processed fluid milk products. The sole difference between Proposal No. 1 and 2 is the minimum percentage of total utilization which is route disposition or transfers of packaged fluid milk products for a 1051.7(a) plant. Proposal No. 1's 25% requirement is recommended in light of the fact that only non-California plants will qualify for pool status via this definition under Proposal No. 1's inclusive pooling terms. Therefore, the 25% requirement provides a modest limitation on the ability of such an out-of-area plant to pool non-Class I milk from out of the area on the order. (Hollon Tr. Vol. XIII, pp. 2740-45 (Oct. 8, 2015); Exh. 63, pp. 10-12.)

b. Other plant(s) – Sections 1051.7(c), 1051.7(c.1), and 1051.7(e)

Proposal No. 1 provides for three categories of other pool plants. Section 1051.7(c) pool plants are the foundation of inclusive pooling, defined as:

> A plant that is located in the marketing area which during the month receives milk from a producer located in the marketing area or from a cooperative marketing the milk of a

> producer located in the marketing area pursuant to § 1051.9(c).

Thus, unless otherwise exempt (see discussion of Sections 1051.8, 1051.8A, and 1051.10, *infra*) any California plant receiving milk from a California producer, by direct purchase or through a cooperative, is a pool plant and part of the pool. The operation of this language is clear and direct. Its purpose is to pool essentially all California producer milk on the FMMO. The necessity for this, and the arguments in opposition, are discussed at Section VII(A), especially (A)(5), *supra*. These plants are not required to deliver any minimum percentage or quantity of milk monthly to pool distributing plants. However, as discussed below, they are obligated to ship at the call of the Market Administrator.

A Section 1051.7(c.1) plant is:

> A plant located in Churchill county Nevada that receives milk from producers located in Churchill County or in the marketing area or from a cooperative marketing the milk of a producer located in the marketing area or in Churchill County pursuant to § 1051.9(c).

This provision recognizes the historical relationship of the milk production in Churchill County, Nevada, and provides for its direct association with the California FMMO pool. (Olsen Tr. Vol. VI, pp. 1215-22 (Sept. 29, 2015)(describing Churchill County – California market linkage of over 50 years).)

A Section 1051.7(e) plant is a plant located outside of the state of California. Such a plant has performance requirements which operate like those in many FMMOs. To be a part of the pool, the plant must demonstrate its supply relationship with the market by delivering not less than 50% of the milk associated with the plant to 1051.7(a) or (b) pool plants. Concentrated milk does not count for these deliveries. If the plant

has producers from more than one state outside the marketing area, each state's production must meet the delivery requirement percentage. The California FMMO will have a low Class I utilization, in the 12% range. There is no need for out-of-area milk to fulfill the market's needs. Nevertheless, milk from out of the area can pool if it performs at the stipulated level.

c. A call requirement for pool plants – Section 1051.7(d).

In Proposal No. 1 there are no mandatory shipping provisions for 1051.7(c) and (c.1) pool plants because there is no need for such requirements. The FMMO will have Class I utilization in the low teens at most and the California system has functioned without mandatory shipping requirements for more than 40 years. Nevertheless, there should be a back-up provision in the FMMO, as there is in the California system, to allow the Market Administrator to require milk to be supplied to distributing plants in the unlikely occurrence of a shortfall. It is noteworthy that all witnesses with experience with marketing in orders with call provisions testified to the effectiveness of the call language's presence in the order: the threat or possibility of a call has always brought forth the milk supplies necessary without a formal call being issued. (Schiek Tr. Vol. XXXVI, p. 5207 (Oct. 29, 2015); Zolin Tr. Vol. XXXVI, p. 5239 (Oct. 29, 2015); Schad Tr. Vol. XXXVIII, pp. 7729-31 (Nov. 16, 2015); Exh. 183.) The Proponents of Proposal No. 1 expect a call in the California FMMO to have the same effect, even without it ever being invoked.

The proposed call language in Section 1051.7(d) has these key features:

Requirements for initiation of a call. A handler initiating a request for a call will be expected to be a Section 1051.7(a) or (b) plant. However, the Market Administrator has the discretion and authority to investigate the need for a call on his own motion or at the

request of any interested party. Any plant requesting a call must utilize in its plant all the milk "within the control" of that handler before a call will be required. A handler requesting a call cannot direct milk to other uses and then expect other pool handlers to satisfy a shortfall in its supply needs via a call.

Required notice and comment. Before issuing a call order, the Market Administrator must investigate the possible need for a call and, if he finds that a call may be warranted, issue a "notice stating that a shipping announcement is being considered and inviting data, views, and arguments with respect to the proposed shipping announcement." Any decision requiring shipments must be in writing and made at least one day before the effective date.

Defined geographic call regions. A call, or order requiring shipments, must be geographically limited both with respect to the designated recipient distributing plants and the procurement area from which milk supplies shall originate. The proposed language sets out two procurement regions - for northern and southern California - and allows the Market Administrator to further refine the regions in his discretion. The procurement and shipping regions must be identified in the written call and the notice of possible call.

Delivery requirements recognizing existing deliveries. If a call is issued it will require operators of Section 1051.7(c) and (c.1) pool plants, as well as cooperative handlers pooling milk pursuant to Section 1051.9(c) to deliver a stated percentage of their producer milk in the region. Some plant operators and cooperatives in all likelihood will already be shipping at the level required by the call. Those parties will not be required to make any additional shipments to pool distributing plants in the call

region. However, plants and cooperatives which are not shipping at the call percentage level will be required to make additional shipments to meet the call percentage or suffer monetary penalty.

Monetary penalty for failing to deliver as required by a call. The monetary penalty for failing to comply with a call is proposed to be $5.00 per hundredweight of shortfall in deliveries required but not made, or 25% of the non-quota blend price for the month, whichever amount is greater. The penalties are payable to the producer-settlement fund.

d. Market Administrator discretion – Section 1051.7(f).

Every current FMMO has a provision for adjustment of order performance requirements by the Market Administrator upon request and after inviting industry comments. Proposal No. 1 adopts this provision, which is also in Proposal No. 2. This provides useful flexibility in order administration which should be part of the California order.

e. Pool plant exclusions – Section 1051.7(g) and (h).

These sections exclude specified plants from the definition of pool plants under the order. The purpose is to avoid conflicts between orders and to avoid unintended pooling of plants not intended to be subject to the regulations. They are identical in Proposal No. 1 and 2 and are uniform in all federal orders.

f. Additional exempt plants – Section 1051.8A.

The Cooperatives propose to extend exempt plant and producer handler status to small plants which process products other than, or in addition to, fluid milk products through a new Section 1051.8A. This modification accomplishes several useful results under Proposal No. 1. First, it addresses the matter of administrative convenience on

the part of the Market Administrator by reducing (but not eliminating) the reporting requirements necessary for the pooling, pricing and audit of a small volume of milk at small non-Class I plants, which will be Section 1051.7(c) pool plants. Secondly, it reduces the burden of meeting more detailed reporting requirements for a group of small volume processors.

Moreover, creating an additional exempt plant category makes consistent the pool plant characteristics and the exempt plant characteristics. Proposal No. 1, without modification, requires inclusive pooling but exempts small Class I processors. Extending this exemption to similarly situated dairy processors who manufacture products other than Class I products will make the order more equitable. It also addresses concerns regarding regulatory impact on small businesses.

Section 1051.8A provides for two subcategories of additional exempt plants: Sub-paragraph (a)(1) addresses plants which process solely Class II, III, and IV products, while sub-paragraph (a)(2) addresses small plants which have Class I, as well as Class II, III, or IV utilization. In either case, the plants will, without the exemption, be pool plants under Section 1051.7(c) or (c.1), but are now exempted by virtue of an aggregate processing volume limitation established for this class of additional exempt plants of 300,000 pounds or less per month.

Proponents chose to increase the traditional size for an exempt plant to 300,000 pounds for these plants in order to give recognition to the fact that an exempt plant may process other than fluid milk products. Importantly, this volume approximates the 315,000 pounds per month estimated production limit for a dairy farm that qualifies as a

small business and it therefore exempts from regulation as a plant any small business producer which processes some of its own production.

g. Producer-handler – Section 1051.10.

The Cooperatives propose that producer-handlers be regulated in the same manner in the proposed California FMMO as they are in the majority of other orders. 7 C.F.R. Section 1030.10 (Producer-handler definition in Order 30). The hearing record establishes that all of the members of the California Producer-Handlers Association ("CPHA") will become fully regulated handlers under this Proposal. Proponents consider the question of the treatment of exempt quota to be a separate issue and will discuss it separately in Section VIII(B), *infra*.

As the USDA has recently found in a national hearing,[43] full regulation of large, vertically integrated, producer-handlers is necessary for orderly marketing in FMMOs. Regulation of large producer-handlers is important for both producer and handler minimum price uniformity. The fundamental need for such regulation has not been contested in this hearing, is supported by the DIC, and not opposed by the CPHA. Proposal No. 1, in line with the national, uniform regulation of producer-handlers in the FMMO system, will establish a maximum monthly route disposition volume of 3,000,000 pounds for an exempt producer-handler. Any disposition in excess of that limit will subject an otherwise exempt producer-handler to full regulation.

Proposal No. 1's proposed 3,000,000 pound limitation is uniform in all FMMOs. There are differences, however, in the administrative provisions between Proposal

[43] *Milk in the Northeast and Other Marketing Areas; Final Decision on Proposed Amendments to Tentative Marketing Agreements and Orders*, 75 Fed. Reg. 10122-10154 (March 4, 2010).

No. 1 and 2. Proposal No. 1, as noted, tracks the language of Order 30. Proposal No. 2 tracks the language of Order 124, which is similar, but not identical, to the language of Order 131. The Proposal No. 2 language is generally much more detailed with respect to the information required to be provided by the producer-handler to the Market Administrator, and with respect to the procedures applicable to the cancellation of a producer-handler's status. Proponents are not certain that there are any substantive differences in Proposal's 1 and 2 with respect to whether any particular operation will qualify as a producer-handler. Consequently, they are not necessarily opposed to the added specificity of Proposal No. 2. Proponents may comment further in their reply brief on the language options, depending upon comments raised in the DIC or other parties' briefs.

For the same reasons as stated above regarding additional exempt Section 1051.8A plants, the Cooperatives also propose to modify the producer-handler definition to include a farm that may process its own milk into other than fluid milk products. The language in modified Section 1051.10 accomplishes that change by retaining the framework of the existing producer-handler language while adding the provision that a producer-handler may also retain its status if it only processes Class II, Class III or Class IV products or processes these products, in some combination with fluid milk products but with the total pounds processed into all products retaining the limit of 3,000,000 pounds.

2. Producer and producer milk definitions – Section 1051.12 and .13.

a. Basic pool producer definition – Section 1051.12.

Section 1051.12 is the definition of "producer" under the California FMMO. Its two subparts define who is a producer – subpart 1051.12(a) – and who is not, or is excluded from being, a producer – subpart 1051.12(b). The producer definitions in the FMMO system are nearly uniform among the orders, and there are only two differences in the language of Proposal No. 1 and 2. Proponents will discuss here just the two points of difference, considering the agreed upon language has been supported by the testimony without further elaboration.

The first difference is in section 1051.12(a)(2) where Proposal No. 2 adds language to accommodate the adoption of a proprietary bulk tank handler ("PBTH") provision which they propose to incorporate in the pool plant provisions of Section 1051.7. The Cooperatives oppose the PBTH provision and, therefore, oppose language recognizing it in the producer milk definition. The mischief that comes with a PBTH order provision is documented in the Western Order experience. *Milk in the Pacific Northwest and Western Marketing Areas; Propose Rule*, 68 Fed. Reg. 49375-49390 (August 18, 2003). That experience should not be repeated here.

The second difference involves the addition of 1051.12(b)(5) in Proposal No. 1. That language deters voluntary depooling via surrender of a Grade A permit by stipulating that if a producer voluntarily gives up a Grade A permit, that producer cannot re-enter the pool for 12 consecutive months. Mr. Hollon described the purpose and function of the .12(b)(5) provision, which is called "dairy farmer for other markets," as follows:

> A dairy farmer for other markets provision is added to insure that a producer who loses his Grade A permit for less than thirty days does not lose his pool status upon the reinstatement of his permit. However, where a permit is given up for more than thirty days the producer is not eligible for pool status until 12 consecutive months have passed.
>
> Section (12) (b) (5) has been inserted to deal with the historical practice in the California market of producers volunteering to give up their Grade A status to avoid being pooled. Producers who voluntarily degrade must remain out of the pool for at least twelve consecutive months. Producers can lose Grade A status occasionally due to issues beyond their control and, therefore, we want to allow the producer the ability to regain pool status when this occurs. It is our expectation that such incidents are correctable in a thirty day period.

(Hollon Tr. Vol. XIII, p. 2763 (Oct. 8, 2015).)[44]

b. Producer milk – Section 1051.13(a-c), California milk 'all-in.'

These provisions, taken together, define the status of the majority of the milk which will be included in the California FMMO pool. Milk received directly at pool plants, whether directly from producers or marketed by Cooperatives, is "producer milk." Proposal No. 1 does not establish a location value for producer milk, although location adjustments will apply to the handler value of milk used as Class I. This provision allows cooperatives to pool milk not delivered to pool plants provided all other requirements of producer milk are met. This provision also allows pool plant operators to divert and pool milk not delivered to their own pool plant (provided all other requirements of producer milk are met). Diversion rights allow the operator of any pool plant to divert milk supplies to another plant while retaining the producer milk status and

[44] In point of fact, it is not only the historical practice, but the 12 month period is required under the current California system regulations. Pooling Plan § 106(a).

payroll responsibility for that milk. Without this provision, a plant operator who wants to retain regular producers on the plant's payroll for the entire month will have to physically receive the milk of such producers into the plant (so that it will be considered "producer milk"), then pump it back into the truck and deliver it to the other pool plant. Such milk will then be considered a transfer from one plant to another with the transferor-handler accounting to the pool for the milk and paying those producers as well. This practice is obviously uneconomic, resulting in unnecessary and costly movements of milk. In addition, the unnecessary pumping of milk is damaging to its quality. Permitting diversions of milk between pool plants will promote the efficient handling of milk.

c. Producer milk – diversion, repooling, and other limits Section 1051.13(d-f).

Subparts (d), (e), and (f) of section 1051.13, define the qualifications for pooling milk by delivery to nonpool plants located outside the marketing area (since any delivery from a producer located inside the marketing area to a plant located in the marketing area is to a pool plant). The limitations for diverted milk are in subsections (d)(1)-(4). First, under (d)(1), to be eligible for diversion, five days' production of a dairy farmer's milk must first be received at a pool plant. The limit for diversions by a section 9(c) cooperative (in (d)(2)), or the operator of a pool plant (in (d)(3)), is 50% of the handler's total producer receipts for the month. Furthermore, cooperative diversion volumes are limited by the required 50% shipments to plants described in section 1051.7(a) or (b). Also, diversion limits may be adjusted by the market administrator pursuant to section 1051.7(f) and milk from outside the marketing area is subject to the state-unit requirements of section 1051.7(e)(1).

Proponents believe these diversion requirements allow milk which demonstrates service as a reserve milk supply in the California market to be pooled. Deliveries to 7(a) and (b) plants contribute the highest value to the pool and, thus, deliveries which meet these rigorous standards will demonstrate that the milk is needed by the market. While rigorous, the diversion standard of 50% recognizes a balancing component for the Class I and II markets, and will not require uneconomical shipments of milk in order to qualify to share in the pool. The need would have to be present and met each month. The California market, at a 12-13% utilization, appears to have an adequate reserve supply for the Class I market. The combination of an initial five day touch base and the 50% diversion limitation should be a valid measure of additional need.

Section 1051.13(e) is a uniform "double pooling" prohibition which is in all FMMOs. It prohibits pooling on the federal order milk which is already participating in a state order marketwide pool.

Section 1051.13(f) regulates the volumes of milk that this type of handler may pool on the proposed FMMO from month to month. The provision limits the volumes to not more than 115% of the volume pooled in the previous month unless the Market Administrator waives the limitation, as an allowance for a new handler, or if he determines that the supply conditions of the reporting handler had a significant change "due to unusual circumstances."

Section 1051.13(f) further prescribes procedures to be followed in case a handler reports milk in excess of the percentages allowed by the proposed FMMO. The excess quantity of milk will not qualify as producer milk and will not be priced under the FMMO or will be down allocated for pricing purposes. Where possible, the reporting handler

will be required to designate the dairy farmer deliveries that should not be considered producer milk. Absent such designation the Market Administrator will make the determination.

d. Pooling of milk from outside the marketing area.

The proposed FMMO primarily involves the marketing and pooling of milk in the state of California and the requirements for equal pricing to producers and handlers. Producers and plants outside the state can clearly participate in the pool, but as in other FMMOs, with different benefits and burdens. Benefits may include the price improvement generated by the California FMMO pool versus the local market and burdens may include the high level of delivery necessary to share in those returns. Qualified distant reserve supplies may choose to pool or not pool depending on advantageous price relationships without causing the extent of disorderly marketing conditions that such behavior will result in if practiced within the marketing area.

VIII. PROPOSAL NO. 1 CONTAINS DETAILED PROVISIONS FOR THE APPROPRIATE DISTRIBUTION OF POOL REVENUES UNDER THE CALIFORNIA FMMO.

Building from uniform order provisions in 7 C.F.R. Part 1000 and crafting the balance of necessary order terms to match the unique marketing conditions of the California marketing area, Proposal No. 1 provides the full set of order language for operation of the California pool. Sections I-VII of this brief have detailed the need for the order, reviewed the legal foundation for its provisions, explained how its pricing terms conform to the national pricing grid, and how the pooling terms are required to build the class price values in the California pool. In this final section, the brief identifies how the pool should be distributed, beginning with a detailed description of the transportation credit program and continuing with the payments for quota, the payments

to out-of-state producers, and the calculation and distribution of the non-quota blend pool. Finally, this section will address the reporting, announcing, and administrative systems for pool operation. To illustrate pool operation, Proponents have attached to the Brief as Exhibit A, a prototype pool and producer component price calculation sheet for Order 1051, the California FMMO, using June 2015 FMMO prices.

A. A Transportation Credit System Should Be Adopted For Movement Of Milk From Production Areas To Class I And II Plants In Population Centers.

An important component of the proposed California FMMO is the inclusion of a transportation credit system to assist in moving milk for Class I and II use from production locations to Class I and II plants in population centers. Proposal No. 1 will accomplish the goal by providing a credit to receiving plant handlers to partially offset transportation costs required to move milk from production point to demand point. The credits will be funded from the marketwide pool. All pool producers who share in the higher valued uses will share a portion of the responsibility for supplying and balancing the Class I and II segments of the market through the transportation credit program.

The proposed transportation credit system was extensively detailed in the testimony of Mr. Hollon. (Tr. Vol. XVII, pp. 3300-3396, 3405-3450 (Oct. 16, 2015); Exhs. 72 and 73.) Proponents will not reiterate that testimony in all its detail in this brief. Mr. Hollon's testimony was substantially unchallenged and the indication from the DIC was that there will not be total opposition.[45] In this brief, Proponents will review the market conditions which underlie the need for a transportation credit system, compare hauling costs with the FMMO differential structure (with reference to the option of partial

[45] (English Tr. Vol. XVII, p. 3413 (Oct. 16, 2015).)

funding of milk movements via location differentials), and describe generally the construction and operation of the proposed transportation credit system.

1. Market Demographics.

Understanding the demographic structure of the California milk marketplace demonstrates that an intra-market transportation credit system is necessary for an FMMO. According to preliminary 2014 census data, California is the most populous state in the United States, its 38.8 million residents accounting for 12.2% of the 2014 total U.S. population of 318.9 million persons. (Exh. 72, Table 7.A Annual Estimates of the Population for the United States: April 1, 2010 to July 1, 2014.) The USDA's February 2015 *Milk Production Report*, the annual summary issue, shows that with a 2014 milk production of 42.3 billion pounds produced or 20.6% of the U.S. total production of 206 billion pounds, California is also the largest milk producing state, a position it has held for many years. (Exh. 72, Table 7.B.)

Within the state, the population is concentrated in the coastal counties and aggregated mostly in the southern portion of the state. (Exh 72, Table 7.C - 7.D.) Of California's 58 counties, 76% of the population is in 12 counties which encompass the major urban areas. 26.2% of the population is in Los Angeles County alone and 47.9% is in the greater Los Angeles metropolitan area, the five counties of Los Angeles, Orange, Riverside, San Bernardino and Ventura. 16.0% of the population is in the San Francisco metro area in the five counties of San Mateo, San Francisco, Contra Costa, Alameda and Santa Clara. The San Diego metropolitan area (San Diego County)

accounts for 8.3% of the population and the Sacramento metropolitan area (Sacramento County) accounts for 3.8%.[46]

The heavy milk production areas in California are not along the coast, near the population centers, but concentrated in the Central Valley in the interior of the state. See Exh. 72 Table 7.F. Milk production has become quite concentrated in the top five Central Valley counties, with Tulare, Merced, Stanislaus, Kings and Kern counties producing 72.8% of the state's production. The mismatch of production areas and population centers is depicted on Exhibit 72, Map 7.H where population density is noted by red dots and demonstrates the high population concentrations on the coastal counties, while production density, noted by solid color shading, is most focused in the central regions of the state. At the same time, the Class I and II processing plants are located primarily in or near the population centers rather than in the production regions. This basic market geography requires substantial shipments of milk substantial distances from the production areas to the metropolitan areas for the higher-valued Class I and II uses. Without a system in the FMMO for sharing of these transportation costs, while the utilization values are shared, inequity and market disorder will follow. (Hollon Tr. Vol. XVII, pp. 3310-11 (Oct. 16, 2015).)

2. The Existing CDFA Transportation Allowance System.

CDFA has operated a system of transportation allowances since 1983. The system offsets a portion of the transport cost for moving milk to designated plants located within designated areas and meeting certain class usage definitions.

[46] This population distribution is depicted graphically in Exh. 72, Map 7.E. The large population counties are depicted by the shades of blue – and concentrated around the Los Angeles, San Francisco, San Diego, and Sacramento metropolitan areas.

Allowances are established by CDFA based on milk movements between designated supply areas and designated sales points. The resulting rates are paid out of the producer milk pool. (*Id.*)

As noted in the CDFA witness's statement, the shipments for which the CDFA system provides an allowance do not include supplies from every county in the state nor deliveries to every Class 1, 2 or 3 plant. (Shippelhoute Tr. Vol. XIII, pp. 2613-30 (Oct. 8, 2015).) Deliveries to plants located within the largest milk supply regions are not afforded an offsetting payment because those locations are able to acquire a milk supply at a lower transport cost. However, deliveries to plants more distant to the largest milk supply regions are able to equalize the transportation component of their procurement costs by the use of the transportation allowance. (*Id.* at 3311-26.)

3. Comparison of Haul Costs versus Federal Order Differential

Mr. Hollon did a detailed study which compared the cost of transporting milk from ranch to Class I and II plant locations with the FMMO differential values (in Section 1051.52). He used transport costs drawn from the CDFA published cost data for a broad, representative array of movements from milkshed areas to plant locations. (Hollon Tr. Vol. XVII, pp. 3323-4 (Oct. 16, 2015).) He noted that the three supply-demand locations that have the largest recovery percentage – comparing differential gain to transport cost – were: (1) the Chino-Area 1 to Los Angeles-Area 3 (73% recovery if all the milk were in the largest differential spread locations) accounting for 2% of the total observations; (2) the South San Joaquin Valley - Area 7, 8, 9 to South San Joaquin Valley - Area 7, 8, 9 (56% recovery if all the milk were in the largest differential spread locations) accounting for 50% of the observations; and, (3) the South San Joaquin Valley - Area 7, 8, 9 to Los Angeles - Area 3 (47% recovery if all the milk

were in the largest differential spread locations) accounting for 8% of the observations. Furthermore, some of the hauls in each of these areas may take place from points that will have a lesser or no differential value difference to offset any transport cost. These three observations collectively account for 60% of all deliveries studied. The remaining 40% show a much smaller contribution from the differential value differences to offset transport cost, and in many cases the differential value is zero. Mr. Hollon concluded that all of these observations, even the most compensatory, are below a reasonable and equitable contribution to cost recovery. (Hollon Tr. Vol. XVII, pp. 3327-31 (Oct. 16, 2015).)

The configuration of production area, population centers, and federal order zones are summarized in this Table:

California Population and Milk Production by FMMO Zone				
Source: Hearing Exh. 73, Table 7.P and Map 7.Q.				
FO Zone	**Population**	**%**	**Milk Production**	**%**
$1.60 Zone	1,773,354	5%	20,706,758,017	49%
$1.70 Zone	4,757,982	12%	14,088,251,341	33%
$1.80 Zone	13,179,809	34%	6,190,253,835	15%
$2.00 Zone	2,491,870	6%	1,030,515,055	2%
$2.10 Zone	16,511,710	43%	44,427,920	0%
Total	38,714,725	100%	42,060,206,168	100%

As the cost study above establishes, the FMMO differential structure alone is not adequate to move milk from supply to demand points. The system needs additional cost recovery to function in an orderly manner and provide appropriate incentive and compensation for moving milk to the higher use classes. Without a transportation credit system which equalizes procurement costs, the Class I and II handlers, and the producers supplying them in high demand areas, will be at a competitive disadvantage

to the Class I and II handlers – and the producers supplying them – located in the heavy milk production areas.

The proposed California FMMO includes a marketwide pool. Proposal No. 1 provides for a uniform non-quota blend price without location adjustments, in essence assuring that all producers share equally in the market's classified utilization. With the cost of the transportation credit system borne by the pool, all producers will also share equally in the cost of serving the Class I and II markets.

For the California FMMO, a system of intra-market transportation credits to compensate milk movements to Class I and II demand points is superior to a system of producer location adjustments for several reasons. First and foremost, as transaction-based compensation, the payments are targeted to only those transactions which enhance the pool. An inherent issue with location adjustments on producer milk deliveries is that they are applicable to any, and all, deliveries to the price zone. (Blaufuss Tr. Vol. XXXV, p. 7142 (Nov. 11, 2015); Hollon Tr. Vol. XVII, pp. 3416, 3449-50 (Oct. 16, 2015).) So, Class III or IV plants located in milk deficit areas receive the same location adjustment and the same compensation from the pool as shipments for Class I and II to that zone. This is avoided with transaction-targeted transportation credits. Second, a transportation credit can be tailored to the actual cost of the delivery and be subject to built-in cost adjustment, for example, a fuel cost adjuster. There is no such flexibility with location adjustments which, again, payout the same zone-adjusted blend to all receipts at the location. The zone adjustments are not currently capable of built-in adjustments for changes in costs. Finally, the California industry, both producer and handler, is familiar with, and comfortable with, a transportation-based compensation

system for deliveries to deficit areas and to uniform non-quota (overbase) prices to producers, regardless of the delivery point of the producer's milk. For the California FMMO, transportation credits, as authorized by the AMAA, allow a market-tailored, fine-tuned system of compensating for milk movements to Class I and II plants in milk deficit areas.

4. The Transportation Credit Program: How It Works.

a. General Description.

The Cooperatives' transportation credit program is a detailed, market-tailored program designed to support the costs of supplying deliveries from eligible farms to eligible plants and is both mileage and transaction based. For each haul trip that meets the criteria for a payment, an established rate per hundredweight, adjusted automatically to reflect changes in the price of diesel fuel, will be paid. Miles for which reimbursement is paid will be calculated from each producer farm or ranch to the delivery plant. Reimbursements will be subject to a maximum mileage limitation to avoid uneconomic shipments, will be paid only on milk actually delivered, and will not include the cost of a local delivery. (Hollon Tr. Vol. XVII, p. 3332 (Oct. 16, 2015).)

b. Eligible deliveries.

Plant eligibility. Deliveries for which transportation credits are payable are defined by both the location and utilization of the receiving plant and the location of the source farm. For plants there are two criteria: location and utilization. Credits are limited to plants located in high demand, high population, milk deficit locations in the marketing area. The delivery zones are defined by counties as specified in Section 1051.55(b)(1) of Proposal No. 1. The counties represent (1) a six-county southern California delivery zone encompassing the greater Los Angeles and San

Diego metropolitan areas; and (2) a 10 county northern California delivery zone for San Francisco and the greater northern California Bay Area. Plants located in the high milk production inland areas of the Central Valley are not eligible for transportation credits. The utilization of recipient plants must be greater than 50% Class I and/or II in the month of delivery or on average during the preceding twelve months. *See* Section 1051.55(b)(2). Class I and Class II utilization contribute differential value to the marketwide pool and represent fluid milk and cream products, and not manufactured products.[47] Class III or IV plants are not entitled to transportation credits. (Hollon Tr. Vol. XVII, p. 3331 (Oct. 16, 2015).)

Producer eligibility. Deliveries of pool producer milk, irrespective of farm or ranch location, are eligible for transportation credits. Proposal No. 1 was modified at the hearing to eliminate the condition that a producer's farm be located in the marketing area for transportation credit eligibility. It is possible that some farms outside the marketing area may be able to economically supply certain Class I or II plants in the credit-eligible zones. If such deliveries occur, they should be eligible for credits. As discussed further below, a mileage limit for calculation of reimbursement amount applies to all deliveries whether from farms inside or outside the marketing area. (Hollon Tr. Vol. XXXVIII, pp. 8063-67 (Nov. 28, 2015); Exh. 192.)

c. Rate of payment.

The proposed credit payment formula has several elements: eligible deliveries defined by from-and-to zones; a payment formula for rate per mile delivered with a built-

[47] With respect to application of the transportation credits to Class I and II, it should be noted that under the current California system, the state transportation allowance is granted to California Classes 1, 2, and 3, the state equivalent to FMMO Classes I and II.

in fuel adjustor to align with current fuel costs; and payment limitations. The formula was developed by the Proponents with the assistance of the Pacific Northwest Market Administrator's office through a detailed study of actual costs incurred by the Cooperatives in May and October 2013 for transporting milk from supply points to demand points in California. The result is a credit-reimbursement program which provides reasonable compensation for qualified deliveries, while avoiding incentives for uneconomic movements. (Hollon Tr. Vol. XVII, p. 3332 (Oct. 16, 2015).)

Transportation zones. There are three transportation credit zones in Proposal No. 1, defined by plant and farm locations. These delivery zones were identified by the Cooperatives as representative of the market's procurement patterns for which transportation credit assistance was necessary. Transportation Zone 1 is a narrowly-defined, population-congested procurement area[48] in which the milk assembly and delivery conditions are different than the conditions in Zones 2[49] and 3,[50] which represent longer distance hauls. The destination points in each Zone are high population areas with a predominance of fluid-use plants. Class I or II plants located in high milk production areas are served with shorter hauls, and thus, lower procurement costs and are not eligible for credits. (Hollon Tr. Vol. XVII, pp. 3336-7 (Oct. 16, 2015).)

[48] Transportation Zone 1 – deliveries to plants located in the counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura originating from dairy farms located in the counties of Riverside or San Bernardino.

[49] Transportation Zone 2 – deliveries to plants located in the counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura originating from dairy farms located in all counties within the marketing area except Riverside and San Bernardino.

[50] Transportation Zone 3 - deliveries to the counties of Alameda, Contra Costa, Marin, Napa, Sacramento, Santa Clara, Santa Cruz, San Francisco, San Mateo, Solano, and Sonoma originating from dairy farms located in the marketing area.

Formulation of payment rates. As stated above, the Cooperatives engaged the Pacific Northwest Market Administrator's office to assist in developing appropriate formulas for the transportation credit system. Data for the study included actual transport costs for May and October 2013 with farm and plant delivery locations for movements in each zone category. Analysis was performed with three objectives: (1) to develop a representative equation to estimate the cost per hundredweight per mile to move milk from farm to plant in each of the Transportation Zones; (2) to generate a credit to the handler that closely approximates the actual cost of delivery for each separate farm-to-plant movement, less $.30 per hundredweight.; and, (3) to reflect, in aggregate, the approximate cost of supplying each of the transportation zones. (Hollon Tr. Vol. XVII, pp. 3342-48 (Oct. 16, 2015).)

The quantitative analysis of the data produced separate equations for credit payment for each of the zones, reflecting the different costs of delivery in the three zones. The resulting equations, tested against the actual underlying cost data performed very well. The zone-specific equations which resulted from the study showed good predictive ability and met the three objectives outlined above, thus providing a rate framework for these pool credits. (Hollon Tr. Vol. XVII, pp. 3342-48 (Oct. 16, 2015).)

Fuel Adjustor. In order to account for volatility in diesel fuel costs, Proposal No. 1 includes a fuel cost adjustor to the credit payment rate. The inclusion of a fuel cost adjustor in the rate formula serves to fairly, and automatically, reflect fuel cost changes, thus maintaining reimbursement in line with actual costs and preventing either underpayment or windfall payments which can occur with fuel cost changes if there

were fixed rate reimbursement.[51] The process for computing the fuel adjustor involves a number of steps and the use of several government data series for fuel cost and highway fuel usage by milk hauling type trucks. Proponents will not repeat the detail of those steps in this brief. [52] In the end, however, the fuel adjustor involves the straightforward concept of adjusting the credit rate per milk per hundredweight of milk transported by the change in cost, up or down, reflected in the change in the price of diesel fuel. The concept, and its application, have been used, and are being used today, for transportation credits in FMMOs 5 and 7. (Hollon Tr. Vol. XVII, pp. 3349-62 (Oct. 16, 2015); *see also* 7 C.F.R. 1007.80-83 and 7 C.F.R. 1005.80-83 (Orders 5 and 7 transportation credit regulations).)

In summary, transportation credits will be applicable to eligible shipments at a rate per hundredweight per mile based on: the applicable farm-to-plant zone rate per hundredweight of milk per mile, adjusted to the current price of fuel, times the mileage from farm to plant, and subject to the payment limitations discussed below.

Payment limitations. The credits are limited in several ways to avoid any uneconomic incentives. First, $.30 per hundredweight is eliminated from the cost of each haul so that no compensation is payable for the cost associated with a local, non-Class I/II, and non-credit eligible haul. A rate of $.30 per hundredweight is a typical

[51] Additionally, a fuel adjustor will reduce the necessity for hearings to adjust the transport reimbursement rate and a fuel adjustor has worked very well in the transportation credits in the Southeastern Orders.

[52] A sample computation for the fuel adjustor per hundredweight per mile is in Table 7.W, Exh. 75. The result of this calculation for the illustrative period is that $.000340 per hundredweight per mile is deducted from the rate calculation (or constant) derived from the regression equations described in Table 7.S for the month the calculation was made. Should the fuel adjustor result in a positive number it would increase the rate calculation.

local haul rate in California, based on the Cooperatives' experience.[53] Second, a mileage limit of 175 miles establishes a maximum amount of credit available for any given haul. Milk from greater than 175 miles should not be routinely needed to service Class I and II plants in the marketing area. Therefore, the additional cost of any such milk movements should be borne by the producer and/or purchasing plant. Also, as noted above, the rate per mile has been calculated so as to approach, but not exceed, the marginal costs of milk transport. Thus, the longer the haul, the greater the cost which must be borne by the producer or plant.[54]

In summary, the Proponents of Proposal No. 1 believe the reimbursement rates and formulae they have proposed will service the market well, while avoiding incentives for abusive or uneconomic shipments. A detailed example of the calculation of the transportation credit payment rate is depicted in Exhibit B to the Brief.

d. Concluding notes.

Payments will be calculated and paid on a per farm basis. While the example in Exhibit B envisions the volume coming from one farm in the source area and delivering to a single plant in a demand area, a single farm can have multiple delivery points in a single month, hence multiple payment rates, and a route can have more than one stop. Each stop will be treated individually for the pounds it delivered to the plant, pro-rating deliveries among producers on a truck if applicable.

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[53] The $.30 rate is also supported by the CDFA data, as noted by Dr. Schiek in cross-examination of Mr. Hollon. (Hollon Tr. Vol. XVII, pp. 3405-07 (Oct. 16, 2015).)

[54] Proponents also suggest that the Market Administrator periodically publish a hauling cost study that details key cost data. A hearing to review the cost data and determine if they wish to alter the reimbursement rates can be requested when and if required.

Handlers will be responsible to report to the Market Administrator all necessary data needed to compute the transportation credit. Transportation credit payments will be made to handlers[55] and handlers will be responsible to furnish information to independent producers relative to the transportation credits received on their milk deliveries. Proponents believe this will enable independent producers to insist that the value of the credit be passed back to the producer. Competitive forces, and the sophistication of California dairy farmers, should assure this end result.

B. Proposal One Prescribes The Distribution Of Pool Proceeds To Producers.[56]

Full explanation of Proposal No. 1's provisions for distribution of the pool involves four topics: (1) treatment of quota; (2) payment to out-of-state producers; (3) payment of the non-quota blend revenues; and (4) reporting and administrative mechanics.

1. Recognition And Payment Of Quota Value.

The value of, and legal rights vested in, California quota owned by California dairy farmers should be recognized by priority payment of the quota premium to quota holders from the California order producer-settlement fund, commonly referred to as the pool. This priority distribution from the pool is understood best in the context of the history of the quota program, already discussed in Section IV, *supra*, and its special recognition in the authorization for this hearing.

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[55] Transportation credits are a species of marketwide service payments under the AMAA. 7 U.S.C. § 608c(5)(J). As such, the payments must be made to handlers. For the great majority of the milk deliveries to which credits will apply, the cooperative will be the Section 9(c) handler and thus also the producer under the order.

[56] The proposed order language, as modified, can be found at Appendix Exhibit 2 (Clean) and Appendix Exhibit 3 (Comparison to Hearing Notice).

The 2014 Farm Bill provides:

> Upon the petition and approval of California dairy producers in the manner provided in section 608c of this title, the Secretary shall designate California as a separate Federal milk marketing order. The order covering California shall have the right to reblend and distribute receipts to recognize quota value…. 7 U.S.C. § 7253.

As previously discussed, the FMMO for California must therefore contain provisions that recognize the value of California quota. The Proponents have already shown how quota, since its inception, has been a capitalized and marketable balance sheet asset. (Oosten Tr. Vol. XXXVIII, p. 7777 (Nov. 16, 2015); Barcellos Tr. Vol. XXXVIII, p. 7822 (Nov. 16 2015); McBride Tr. Vol. VI, p. 1275 (Sept. 29, 2015).) Additional quota was issued by California in 1978, and in subsequent years,[57] but none since 1992. The importance of California's quota system is confirmed by Pooling Act section 62712(e), which provides that the Pooling Plan and its quota provisions cannot be substantively amended or terminated without a majority referendum.

In 1993, the California Legislature established the current method of calculating the quota premium. California Food and Agriculture Code §§ 62750-62756, sometimes referred to as "Chapter 3.5." The quota premium was set at a fixed $0.195 per pound of solids-not-fat (equivalent to $1.70 per hundredweight of milk at 3.5% butterfat and 8.7% solids-not-fat). For some California counties in the southern marketing area, and all northern California counties, the fixed premium is reduced by Regional Quota Adjusters

[57] From 1973 to 1992, some quota was issued each year except 1981, 1982, 1983 and 1988.

("RQAs"); there is no RQA adjustment for other southern California counties.[58] Section 62750 specifies how producers are to be paid for the solids-not-fat quota held, the solids-not-fat not covered by quota, and for milk fat whether or not covered by quota. Chapter 3.5 remains operative until the California Secretary of Food and Agriculture certifies to the California Secretary of State that producers have voted in a referendum (provided for in sections 62753-62754) to suspend the operation of the Chapter, in which case the Pooling Plan provisions in effect on December 31, 1993 again become operative. § 62756(a).

In the event of adoption of an FMMO for California, section 62726 of the Pooling Act provides that provisions of that Act that are in conflict with, or are unnecessary or are a duplication of the FMMO are suspended. However, there are no similar provisions suspending Chapter 3.5 in the event of adoption of an FMMO, and the quota premium established by that Chapter will remain in effect notwithstanding the adoption of an FMMO.

a. Value of quota.

Testimony of California producers and that of the Cooperatives' witnesses, Dr. Eric Erba ("Dr. Erba") and Mr. Hatamiya, established that quota has substantial value to California producers holding quota. (Exhs. 43 and 56.) As of January 2015, 815 dairy farms out of 1407, or 58%, hold quota as follows:

[58] RQAs were developed to address certain equity issues arising from the elimination of location differentials. RQAs are currently determined by the geographical county location of the producers' dairy farm, are applied to the hundredweight equivalent of quota produced at 3.5% butterfat and 8.7% solids-not-fat, and range from a $0.00 per hundredweight reduction for some dairy farms in counties in the southern California area to minus $0.27 per hundredweight for dairy farms located in Fresno, Kings and Tulare counties.

Percentage of Milk Production Covered by Quota	Percentage of Dairy Farms
0%	42%
1% to 20%	20%
21% to 40%	13%
41% to 60%	9%
61% to 80%	7%
Over 80%	9%
Total	100%

Quota has been bought and sold annually between producers, commencing with August 1969, the month after quota was created under the Pooling Act. As of August, 2015, the price per pound of quota sold without cows ranged from a high of $530/lb. to a low of $525/lb., averaging $525/lb. Quota prices per pound (of sales without cows) have been above $500 since June 2014, and have averaged monthly during that period from a low of $519/lb. to a high of $538/lb., with $525/lb. being the most frequent average monthly price. Testimony from Mr. Hatamiya established that, as of January 2015, CDFA records indicated there were 2,215,977.6 pounds of quota solids-not-fat holdings. (Exh. 54, p. 14.)[59] This represents 21.94% of all quota solids-not-fats as of January 2015. Based on the most currently available average price per pound of $525/lb., this quota has a value of $1,163,388,061. (*Id.*)

Uncontradicted testimony from many producers, Dr. Erba, and Mr. Hatamiya established the importance of quota to their dairy operations, both as a valuable balance sheet asset for financing purposes and as a stream of income. Producers

[59] Dr. Erba's testimony regarding quota solids-not-fats holdings as of the same month are minisculely different – 2,215,987 pounds. (Exh. 43, attached Exh. 4.D thereto, "Table 3.")

testified that their quota holdings have been utilized to obtain financing, either as balance sheet asset support or direct collateral, for operations, facility maintenance, facility improvements and expansions. (Oosten Tr. Vol. XXXVIII, p. 7777 (Nov. 16, 2015); Barcellos Tr. Vol. XXXVIII, pp. 7821-2 (Nov. 16 2015).) There was further testimony that producers with dairies of varying sizes deemed quota revenues were essential to their monthly cash flow, helping to meet higher costs of production and providing an excellent return on investment. (Hatamiya Tr. Vol. XI, p. 2251 (Oct. 6, 2015); AcMoody Tr. Vol. XVI, p. 3193 (Oct. 15, 2015).) There was testimony from some producers that revenue from quota holdings meant the difference between continuing in dairy farming or going out of business. (Verburg Tr. Vol. XXXI, p. 6215 (Nov. 5, 2015).)

Testimony further established that California accounting firms that specialize in dairies account for quota at the cost paid for it, recognize quota value as an investment and a transferable intangible asset, may classify quota under current assets, intangible assets and/or long term assets, and state that if the quota program were eliminated, it will result in massive loss write-offs, in the case of some dairies in millions of dollars. (Verburg Tr. Vol. XXXI, p. 6214 (Nov. 5, 2015).) Testimony also indicated that major dairy lending financial institutions place a value on quota ownership as an unencumbered, marketable asset, increasing borrowing leverage, providing liquidity and a steady, assured source of cash flow and revenue. (Barcellos Tr. Vol. XXXVIII, pp. 7821-22 (Nov. 16, 2015).)

b. Recognition of quota value.

There were four proposals concerning how a California FMMO should recognize quota value: the Cooperatives' Proposal No. 1; the DIC's Proposal No. 2;[60] the "annuity" proposal suggested by Dr. Schiek on behalf of DIC in testimony on November 9, 2015; and a further annuity proposal by Dr. Schiek on November 17, 2015.[61] However, only Proposal No. 1 accomplishes the statutory requirement of the Farm Bill.

The provisions concerning quota contained in DIC's Proposal No. 2 will result in the elimination of quota and destruction of the value of quota within three to four monthly decision points as concluded by the Preliminary Impact Analysis and the testimony of Mr. Hatamiya. The testimony of Dr. Schiek, the DIC's economist and chief witness, conceded that Proposal No. 2 will eliminate quota, albeit, in his opinion, perhaps over a longer, but unspecified period of time. (Tr. Vol. XXXIII, pp. 6705-6707, 6712, and 6610 (Nov. 9, 2015); Schiek Tr. Vol. XXXIX, p. 8016 (Nov. 17, 2015).) The elimination of quota that will result from the operation of the quota provisions of Proposal No. 2 will cause significant economic damage to dairy farmers and the counties where their dairy farms are located, including loss of substantial investments,

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[60] Although the DIC in the hearing contended that quota program incorporation in a California FMMO was discretionary and not mandatory upon the Secretary, its own Proposal contained provisions concerning quota, and Dr. Schiek, its economist and principal witness testified that "…Dairy Institute did not set out, nor is it our goal to destroy quota." (Tr. Vol. XXXIII, pp. 6624 and 6690 (Nov. 9, 2015); Exh. 145, p. 1.) However, as discussed in subsection (b), *infra*, Proposal 2 would eliminate and destroy quota.

[61] Dr. Schiek testified that this proposal had not been yet approved by the DIC and therefore represented his own suggestion and not a Dairy Institute position. (Tr. Vol. XXXIX, p. 8017 (Nov. 17, 2015).)

massive asset write-offs on their balance sheets, reduced access to capital and financing and loss of significant monthly cash flow.

For these reasons, the quota provisions of Proposal No. 2 do not recognize quota value but rather serve to destroy it. The two annuity proposals suggested in Dr. Schiek's testimony likewise do not recognize quota value and do not satisfy the requirements of the 2014 Farm Bill: they do not reblend and distribute receipts. They do not recognize the value of quota which will otherwise continue unless changed by the California legislature or by a vote of California producers, but rather will eliminate quota over a relatively brief period of time.

The annuity proposals also are unacceptable, impractical, and incompatible with the principles set forth in the 2014 Farm Bill for several clear reasons. First, there is no USDA mechanism to establish and administer an annuity. Second, there is no feasible funding source from which annuity payments can be made. The only source suggested in the annuity proposals was payment out of the pool itself, but payment out of the pool revenues will in effect have quota holders buying themselves out with their own revenues. Moreover, it will impose upon non-quota holders the burden of contributing to the buy-out of quota holders. The total annuity annual payout proposed in Dr. Schiek's November 17, 2015 testimony of $11,833,486 is virtually equivalent to the total current annual payout to quota holders from the pool – $11,610,813.27. (Schiek Tr. Vol. XXXIX, pp. 8018-8019 (Nov. 17, 2015).) But, according to Dr. Schiek's testimony, the annuity payments will last 11 years, three months, whereas under the current quota

system, the quota payments will last indefinitely unless changed by the California legislature or by vote of producers.[62]

Furthermore, the testimony of Dr. Erba, based on input from financial institution sources, indicated that establishing a quota buyout program and providing for its financing will face a daunting number of hurdles. It will require new California legislation or at least and amendment of the Pooling Act, as well as changes to the Pooling Plan. (Tr. Vol. XXXX, pp. 8115-8117 (Nov. 18, 2015).) A buyout will also necessitate the creation of a new entity to make a first priority claim ahead of producers against the Milk Security Trust Fund for non-payment of diverted quota payments. (*Id.*) There will need to be changes to the reporting, billing and payment system and to the duties and functions of the CDFA Milk Pooling Branch. (*Id.*) The government will have to authorize bonds or other financing mechanisms to pay for the buyout, and adopt legislation prohibiting material changes in the pooling system while bonds or other financing mechanisms are outstanding. (*Id.*) Finally, the buyout will require adoption of legislation terminating quota payments upon full retirement and irrevocably eliminating producers rights to quota payments diverted to the new quasi-governmental entity. (*Id.*)

The Cooperatives' Proposal No. 1, on the other hand, fully complies with the Farm Bill's provision that a California FMMO contain provisions for the reblending and distribution of receipts and gives full recognition to the value of quota. *See* Proposal No. 1, Vol. 80 Federal Register, No. 151 (August 6, 2015), commencing p. 47210); §§ 1051.17, 1051.71, 1051.72 and 1051.73.

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[62] There has been no change in the quota premium established since it first became effective on January 1, 1994, a period of 21 years.

The DIC raised two objections to incorporation of the California quota system in the manner proposed by the Cooperatives in Proposal No. 1: (1) that it violates the AMAA principle of "uniform pricing;" and, (2) that it constitutes an impermissible trade barrier in violation of AMAA section 608c(5)(G).

The DIC's uniform pricing objection is based on its legal assertion that since the Farm Bill provision regarding establishment of a California FMMO did not expressly amend the AMAA, the AMAA provision regarding uniform pricing controls the application of the Farm Bill provision regarding California quota. However, as discussed in Section III, *supra*, the Farm Bill's provision that a California FMMO shall contain provisions that authorize the reblending and distribution of receipts to recognize quota value must be given effect, and authorizes a different pricing for quota. Otherwise, the Congressional language will be virtually meaningless. Therefore despite the fact that the Farm Bill does not expressly amend the AMAA, by its provision allowing reblending and distribution of proceeds and requiring recognition of quota value, it either impliedly amends the AMAA, or, being the later enacted statute and addressing the particular issue of quota which the AMAA does not, the Farm Bill controls over and supersedes the AMAA on this issue.[63] Moreover, the Cooperative's Proposal No. 1 does provide for uniform payment to all California producers in similar circumstances – uniform quota premiums to the extent production is covered by quota, and a uniform blend price for California production not covered by quota.

[63] Dr. Schiek himself testified that, prior to adoption of the Farm Bill provision, there was no authority under the AMAA to reblend receipts or to distribute pool funds to recognize quota value, but there was such authority granted by adoption of the Farm Bill. (Tr. Vol. XXXIII, pp. 6727-6732 (Nov. 9, 2016).)

With respect to exempt quota, the Cooperatives recognize that, pursuant to California law, exempt quota can be sold and continue to have all the entitlements of regular quota, including the $1.70 per hundredweight premium. (Hollon Tr. Vol. XVIII, p. 3494 (Oct. 19, 2015).) California handlers can own farms and own quota like any other producer, and at least some of the producer-handlers who own exempt quota, also own "regular" quota which they supply to their own distributing plants. (*Id.*) The impact to the pool of exempt quota is greater than the impact of regular quota, but significantly less than the impact of fully unregulated supplies. (Hollon Tr. Vol. XVIII, p. 3494-5 (Oct. 19, 2015).) Transportation credits under Proposal No. 1, could, and likely would, apply to some deliveries of farm milk presently covered by exempt quota, if that quota was converted to regular quota. (*Id.*) Therefore, the Cooperatives do not oppose the treatment of exempt quota as requested by the CPHA.

For all these reasons, California quota should be paid from the producer-settlement fund as a priority obligation, before the distribution of net pool (non-quota blend) revenues among all producers.

2. Payment To Out-Of-State Producers.

Since January 2009, data published by the CDFA indicate an average of 54.5 million pounds of milk per month came from farms located outside of the proposed marketing area, and were marketed to California processing plants. (Hollon Tr. Vol. XXXVIII, p. 7659 (Nov. 16, 2015).) Under a California FMMO, these deliveries will be fully pooled. (*Id.*) To address a concern raised at the hearing that farms located outside of California are not eligible to own quota, without conceding the concern's validity, Proponents have modified Proposal No. 1 to provide for the payment of a blend price adjustment to these producers so that their total receipts are undiminished by

quota payments. This is accomplished through payment of an "out of state" ("OOS") adjuster; see Section 1051.61(a)(2) at Appendix Exhibits 2 and 3, which pays to out-of-state producers an adjustment equal to the amount by which the non-quota blend is reduced by the quota premium payments.

3. Payment Of The Non-Quota Blend.

After the value of the OOS adjuster and the quota premiums have been paid from the pool, the remaining value goes to all producers uniformly as a non-quota blend or non-quota uniform price. (Erba Tr. Vol. X, pp. 2139-40 (Oct. 5, 2015).) All producers, in and outside of California, share equally in the value. (*Id.* at 2141.)

The Cooperatives propose that this value be shared on the basis of an MCP program based on three components: butterfat, protein, and other solids. (Wegner Tr. Vol. VIII, p. 1570 (Oct. 1, 2015).) MCP will be applicable both to handlers and producers, following the predominant FMMO model which prices components to handlers of Class I (fat and skim); Classes II and IV (fat and solids-not-fat); handlers of Class III (fat, protein, and other solids) and to producers (fat, protein, and other solids) on all milk. (*Id.*) This pricing system eliminates the need for regional yields based on regional differences in the milk composition. The value of milk will be adjusted automatically based on the level of components contained in the milk in each order, even though the component prices are the same nationally. This automatic adjustment means that handlers will pay the same price per pound of component, but may have differing per hundredweight values based on the milk component levels, creating equity in the minimum cost of milk used for manufacturing purposes. (Wegner Tr. Vol. VIII, p. 1571 (Oct. 1, 2015); *see Milk in the New England and Other Marketing Areas, supra*, 64 Fed. Reg. at 16100.)

Producers will be paid twice per month based on MCP calculations. (Wegner Tr. Vol. VIII, p. 1580 (Oct. 1, 2015).) They will be paid for pounds of butterfat, protein, and other solids. (*Id.*) All producers in the FMMO will receive the same component prices. (*Id.*) There will be no somatic cell count adjustments included in the regulated prices. (*Id.*)[64] Federal Order Reform identified the source of the component prices: the butterfat, protein, and other solids prices are component prices based on the value of the use of milk in manufacturing. (*Id.*; *see Milk in the New England and Other Marketing Areas, supra*, 64 Fed. Reg. at 16095.)

In the California FMMO under Proposal No. 1, there will be no PPD value, as such, paid to producers. (Wegner Tr. Vol. VIII, pp. 1580-1 (Oct. 1, 2015).) Instead, the funds generated from the PPD value computation will be paid across all three components in a ratio representative of their value in the pool. (Wegner Tr. Vol. VIII, p. 1581 (Oct. 1, 2015).) More specifically, the Market Administrator will calculate the contribution of each component, butterfat, protein, and other solids, to the value of the Class III components to producers on an annual basis. (*Id.*) The higher the PPD, the larger the adjustment to each component; the larger the component's contribution to the value of the Class III components to producers, the larger the share of the PPD adjustment. (*Id.*) A negative PPD will reduce the component prices, and accordingly, the larger the component's contribution to the value of the Class III components to producers, the larger the reduction to the component's price. (*Id.*)

[64] In this respect, the California FMMO would follow Orders 1 and 124, which have MCP but do not have somatic cell adjusters.

The PPD concept, in Proponents' view, adds an unnecessary level of complication to the understanding of the FMMO pricing. (*Id.*) More specifically, negative PPDs that can occur when increases in commodity prices lead to class price inversions are even more difficult to explain to producers. (*Id.*) Additionally, since the existing California system does not include a PPD, eliminating a PPD will mean one less pricing complexity.

4. Administration Of The Pooling And Payment Process.

Administration of the California FMMO will require participation of both the CDFA and USDA in distribution of the pool. In effect, the California FMMO will not disturb the California quota program. (Erba Tr. Vol. IX, p. 1827 (Oct. 2, 2015).) Instead, under the Cooperatives' Proposal No. 1, the quota program becomes embedded within the California FMMO with full information transfer between the two governmental agencies. (*Id.*) Each month CDFA will communicate to the California FMMO Market Administrator all financial calculations relative to the net cost to the pool of quota payments. (*Id.*) The Market Administrator will then take all steps to assure that quota values are deducted from pool revenues and paid to producers properly. (*Id.*) Also, the Market Administrator will remit any necessary information regarding quota payments back to CDFA to allow ongoing administration of the quota program. (*Id.*) Thus, Proposal No. 1 leaves all jurisdiction over quota administration, calculations, recordkeeping and regulatory changes to CDFA. (*Id.*) As such, the laws, regulations, and policies in operation at the time of adoption of the California FMMO will remain unchanged. (Erba Tr. Vol. IX, pp. 1827-8 (Oct. 2, 2015).)

There are no provisions in Proposal No. 1 that will alter quota payments. (Erba Tr. Vol. IX, p. 1828 (Oct. 2, 2015).) The quota premium of $.195 per pound of quota

solids-not-fat is maintained, as are the applicable RQAs. (*Id.*) As a practical matter of providing the Market Administrator with the information specified in Sections 1051.61 and 1051.62, CDFA will have to determine, obtain, and/or verify each month:

- The active California dairy producers;
- The amounts of quota owned by each producer after reviewing and applying quota transactions that occurred as of the 15th day of the prior month;
- Location of each producer (to verify applicable RQA);
- Number of days of eligible production; and
- Individual producer quota payment after taking into consideration applicable RQAs and eligible production for the month.

According to the handler reporting requirements contained in Section 1051.30 of Proposal No. 1, pool handlers will report to the Market Administrator as of the 9th day after the end of the prior month, the pounds of milk, butterfat, protein, and other nonfat solids contained in producer milk. (*Id.*)

The intention is that before the 14th day after the end of the prior month, CDFA determine and report to the Market Administrator of the California FMMO the applicable individual producer quota payments. (Erba Tr. Vol. IX, p. 1830 (Oct. 2, 2015).) At the same time, CDFA shall report to the Market Administrator the quota pounds associated with the milk supply received by each handler, which will be used to determine possible payments into or draws from the producer-settlement fund. To be clear, only information is exchanged between the two regulatory agencies; no money will move between CDFA and the Market Administrator. (*Id.*)

After combining all values into a single milk sale revenue pool and making the necessary adjustments to that revenue pool described in Section 1051.60, the Market Administrator shall deduct from the revenue pool an amount equivalent to the quota premium as reported to the Market Administrator and by CDFA prior to calculating any milk component prices. (Erba Tr. Vol. IX, pp. 1830-1 (Oct. 2, 2015).) The Market Administrator shall announce publicly the applicable quota premiums for solids-not-fat to be paid to quota holders on eligible milk production and the statistically uniform price for non-quota milk, as well as other relevant prices by the 14th day after the end of the prior month. (Erba Tr. Vol. IX, p. 1831 (Oct. 2, 2015).)

The producer-settlement fund is established and used by the Market Administrator as a repository for all payments made by handlers and the fund from which payments are made within the FMMO. (Erba Tr. Vol. IX, pp. 1831 (Oct. 2, 2015).) Payments due any handler shall be offset by the payments owed by the handler. (*Id.*) Payments into the fund by handlers shall follow the steps provided in Section 1051.71 and reflect announced minimum prices and utilization of the components of milk. (*Id.*) If any payments are due by a handler, they are to be received no later than the 16th day after the end of the prior month. (*Id.*) The procedural steps for payments due handlers from the producer-settlement fund are specified in Section 1051.72. (*Id.*) Payments from the producer-settlement fund reflect monies due producers based on each handlers producer payroll, which closely follows procedures followed in other FMMO's. (*Id.*) One significant difference for the California FMMO, is that the additional value resulting from a handler receiving milk covered by quota is credited to the handler from the producer-settlement fund. (Erba Tr. Vol. IX, p. 1831-2 (Oct. 2, 2015).) This allows

handlers to pay appropriate amounts for all milk received no matter how the milk is used and no matter if the milk is covered by a quota. (Erba Tr. Vol. IX, p. 1832 (Oct. 2, 2015).) Payments from the producer-settlement fund, if any, shall be made by the 17th day after the end of the prior month. (*Id.*)

The monthly tasks and the data sequence for pool administration is depicted in the following charts:

Dates and Steps for Final Payment to Producers and Cooperatives[65]		
Entity	**Task to be Completed**	**Date**
Pool Handler	Reports milk, fat, protein, other solids to MA and CDFA	9th Day following EOM
CDFA	Analyze quota holdings by producer and by handler	After handler reports received
CDFA	Reports to MA the payment to each producer with quota, organized by handler	Before 14th Day following EOM
MA	Aggregates for pool utilization and determines each handler's obligation	After handler reports received
MA	Announces producer prices by component, five quota prices and uniform price	Before 14th day following EOM
MA	Sends statements to handlers	After prices announced
Pool Handler	Pay into producer-settlement fund (those issued a debit)	By 16th Day following EOM
Producer-Settlement Fund	Pay out to pool handlers which are due a credit	By 17th Day following EOM
Pool Handler	Pay cooperatives	By 17th Day following EOM
Pool Handler	Pay producers	By 18th Day following EOM

Order Section	**Function**	**Date**
1051.30(a)	Reports of all receipts	9th
1051.31(a)	Producer receipts	9th

[65] CDFA = California Department of Food and Agriculture; MA = Market Administrator of California FMMO; EOM = End of Month

Order Section	Function	Date
1051.31(b)	Producer payroll	20th
1051.62	Pool prices announced	14th
1051.71	Payments to Producer-Settlement Fund	16th
1051.72	Payments from Producer-Settlement Fund	17th
1051.73(a)(1)	Partial payment to producers	18th
1051.73(a)(2)	Final payment to producers	18th
1051.73(b)	Final payment to coops	Day before (a)(1) and (a)(2)
1051.73(c)	Final payments to coops	Day before (a)(1) and (a)(2)

In summary, Proposal No. 1 provides a fully-developed program for administration of a California FMMO which fully recognizes and retains the value of California quota; allows the pooling of milk from out-of-state, subject to the terms of the order, and provides for it to receive a price undiluted by quota through payment of an out-of-state adjuster; and uniformly distributes the remaining values to all pool producers on the basis of a multiple component pricing system for three milk components – butterfat, protein, and other solids.

IX. CONCLUSION

The U.S. dairy industry stands at a momentous threshold – the entry of California, the nation's largest milk producing area, into the FMMO system.

Congress has twice taken the unprecedented step of expressly inviting California to join the federal system, upon petition of its dairy farmers and their approval of an FMMO by referendum. Equally unprecedented, Congress further mandated that a value created under state law be recognized in the FMMO.

The response of California's dairy farmers, the leading California Cooperatives who are the proponents of Proposal No. 1, and the major dairy farmer trade

associations in support of Proposal No. 1, has demonstrated unparalleled unanimity. California's dairy farmers, the milk from whose farms is manufactured into products that compete in national markets, want and need the federal minimum prices that reflect national values for these products, a benefit enjoyed by the nation's dairy farmers outside of California.

The discrepancy between minimum producer prices under California's state system, as compared with the national uniform minimum prices established under FMMOs, has placed California's dairy farmers at a competitive disadvantage with their counterparts elsewhere in the nation, has cost them more than $1.5 billion since 2010, and has caused many of them to relocate their dairy operations outside of California or to abandon dairy farming entirely and devote their efforts to more profitable and reliable agricultural and other pursuits.

California's regulatory system has failed to adequately address these deep-rooted issues, despite repeated efforts by California dairy farmer organizations to obtain relief through the state system. Moreover, California regulators have not been able to address issues arising from milk deliveries to California plants from out of state producers.

The record overwhelmingly demonstrates the need for and desirability of a California FMMO. But any California FMMO must assure actual achievement of the real benefits of an FMMO. Because of the unique structure of the California dairy industry and the unique economic conditions prevailing in the state, these benefits can be achieved only through inclusive pooling of all milk for all uses. Without inclusive pooling, the supposed benefits of a California FMMO would be merely ephemeral and

illusory. And, to be acceptable to California's dairy farmers, a California FMMO must comply with the Congressional mandate to recognize the value of quota that has developed over the last 47 years.

The Secretary should reject arguments, unsupported by actual evidence in the record, that adoption of Proposal No. 1 would place California cheese manufacturers at a competitive disadvantage compared to cheese manufacturers elsewhere, and should pay no heed to the theoretical economic arguments, already previously rejected by the USDA, that would reverse longstanding policy establishing national uniform classified prices of milk for all uses, and instead revert to regional pricing on the basis of a theory of "locational value" of milk.

The Secretary should likewise reject specious legal contentions that mandatory pooling is permissible under the AMAA only for milk utilized as Class I, that the fact that the 1996 and 2014 Farm Bills did not expressly amend the AMAA means that recognition of the value of quota would violate that AMAA principle of uniform prices notwithstanding the Congressional mandate, that recognition of quota value is discretionary, not mandatory, and that quota recognition will somehow constitute a trade barrier impermissible under the AMAA.

DIC's Proposal No. 2, with its low prices as shown in Exhibit 162A and its permissive depooling, makes the benefits of a California FMMO truly illusory, continues non-uniform producer pricing in violation of the national principle of uniform pricing, and would destroy the value of quota in a short period of time, rather than recognize its value.

The Cooperatives' Proposal No. 1, on the other hand, will bring California into the uniform national classified pricing system, recognize the reality that the markets for the manufactured products of milk are national, not regional, assure that the benefits of FMMO classified pricing will be real and not illusory, and truly recognize the value of California quota. Proposal No. 1 is the only proposal that achieves these results.

The time has come to seize the day and bring the California dairy industry into the federal system at long last as proposed in Proposal No. 1.

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Proposed California Federal Milk Marketing Order: Sample Pool

Computation of Producer Component Price Adjustment

June 2015 Prices

EXHIBIT A

PROPOSED CALIFORNIA FEDERAL MILK MARKETING ORDER: SAMPLE POOL
COMPUTATION OF PRODUCER COMPONENT PRICE ADJUSTMENT
JUNE 2015 PRICES

		Utilization 1/ Percentage	Product 1/ Pounds	Component Pounds	Rate	Value
Class I	Differential Value (Net of Fortification Allowance) 2/				(memo $1.92) 2/	$8,311,000.00
	Product	13%	455,000,000			
	Skim Milk			446,810,000	$9.3700	$41,866,097.00
	Butterfat			8,190,000	$2.0281	$16,610,139.00
Class II	Product	8%	280,000,000			
	Nonfat Solids			24,640,000	$0.8511	$20,971,104.00
	Butterfat			22,400,000	$2.1081	$47,221,440.00
Class III	Product	44%	1,540,000,000			
	Protein			47,740,000	$2.6915	$128,492,210.00
	Other Solids			87,780,000	$0.2322	$20,382,516.00
	Butterfat			55,440,000	$2.1011	$116,484,984.00
Class IV	Product	35%	1,225,000,000			
	Nonfat Solids			107,800,000	$0.7529	$81,162,620.00
	Butterfat			44,100,000	$2.1011	$92,658,510.00
Total Producer Milk			3,500,000,000			$574,160,620.00
Add:	Overage					40,000.00
Subtract:	Transportation Credit 3/					2,740,000.00
	Quota Premium Value 4/					11,467,182.95
	Out of State Adjustment Value 5/					1,146,600.00
	Producer Milk Protein					292,027,750.00
	Producer Milk Other Solids					46,323,900.00
	Producer Milk Butterfat					273,416,143.00
Total Milk and Value			3,500,000,000			-$52,920,955.95
Add:	One-Half Unobligated Balance Producer Settlement Fund					1,575,000.00
Total Value					(1.46702731)	($51,345,955.95)
Subtract:	Producer Settlement Fund Reserve				0.042972687	1,504,044.05
Producer Component Price Adjustment				Dollars Per 6/ Hundredweight	($1.51)	($52,850,000.00)

1/ Product pounds and utilization percentages are rounded numbers for approximation of California pool. Drawn from CDFA statistical information esp. Exh. 61 and possible new plants and/or milk.

2/ $1.92 Class I differential estimate from Hollon testimony Exh. 64, Table 5B1 and CDFA Fortification allowance estimate from Exh. 61, Table D of $450,000.

3/ Section 1051.55 Value estimated from CDFA Exh. 61 table H transportation allowance less transportation credit.

4/ Section 1051.17(b) Value from CDFA Exh. 61, Table 1 including Regional Quota Adjusters

5/ Section 1051.61(a.2)(i) Represents Quota value divided by lbs. of milk in the pool and 10% of milk from OOS.

6/ Rate/cwt may be needed for pricing unregulated supply plant receipts and partially regulated distributing plants

MINIMUM PRODUCER PRICES **JUNE 2015**

	Components in Producer Milk			
	Butterfat	Protein	Other Solids	Nonfat Solids
Total pounds	130,130,000	108,500,000	199,500,000	308,000,000
Percentage 1/	3.72%	3.10%	5.70%	8.80%

Producer Component Price Adjustment: ($52,850,000.00)

Percent Contribution to Value of Class III Components to Producers 2/					
Protein	45%	Other Solids	15%	Butterfat	40.00%

	Calculation of Producer Component Prices			
	Class III Component Price	(Producer Component Value Adjustment x Contribution %) ÷ (Component lbs.)		Equals: Producer Component Price
Protein 3/	$2.6915	($52,850,000.00) x 0.45 ÷ 108,500,000	-$0.2192	$2.4723
Other Solids 4/	$0.2322	($52,850,000.00) x 0.15 ÷ 199,500,000	-$0.0397	$0.1925
Butterfat 5/	$2.1011	($52,850,000.00) x 0.40 ÷ 308,000,000	-$0.1625	$1.9386

Quota Premium Value 6/	(per cwt.)	$1.7000
Out of State Producer Adj. Rate 7/	(per cwt.)	$0.3276
Producer Protein Price	(per pound)	$2.4723
Producer Other Solids Price	(per pound)	$0.1925
Producer Butterfat Price	(per pound)	$1.9386
Uniform Price / Non-quota Blend 8/	(per cwt.)	$15.28

	Producer Milk			
	Utilization	Product Pounds	Skim Milk	Butterfat
Class I	13.0%	455,000,000	446,810,000	8,190,000
Class II	8.0%	280,000,000	257,600,000	22,400,000
Class III	44.0%	1,540,000,000	1,484,560,000	55,440,000
Class IV	35.0%	1,225,000,000	1,180,900,000	44,100,000
Total	100.0%	3,500,000,000	3,369,870,000	130,130,000

1/ Product pounds and utilization percentages are rounded numbers for approximation of California pool. Drawn from CDFA statistical information esp. Exh. 61 and possible new plants and/or milk.

2/ Section 1051.61(f)(1) Percentages used to allocate Producer Component Price Adjustment to Class component prices to compute Producer component prices. Pecentages are estimates.

3/ Per Section1051.61(f)(3)

4/ Per Section 1051.61(f)(4)

5/ Per Section 1051.61(f)(2)

6/ Per Section 1051.17

7/ Section 1051.61(a.2)(i) Represents Quota value divided by lbs. of milk in the pool.

8/ Section 1051.62(d) Sum of 3.5 lbs Butterfat, 2.9915 lbs (true) Protein, and 5.6935 lbs Other Solids at above producer prices.

Computation of Transportation Payment

EXHIBIT B

Computation of Transportation Payment

				Oct-14 Transportation Zone 1	Oct-14 Transportation Zone 2	Oct-14 Transportation Zone 3
1051.55 (b) (1)	A	Zones		(i)	(ii)	(iii)
	A	(from the CDFA recap sheets)		Average Chino / LA	Average SSj / LA	Average NSj / N Bay
1051.55 (b) (1)	A	Pounds		49,992	50,005	50,069
1051.55 (c) (1) (i)	B	Miles		32	143	90
1051.56 (a) (1)	C	EIA Diesel Price - round 3 places		3.094	3.094	3.094
1051.56 (a) (2)	C	*Diesel base*		*4.110*	*4.110*	*4.110*
1051.56 (a) (2)	C	Subtraction	$3.094 - $4.110	$ (1.016)	$ (1.016)	$ (1.016)
1051.56 (a) (3)	C	Truck MPG base		5.8	5.8	5.8
1051.56 (a) (3)	C	*Divide - round 6 places*	($1.016) / 5.8	*$ (0.175172)*	*$ (0.175172)*	*$ (0.175172)*
1051.56 (a) (4)	C	*Typical Tank CWT*		*51,510*	*51,510*	*51,510*
1051.56 (a) (4) (5)	C	*Divide - round 6 places*	($0.175172)/ (51,500 / 100)	*$ (0.000340)*	*$ (0.000340)*	*$ (0.000340)*
1051.56 (a) (6) (a)	D	Intercept		0.044970		
1051.56 (a) (6) (b)	D	Intercept			0.004850	
1051.56 (a) (6) (c)	D	Intercept				0.054410
1051.56 (a) (6) (a)	D	Mileage Coefficient		0.003180		
	D	Plus Fuel Adjustment	$0.00318 + ($0.000340)	0.002840		
1051.56 (a) (6) (b)	D	Mileage Coefficient			0.005460	
	D	Plus Fuel Adjustment			0.005120	
1051.56 (a) (6) (c)	D	Mileage Coefficient				0.005710
	D	Plus Fuel Adjustment				0.00537
1051.56 (a) (6)	E	Factor per cwt for the miles driven	$0.04497 + ($0.002840 * 32)	$ 0.135850	$ 0.737010	$ 0.537710
1051.5 (c) (ii)	F	Payment to load (rate X cwts hauled)	$0.135850 * 49,992 /100	$ 67.91	$ 368.54	$ 269.23

CERTIFICATE OF SERVICE

I, Marvin Beshore, Esquire, certify that on March 31, 2016, I served true and correct copies of the foregoing, by email to the following:

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