UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

In the Matter of:

MILK IN THE NORTHEAST AND OTHER MARKETING AREAS	))	DOCKET NO.: A0-14-A76, et al.; DA-07-01

BRIEF AND PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

SUBMITTED BY

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January 30, 2006

INTRODUCTION

This proceeding is yet another in a long line of Federal milk order rule-making proceedings seeking to establish higher regulated minimum prices for dairy farmers. Proponents' proposals in this proceeding are fatally flawed for two reasons contradicting long-standing agency policy: (1) the proposals subtly but clearly disassociate Class I and II product prices from surplus milk uses; and (2) the proposals would significantly and without legal justification increase Class I and II prices throughout the Federal order system in the face of clear existing and expected adequate supplies of milk. Thus, the proposals ignore the statutory requirement (that has at least until now routinely been relied upon by the agency) mandating that the Secretary recognize both supply *and* demand factors in setting prices. The proposals should be summarily rejected and this proceeding immediately terminated just as the Secretary summarily rejected and terminated a similar proceeding in 1998.

This Brief is filed on behalf of Dean Foods Company, a national milk processing company operating multiple fluid milk plants fully or partially regulated by each of the Federal milk marketing orders. As to Class II pricing issues, this Brief is also filed on behalf of the New York State Dairy Foods Association, Inc., a trade association of dairy processing and manufacturing companies doing business in New York.

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Dean Foods Company and New York State Dairy Foods Association, Inc. (as to Class II issues) hereby submit the following proposed Findings of Fact and Conclusions of Law and requests a specific holding on each proposed Finding and Conclusion pursuant to 5 U.S.C. §557(c) (2007).

HISTORICAL PERSPECTIVE

An overview of Federal milk order pricing decisions and case law reveals a rich and consistent tapestry of decisions supporting the positions taken in this Brief. The Secretary's consistent and repeated positions regarding his application of the Agricultural Marketing Agreement Act (7 U.S.C. § 608c – the "AMAA") should be again followed here. In fact deviation from those past decisions would require that the Secretary thoroughly explain and justify under heightened scrutiny his change in policy under the doctrine found in *Motor Veh. Mnfrs. Ass'n of the United States v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29 (1983).

Section 608c(18) Minimum Price Factors

In particular the Secretary has expressly disclosed, discussed, dissected, and determined that the parity prices required for milk are not reasonable in view of the remaining factors discussed in 7 U.S.C. § 608c(18).[1] The remaining AMAA statutory price factors are written with the conjunction "and" revealing that both supply and demand factors are critical. Indeed the Secretary has long concluded that if supply and demand are in balance, no price increase is justified. 63 Fed. Reg. 32147, 32150 (June 12, 1998) ("The petition for flooring the BFP is denied because there is no evidence of a national milk shortage, either for all uses or for fluid uses").

One of those factors contained in subparagraph 18 of 7 U.S.C. § 608c is the cost of feeds. However, as a starting point, the Secretary has for nearly 50 years said that the costs of feeds and other costs of production were or are accounted for first in the Grade B Minnesota-Wisconsin

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[1] The Secretary's most recent finding consistent with his long-standing policy was made as recently as November 17, 2006 in the "Make Allowance" hearing Tentative Final Decision. 71 Fed. Reg. 67467, 67488 (November 22, 2006).

("M-W") price series, thereafter the BFP price series, and thereafter the Class III/IV formulas as proxies for the previous competitive price series. *See, e.g.*, 60 Fed. Reg. 7290, 7298 (February 7, 1995) ("A host of economic conditions affect both supply and demand. The interaction of supply and demand results in a 'market' price. Thus, the M-W price, as a competitive pay price, reflects all of the economic conditions that affect both supply and demand and is automatically responsive to any changes that affect economic conditions"). That statement was made in support of the Secretary's Final Decision to replace the then M-W price series with what became known as the Basic Formula Price ("BFP"). Interestingly, the hearing notice for the M-W price series replacement hearing contained an express statement that "any change in price levels must be justified under the supply and demand standards [of the AMAA]." 60 Fed. Reg. at 7297. And relevant (if not dispositive) to this proceeding the Secretary concluded that "[t]he hearing record reveals that current price levels are achieving a reasonable balance between supply and demand for milk. Present price levels are ensuring consumers of an adequate supply of milk while maintaining sufficient reserve supplies." *Id.*

As part of the Federal Order Reform process dictated by the 1996 Farm Bill, the Secretary determined that the BFP was no longer adequate (because the competitive price series was too thin and limited to one product and one region to be a useful statistical measure) and replaced it with the price-level comparable product-price formulas in use today. 64 Fed. Reg. 16026, 16101 (April 2, 1999) ("The Class III and Class IV prices clearly reflect the value of the milk used in the respective manufactured products, whereas the current basic formula price reflects primarily the value of the milk used to manufacture cheese in a particular region of the U.S. (Minnesota and Wisconsin)"). Again, the Secretary concluded that the price formulas adequately ensured a milk supply for consumers.

The Secretary went to great lengths in that Final Decision to discuss the fact that the price of feeds is indirectly taken into consideration as a result of supply and demand signals in the marketplace. 64 Fed. Reg. at 16095-16096. Only the conclusion of that lengthy discussion is reproduced here:

> The pricing system contained in this decision will function in the same manner as the current pricing system by accounting for changes in feed costs and feed supplies indirectly. The product price formulas adopted in this rule should reflect accurately the market values of the products made from producer milk used in manufacturing. As feed costs increase with a resulting decline in production, commodity prices would increase as a result of manufacturers attempting to secure enough milk to meet their needs. Such increases in commodity prices would mean higher prices for milk. The opposite would be true if feed costs were declining. Additionally, since Federal order prices are minimum prices, handlers may increase their pay prices in response to changing supply/demand conditions even when Federal order prices do not increase.

Thus, the Secretary has concluded that the various prices series he and his predecessors have used to establish minimum price formulas for manufactured milk products "reflect supply and demand for the milk used in all products." *Id.* The Secretary repeated this conclusion in November 2006 when he adopted new changes to the product price formulas in the form of make allowance amendments. 71 Fed. Reg. at 67488.

Further, the Secretary has found that relying on cost of production (in a purported effort to increase minimum prices) or the support price program (in order to decrease minimum prices) is inappropriate because those factors alone do not encompass all economic conditions affecting supply and demand. 60 Fed. Reg. at 7298 ("As a result of not encompassing all economic supply and demand factors, these two types of proposals [cost of production and support price] would establish prices that are not in conformance with the requirements of the Act").

Not surprisingly the Secretary has been challenged in his assessment that the costs of feeds and the supply and demand factors are indirectly considered in the competitive price series and its product-price formula replacement. However, in the only case actually decided on the merits regarding the Secretary's determination that prices of feeds are indirectly considered in setting Class III and IV prices, the Secretary prevailed. *Minnesota Milk Producers Ass'n v. Glickman,* 153 F.3d 632 (8th Cir. 1998) (when milk producers in Upper Midwest challenged Class I price structure as resulting in prices that are too high under AMAA standards, Appeals Court concluded that the validity of the M-W price series was properly before that Court and that that price series properly considered all relevant AMAA factors even though it did so indirectly).

The only other action, prior to 2007, challenging this determination of indirect consideration of the section 608c(18) factors is not credible or binding precedent on the Secretary or any Court. In *St. Albans Cooperative Creamery v. Glickman,* 68 F. Supp. 380 (D.VT. 1999), a Temporary Restraining Order prevented the Secretary from implementing the Final Rule from Federal Order reform. In not following the Eighth Circuit's determination, that Court acknowledged that it had limited submissions (68 F. Supp. at 392), wrongly asserted that the Eighth Circuit's holding was *dicta* ("was not at issue directly" (68 F. Supp. at 389)) and eventually transferred the case to the District of Columbia District Court (where multiple cases were consolidated) which eventually dismissed the entire action without prejudice. *St. Albans Cooperative Creamery v. Glickman,* Docket No. 1:00-cv-00222-EGS (D.D.C. 2000) – Complete docket of D.C. case including transfer from Vermont and dismissal attached as Attachment A to this Brief. A decision regarding a TRO (the denial or grant of which may not be appealed) that becomes part of a dismissed action carries no precedent. *Fund for Animals v. Mainella,* 335 F. Supp.2d 19, 27 (D.D.C. 2004) (opinion denying temporary restraining order has no preclusive

effect on the parties in future litigation and likewise "has no precedential value as to the merits of the matter in dispute").

Moreover, the assertion that the Minnesota Milk Producers' case finding was *dicta* as opposed to the law of the case is just flat wrong because the Eighth Circuit Court directly addressed the issue of whether the M-W lawfulness was properly before it, concluded that it was, and then ruled that the M-W properly took into consideration the AMAA factors through indirect means. *Minnesota Milk Producers, supra,* 153 F.3d at 645 ("The question of the lawfulness of the differential could not be resolved without accounting for the effect of the base price"). Notwithstanding the *St. Albans* Court statements that the Eighth Circuit did not provide a rationale for its decision (68 F. Supp. at 389), the *Minnesota Milk Producers* opinion did precisely that pointing out that the Secretary had a long discussion and relying on the history from 1961 to the present – that the M-W was based on sound economic rationales. *Minnesota Milk Producers, supra,* 153 F.3d at 646.

The Secretary's long-standing position regarding the AMAA factors has thus been endorsed by the only court to reach a decision on the merits. That long-standing position cannot be easily abandoned, nor should it be. Thus, one cannot examine the Class I and Class II pricing structures without addressing first the base prices upon which they are based. *Minnesota Milk Producers, supra,* at 645 ("The question of the lawfulness of the [Class I] differential could not be resolved without accounting for the effect of the base price"). And in examining that portion of the Class I and Class II prices, it becomes obvious that the Secretary has concluded that the AMAA pricing factors (other than adequate supply) are subsumed in the prices for Class III and IV. That has been the policy since 1961. Abandoning it now is not justified.

In the 1990's the Secretary repeatedly declared in Federal order decisions and argued in federal court that the AMAA factors (except for adequate supply discussed below) were properly considered in the base price series. The Secretary cannot now abandon that position without proper explanation and rationale under *Motor Vehicle Mnfrs. Ass'n, supra*. Moreover, having prevailed in the earlier Eighth Circuit action relying on this very argument, the Secretary would be abandoning the very position that prevailed in that case for him when the Eighth Circuit reversed the lower court's judgment enjoining Class I differentials in most Federal milk marketing orders. Thus, reversing his position now could well jeopardize the holding in that case as a change in circumstances not only undermining the *res judicata* and *collateral estoppel* impacts of that case[2], but also potentially dictating the opposite result. Those seeking the relief in these proposals today should be aware that the very foundations of the Class I pricing structure may be at risk should they continue down this path.

Class I Prices Must Be Linked To Surplus Milk Values

The next logical step in the process is to recognize that the proposals in this hearing would raise Class I and II differentials through a back-door approach that is designed and results in a de-linked Class I and II pricing system. The Secretary has repeatedly rejected any such de-linked prices and should do so again here.

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[2] Both *res judicata* and *collateral estoppel* principles (legal rules designed to put completed litigation to rest) depend on upon a central theme – that the issues and facts litigated remain the same. *Corestates Bank, N.A. v. Huls Am., Inc.*, 176 F.3d 187, 194 (3d Cir. 1999) (as to *res judicata*) and *Nat'l R.R. Passenger Corp. v. Pennsylvania Pub. Util. Comm'n*, 342 F.2d 242, 252 (3d Cir. 2003); *Burlington N. R.R. Co. v. Hyundai Merch. Marine Co., Ltd.*, 63 F.3d 1227, 1231-32 (3d Cir. 1995) (as to *collateral estoppel*). Should the Secretary alter his consistent position regarding the application of the supply and demand factors, that fact (and change in legal rule) could very well undermine the precedential effect and finality of any earlier decision relying upon the Secretary's conclusions.

While the Federal order reform process was ongoing, the Secretary held a formal rule-making hearing in 1998 with a very similar proposal to the hearing in this proceeding. In that case, the dairy farmer proponents requested that the base price for Class I and Class II milk be "floored" at $13.50 resulting in a predicted average increase of Class I and II prices of $1.05. Whenever the base price (mostly a cheese price in 1998) was below $13.50, the Class I and II prices would nonetheless be based upon the $13.50 floor price. Proponents' argument that their proposal today is not strictly a de-linking rings hollow. If the 1998 proposal had been adopted, manufactured minimum prices and fluid milk minimum prices would have been de-linked when the base price was below $13.50, but the prices would remain linked when the base price rose above $13.50.

Similarly if the proponents' proposals are adopted today, the linkage between Class I and II and Class III and IV will be modified and under certain circumstances just as with the 1998 price floor proposal will be de-linked. Since the proposal doesn't look to increase Class I and Class II prices directly by modifying the specific sections of 7 U.S.C. § 1000.52 or 7 U.S.C. § 1000.50(e) or (g), the proposals instead lock-in a portion of the base price based upon a significant portion of the then existing 2006 Class III and IV price formulas. This results today in a back-door Class I and II price increase, but in the future if Class III or IV make allowances are changed will also result in a relative price increase (if make allowances are increased) or a relative price decrease (if make allowances are decreased). Thus, future changes in the Class III and IV formulas will lead to additional and unrelated de-linkage. This divorces the Class I and II prices from the base price.

But the Secretary rejected the 1998 price floor using language that is absolutely and perfectly applicable to this proceeding:

> We are denying a proposal to establish a price floor under the Basic Formula Price (BFP) used to calculate Federal milk marketing order prices for Class I and Class II milk, and we are terminating the rulemaking proceeding The record does not justify establishing a price floor, given the current and projected supply and demand for milk. The price floor would have unequal effects in different regions of the country, even for farms of similar size, because of different Class I milk utilization rates. As a result, those who would benefit the most from a price floor would not necessarily be the farms that have the greatest financial need for such assistance.

63 Fed. Reg. 32147 (June 12, 1998). The rationale for linked pricing is clear – "[t]he raw material used in both Class I products and manufactured dairy products is the same and therefore the separate uses must compete for the given supply of milk." 64 Fed. Reg. at16102. De-linking the prices ignores this material fact of real life market competition.[3]

Just as today, in 1998 there was adequate milk production and supply that did not justify a price increase above that produced through the blend prices. USDA baseline projections for milk production and consumption were in balance. 63 Fed. Reg. at 32150. And they are again today if one examines the Hearing Notice baseline projections. Ex. 1. The Secretary concluded on November 16 in the Class III/IV make allowance proceeding that parity prices would not be reasonable and that milk supply and demand was and would be sufficient to meet consumer needs (71 Fed. Reg. at 67488) and simultaneously issued a Hearing Notice (Ex. 1) discussing the potential for Class I and II price increases using the very same statutory factors. However, the

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[3] Further in the Federal order reform Final Decision the Secretary determined that "the price link between Class I and Grade A milk used to manufacture Class III and IV products should be maintained since Grade A milk can be used for fluid use as well as for manufacturing uses." 64 Fed. Reg. at 16103. This statement is critical because the cost of maintaining Grade A status is just as necessary for Grade A milk used in manufacturing as for fluid milk and thus the costs of Grade A status ought properly to be part of the market price calculation that balances supply and demand – e.g. the Class III and IV prices. Thus, any purported increase in Grade A qualification costs (which opponents contest in any event) is not relevant to a proposal to increase Class I differentials whether through the front or back door.

Hearing Notice Baseline reveals that even without a price increase the Secretary expects to purchase 290 million pounds of surplus milk products from 2007 through 2015.

The proponents are trapped by this analysis – that there is an adequate supply of milk – so they in turn merely argue that an element of costs (transportation, Grade A) have increased. However, the Secretary has repeatedly said that costs of production are merely one side of the supply and demand equation and cannot be viewed in isolation. *See, e.g.* 60 Fed. Reg. at 7298 ("While the cost of milk production is an economic factor that affects supply, it is not a price indicator that reflects all economic supply and demand factors").

Indeed no one at this hearing argued or could argue in light of actual milk supplies and consumption that milk supply is inadequate. This is important because during Federal order reform the Secretary also said that after adopting the base line prices, the AMAA factor that remains for adopting and adjusting Class I differentials is "an adequate supply of wholesome milk." 64 Fed. Reg. at 16095.

An underlying problem with the proposals is that it permanently undercuts the supply and demand factors used by the Secretary for 46 years. Congress clearly intended for the Secretary not to blindly follow parity prices if they would not be reasonable in light of supply and demand factors. However, divorcing Class I and II prices from future changes in make allowances will suffer the same economic infirmity as if the Secretary followed parity prices – the result could well (and indeed will immediately) be unreasonable. Note again that the Secretary's own model establishes that there is now and will be adequate supplies of milk to meet consumer needs using either the Secretary's baseline or any of the proposed changes to measure supply and demand. Ex. 1. Thus, an unjustified price increase will, like parity prices, not be reasonable in light of all supply and demand conditions.

The next issue concerns the unequal impacts of the proposals on different dairy farmers. So too in 1998 and now the proposals would have unequal effects on farm-level prices:

> The proposed floor under Class I and II prices would have unequal effects on farm-level milk prices unrelated to the financial need of the farmers affected. The benefit of the proposed floor to a producer would depend on the proportion of Class I and II milk used in the order in which the producer's milk is pooled. Thus, a producer whose milk is pooled under a marketing order with a relatively high 80 percent Class I and Class II use would get 80 percent of the projected $1.05 difference between the proposed floored price and the projected BFP for the last half of 1998 and early 1999, or $0.84 per cwt. On the other hand, producers in marketing order areas with a relatively low 20 percent Class I and Class II use would receive the benefit of only $0.21 of the $1.05 increase in class prices. Producers in high Class I use areas already receive higher blend prices for their milk than producers in areas with lower levels of Class I use, and the effects of the price floor proposal would widen the differences between such areas.

Id. Today there can be no doubt that there will be unequal effects on farm-level prices. If one simply substitutes the expected $0.77 cent increase for the then $1.05 increase, the same logical conclusion is reached. The Baseline Model contained in Exhibit 1 again supports this conclusion. The Class I price increase results in cash receipts increases, but only for Class I products; all other classes suffer price declines as a result of the Class I increase (consistent with the Secretary's previous findings on this kind of issues). Since each Federal order has a different Class I utilization, dairy farmers in low Class I utilization market are going to see substantially less of any price increase (indeed using the chart of utilization reproduced below and applying the Baseline model leaves dairy farmers in Order 30 market with virtually none of the anticipated revenue over the nine year average (approximately $440,000).[4] The Final Decision terminating the 1998 decision precludes adoption of these proposals on policy grounds – de-linking Class I

[4] Ironically the model further reveals that a Class II price increase per the proposals will result in overall price decreases on all milk for all farmers. This analysis alone should defeat the Class II proposal.

and II from the base prices is inappropriate. If a Class I or Class II price increase is merited (and it is not), it must be done by modifying the correct sections of the Federal orders. But Section 1000.52 is not open in this proceeding. So a front door approach would be outside the scope of the hearing notice.

Further, during Federal order reform, the Secretary considered multiple options for setting Class I differentials. He rejected during the Proposed Rule all but two options and in the Final Rule noted that the other options were rejected for the reasons stated in the Proposed Rule. 64 Fed. Reg. at 16110. This makes the Proposed Rule from 1998 relevant concerning the rejected options. One of those options – known as Option 5, would have floored the Class I price at 1996 levels – the base price being the average Class I price in 1996 adjusted upward or downward in the future for an index of cost of feeds and fluid milk use rates. Option 5 from 1998, like today's Proposal 5 would take a baseline price (base price formula from 2006) and use it to adjust Class I prices. But the Secretary rejected that proposal even though it met a number of USDA's criteria because:

> [T]he higher Class I prices will stimulate milk production, which will then lead to lower manufacturing prices. Because it is the blend price that is paid to producers, the increase in the Class I prices will not be enough to offset the decrease in prices of the other classes of use and the changes in utilization which will affect the differential level. . . . Next, Option 5 may cause disorderly marketing with the introduction of inter-market disparities based upon temporary changes in use. Producers in high Class I markets would benefit at the expense of producers in low Class I markets. In addition, flooring the Class I prices will shift volatility to milk prices in manufacturing markets.

63 Fed. Reg. 4802, 1904 (January 30, 1998). Even accounting for technical differences in the proposals (and Federal order reform Proposal 5 was sponsored by a significant element of

today's proponents), the results would be the same. The Secretary's conclusion should likewise be the same. Today's proposals should be rejected.

There Must Be a Coordinated Set Of Class I Differentials

The Secretary declared that the Class I differentials adopted in Final Rule met the AMAA statutory requirements. In setting that price level (later modified by Congress with no legislative history), the Secretary concluded that one criterion for setting Class I prices was to: "Facilitate orderly marketing with coordinated system of prices." 64 Fed. Reg. 16109:

> A system of Class I prices needs to be coordinated on a national level. Appropriate levels of prices will provide alignment both within and among marketing areas. This coordination is necessary for the efficient and orderly marketing of milk.

There is nothing remotely coordinated about an approach to Class I differentials that fixes the base price formula in a point in time (formulas from 2006 set for Class I and II into the future) and causes an immediate across the board increase in Class I and II prices that automatically results in different blend price changes throughout the Federal order system. This is not coordination based upon an analysis of the impacts on each order and all the orders' producers. This is simply a price increase that is not actually coordinated and thought through.

This non-coordination of pricing issue and problem was the essence of Mr. Kinser's testimony on behalf of Dean Foods regarding the relationship between Class I and blend price levels and pooling issues. Tr. 953-954 and 1048-1060. The law of unintended consequences caught up with industry when the Secretary (with an assist from Congress) completed Federal order reform. Consolidation of Federal orders and changes in relative price relationships and changes in pooling standards resulted in new opportunities for industry participants to utilize Federal orders not for the purpose of orderly marketing, but in order to gain financial advantages

through pooling whether or not milk was actually delivered or needed in given markets. The Secretary held a number of hearings to address pooling issues because of these unintended problems. Mr. Kinser's testimony cautions the Secretary that we are doomed to repeat past failures if the proposals are adopted without economic justification and without consideration of the critical factor of national coordination of pricing. Tr. 961-1008.

Dean appreciates the opportunity to interact with the Secretary's staff through the formal hearing process through witness testimony. A series of questions asked on behalf of the Secretary inquired about the relationship of these proposals and pooling issues. Dean here seeks to amplify its answers to those important questions – no additional facts are provided, merely elaboration of the relationship between pooling and Class prices.

Maintaining orderly marketing conditions depends partly on efficiently moving milk to where it is needed. The decision to move milk from one plant to another and from a non-pool source to a pool source is a function of the raw milk's distance to the market, the value at the point of delivery and the amount of milk required to be able to pool on a given order. As to an existing dairy farm and fluid milk plant location, nothing can be done to alter distances, so it is of no real concern to this issue. However, the milk's value at the point of delivery and amount required to pool are both connected because there is a cost of moving the milk that must be balanced against the increased value of pooling it. The proposals being considered at this hearing would increase the value of Class I and II milk without any consideration of the amount of milk required to qualify for drawing the blend price; this alters the financial equation for deciding whether to pool. This is a problem, because each order has a different utilization. Since these proposals only moves two of the classes and moves them at different rates the impact will be different upon each order.

	Class I	Class II	Class III	Class IV
Proposal Impact	$ 0.77	$ 0.219	$ -	$ -

Federal Order	#5	#7	#30	#32	#33
Class I Utilization	66.26%	59.27%	16.86%	31.40%	38.42%
Class II Utilization	16.24%	11.55%	5.51%	12.84%	16.99%
Class III Utilization	5.36%	20.60%	74.92%	44.51%	37.44%
Class IV Utilization	12.14%	8.58%	2.71%	11.25%	7.15%
Blend impact	$0.55	$0.48	$0.14	$0.27	$0.33

Source for order utilizations - *See* 2006 Federal Order Statistical Overview published by the Central Order Market Administrator at http://www.fmmacentral.com, official notice requested.

Now when one considers the milk value at point of delivery, the value depends on which order the milk will be pooled. Handlers have a choice on where they move some milk to qualify the producer; the balance remains in the closest plant, often that is a non-pool plant or a manufacturing plant that is pooled. Tr. 971-972. Economic logic tells us that changing the spread between the orders will cause handlers to change where they pool producers' milk – seeking the highest value. This will cause dilution of that pool over time and lead to another round of pooling provision hearings. The List of nine post-Federal order reform "Pooling Decisions" (not including hearings in Arizona-Las Vegas (a.k.a. "producer-handler" hearing) and the Southeast-Appalachian Proposed Merger) is attached to this Brief as Attachment B.

A simple example would be a dairy farm located in northeastern Indiana (physically in Order 33), but with choices to market milk on all five of the orders listed in the chart above. This farmer's milk thus could go to any of the above listed orders. However, suppose the closest plant is a non-pool plant. Thus, in absence of deliveries to one of the above listed orders the milk would remain out of the pool. The closest distributing plant, to qualify would result in the producer's milk being pooled on Federal Order 33. Now with this change, the producer's milk value would increase 33 cents. However if the producer could haul the milk a little farther, the

milk would deliver to a #5 distributing plant and the milk could be pooled on that Order. Now, with the change being considered at this hearing a few extra miles in hauling could net the producer an improved blend of 22 cents. If this simple example would apply to a large supply of milk (quite reasonable especially when you think about Indiana), the blend price on Federal order #5 will get diluted as all the milk left (diverted) to the non-pool plant will increase the Class III or Class IV utilization on Federal Order #5. This will result in a lower blend price for all dairy farmers pooled on Order 33.

Left unchecked, increasing the Class I price will alter the relationship among the different Federal orders. This will result in handlers making different pooling decisions. This subtle shift overtime can, as has been demonstrated in past hearing records, result in a dilution of Federal order pools causing local dairy farmers to receive lower prices than before the diversions started.

This then is why it is terribly important for the Secretary to carefully compose a coordinated set of national Class I prices based upon all economic factors including Class I utilization, relative blend prices and pooling provisions. This also answers the question posed to Mr. Kinser as to why the decision of who (generally, not specifically by individual dairy farmer) gets to share in the pool is so important to the Secretary and to handlers as well as dairy farmers. Indeed this discussion supports the Secretary's previous findings and conclusions NOT to alter these price surfaces simply because dairy farmers want (or as argued "need") additional revenue because these changes are not justified in light of existing supply and demand conditions and existing relationships among Federal orders.

Indeed, should the Secretary decide that contrary to the opposition a Class I and/or Class II price increase is justified, then he is required to consider and completely address these arguments and all economic factors under the AMAA per his past decisions. Otherwise, the

Secretary will not properly apply the AMAA factors. We conclude that if he does make the proper analysis, no change will result. On the other hand, if the Secretary chooses to take no action, he has a less substantial burden and his decision is entitled to greater deference as described in *Minnesota Milk Producers Ass'n, supra,* 153 F.3d at 642:

> Finally, case law suggests that agency inaction is presumptively unreviewable. 'An agency's decision not to take enforcement action should be presumed immune from judicial review. . . ." *Heckler v. Cheney,* 470 U.S. 821, 832 84 L. Ed. 2d 714, 105 S. Ct. 1649 (1985). 'The general exception to reviewability provided by [5 U.S.C.] § 701(a)(2) for action 'committed to agency discretion' remains a narrow one, but within that exception are included agency refusals to institute investigative or enforcement proceedings, unless Congress has indicated otherwise.' *Id.* at 838. Though the untaken action in this case is amendment, and not enforcement, the principle remains that a decision to do nothing is entitled to more deference than a decision to act.

(footnote omitted).

Congress' 1999 Action On Federal Order Reform Did Not Alter AMAA Factors

Furthermore, when Congress in 1999, after much litigation (only one of the myriad of lawsuits filed ever resulted in negative, temporary injunction against Federal order reform) imposed Option 1A, but did not say why it so acted and did not provide a rationale underlying its action – indeed Congress did not actually amend the enabling statute (AMAA) itself unlike what it did in 1985 and unlike its most recent actions in enacting the Milk Regulatory Equity Act of 2005 Food Security Act of 1985 § 131(a), 7 U.S.C. § 608c((5)(A) and the Milk Regulatory Equity Act of 2005, 7 U.S.C. § 608c(5)(M) and (N) – Congress did not modify the statutory pricing factors or the Secretary's interpretation of their application. Congress obviously knows how to statutorily and through the AMAA change the Class I differentials. Instead Congress' actions in 1999 largely maintained the status quo – Congress certainly did not mandate increased

Class I differentials. Maintaining the status quo as it did in 1999 can hardly be said to create a new "rule of law" demanding price increases in the future based upon some unknown and undisclosed criteria.

However, Congress has had ample opportunity in multiple Farm Bills since 1961 to tell the Secretary that his and his predecessors' interpretation of the AMAA was incorrect; it has not done so and the Secretary can and should conclude that that Congressional inaction can be construed as its acquiescence to the Secretary's 46 year interpretation. Case law establishes that consistent judicial decisions not altered by Congress are entitled to greater deference. So too after 46 years (and the Eighth Circuit's Opinion in *Minnesota Milk Producers*) should the Secretary's handling of the AMAA factors be entitled to deference. Congress was fully aware of the Secretary's interpretations, and by reference to long-established rules of statutory construction is deemed to have approved them by its decision not to alter the legal status of base pricing when it adopted the various Farm Bills since 1961. *Gore, Inc. v. Glickman,* 137 F.3d 863 at 870 (5th Cir. 1998) ("Congress's 'failure to disturb a consistent judicial interpretation of a statute may provide some indication that Congress at least acquiesces in, and apparently affirms, that [interpretation].'" (quoting *Monessen Southwestern Railway Co. v. Morgan*, 486 U.S. 330, 338 (1988))).

Moreover, the 1999 Congressional action did not change the Secretary's conclusions that the adopted Class I differentials (lower than Option 1A) established a national Class I pricing structure, resulting in prices high enough to generate sufficient revenue for producers so that an adequate supply of milk can be maintained while continuing to provide equity to handlers. Section 608c(18) was left intact (except for natural expiration of temporary language regarding current and future anticipated needs) and so, too, was the Secretary's consistent agency

interpretation of that section. According to *Chevron v. Natural Resources Defense Council*, 467 U.S.837, 843-44 (1984), which stands for the proposition that an administrative agency's construction of a statutory provision it is entrusted to administer shall be given substantial deference, the Secretary's own consistent interpretation should be given due consideration.[5]

Consistent with this analysis the Secretary and his Staff have not taken, post-1999, the position that the 1999 Congressional action meant that the Option 1A economic rationale trumped in any way the AMAA factors. For instance, both Exhibits 46 and 47 are 2003 letters deciding not to hold a hearing to increase Class I and Class II prices for reasons entirely consistent with the 1998 price floor decision (unjustified Class II price increase would lead to product substitution and increase in Class I and II prices would result in unequal benefits to dairy farmers both within and without the federal order program). These letters, although not in the form of formal rulemaking, certainly support the conclusion that the AMAA supply and demand factors remain paramount after 1999. Further, the Secretary recently concluded that there was an adequate supply of milk for fluid handlers operating in St. Louis and regulated under the Central Federal order market. This led to the rejection of transportation credits for moving milk in that market. 71 Fed. Reg. 9031, 9045 (February 22, 2006) ("This evidence provides a basis to conclude that the order provisions attract sufficient milk for fluid use. In this regard the need for additional government intervention beyond what the order currently provides in meeting the market's fluid demands is not warranted"). These official letters and rulemaking decision further contradict the National Milk Producers position that the Class I differential base of $1.60 should

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[5] Dean recognizes, as it has argued in Federal court, that there are limits on the Secretary's interpretation. The Supreme Court in *Chevron*, and in a number of cases since, has also made clear that courts remain the arbiters of what a statute means. As such traditional rules of statutory construction should be applied to ascertain Congress' intent before giving deference to an agency's interpretation of the statute. In this particular instance, the Secretary's interpretation is both long-standing and supported by the courts as arbiter.

be increased simply because costs have increased (even assuming that they have increased or that they are relevant). Much of any alleged cost increase would have been incurred by the time of the Central order proceeding and yet the Secretary concluded that further government intervention was not warranted. The same conclusion must be reached today.

THERE IS NO JUSTIFICATION TO INCREASE CLASS II PRICES OR ALTER RELATIONSHIP WITH CLASS IV

The problems with the proposals to change Class II suffer from all of the frailties as to Class I, but are even worse. Class II products are sold on a national (if not international) basis. Tr. 954. As such, a price increase for Federal order Class II operations in the face of unregulated or state regulated manufacturers is simply unjustified. Tr. 952-955.[6] This problem is especially acute if one considers the implications of the Secretary's own economic model – that a Class II price increase will result in overall lower cash receipts by all Federal order dairy farmers. Thus, a price increase adversely affects Federal order Class II operations and simultaneously results in an overall price reduction for dairy farmers. Adoption of such a proposal in light of existing adequate milk supplies would be the height of arbitrary and capricious action.

National Milk Producers purported to rearrange the pricing formula using "simplified methodology." Tr. 43-47. But the underlying theory divorces the Class II price from the Class IV price, which is the proper comparison. The result of the price simplification more than

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[6] The implication that a small family business could not be adversely affected by an additional loss of $328 per load of cream was both unnecessarily sarcastic and lacking in economic justification. Tr. 960. If a Class II manufacturer is consistently out of line on costs, the differential is less important than the fact that the added cost relative to competitors is permanent. The northeast has lost substantial manufacturing capacity and cannot afford further losses of $328 per load, ten loads per month or $39,360 per year. Tr. 953. The choice is simple – alter your use of fresh milk (Tr. 954) or move your operation to a non-federal order area. Tr. 954-955.

doubles the effective Class II differential, certainly not justified by any costing data and fails to account for this permanent difference as one that can and likely will result in replacement of fresh dairy products. Tr. 976-980. Moreover, National Milk's allegation that product replacement does not occur in California is undercut by Mr. Kinser's testimony and exhibits that establish that any differences in California's system are temporary and transitory whereas adoption of the Federal order proposal will result in a flat line cost difference that can and will lead to replacement opportunities supplanting Class II fresh milk in Federal orders in order to compete with non-Federal order Class II operations. *Id.*

The Class II price increase intended by the proposals is simply not well considered. Federal order plants will alter milk usage in order to compete and in any event dairy farmers will receive less, not more money over the nine-year average of the Secretary's model. The proposal can and should be summarily rejected.

THERE IS NO EMERGENCY

The Secretary found on November 16, 2006 that adjusted prices after adopting amendments for Class III and IV reflect supply and demand factors and will "ensure a sufficient quantity of pure and wholesome milk, and be in the public interest." 71 Fed. Reg. at 67488. Simultaneously he issued this Hearing Notice. The two documents cannot be read in isolation. Both the Secretary's Class III and IV Final Decision and the economic model presented in the Hearing Notice for this proceeding establish beyond peradventure that the AMAA statutory requirements are already met. Beyond that, the proposals would simply unjustifiably enhance milk prices on both Class I and Class II, de-link Class I and II pricing from manufactured classes in contravention of long-standing agency policy, lower returns to dairy farmers as a result of

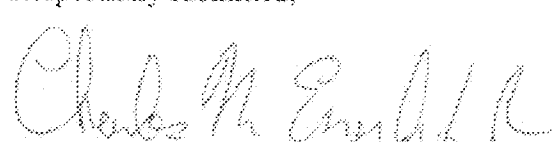
Class II price enhancements, harm Class II processors, and alter – without analysis – the existing coordinated blend prices among Federal orders.

There simply is no "emergency" regarding orderly marketing conditions. A contrary conclusion would contradict all that has gone before and substantially and significantly alter all past and future agency rule-making involving milk orders. Emergency consideration should be denied. And while the proposals ought to be denied also, should the Secretary conceivably wish to move down the path taken by the proposals, issuance of a Recommended Decision would be absolutely necessary since the Secretary would be modifying or abandoning decades of his own established policy.

CONCLUSION

As opposed to emergency consideration, the Secretary should follow past precedent, issue an immediate Final Decision turning down the proposals and terminate this proceeding. This is what the Secretary correctly did in 1998. He should do so again today.

Respectfully submitted,



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