BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE AGRICULTURAL MARKETING SERVICE

In the Matter of Milk in California; Notice of Hearing on a Proposal to Establish a Federal Milk Marketing Order	7 C.F.R. Part 1051 Docket No.: AO-15-0071; AMS-DA-14-0095

Fresno, California, November 2015

Testimony of Gino Tosi

In Support of Proposal 4 of Ponderosa Dairy,

Ponderosa Dairy

Proposal to Establish a Federal Milk Marketing Order for the

State of California

My name is Gino Tosi. I previously testified in support of Proposal 3 on behalf of the California Producer-Handler Association. I am now appearing on behalf of Ponderosa Dairy ("Ponderosa") in support of its proposal, published in the Hearing Notice as Proposal 4.

The intent of Proposal 4 is to provide for, in the event that this proceeding results in the issuance of a Federal milk marketing order ("FMMO"), continuing the exclusion of out-of-state milk from the pooling and pricing provisions of the FMMO as it is currently excluded from pooling and pricing under the California State order. Specifically, this would be accomplished through a provision that is part of all FMMOs specifying payments to be made by handlers operating a partially regulated distributing plant.

The Cooperative proposal does not provide for such exclusion. I understand the Dairy Institute of California ("DI") proposes two pools in its proposal – one delegated to the State of California for quota and one for "traditional" FMMO pooling that results in a Federal order blend price.

The need for the Ponderosa proposal arises from the inability of milk produced outside the State of California and delivered to plants in California from receiving the full benefits of being pooled. Such out-of-state milk would receive differential treatment and bear pricing burdens that, in my opinion, constitute a trade barrier to the out-of-state producer. The current California State order, which once pooled and priced out-of-state milk, no longer does so because the U.S. Supreme Court found this to be in violation of the commerce clause of the U.S. Constitution. and on remand to the District Court

Background

I make reference to my earlier testimony in which I described my background. I ask that testimony be noticed here for the purposes of my testimony on behalf of Ponderosa's proposal.

Proposal 4 Specifics

Proposal 4 would add a new paragraph (e) to Section 1051.76 as described in either Proposal 1 of the Cooperatives or Proposal 2 of the DI. The order language would be as follows:

> ***Section 1051.76 Payments by a handler operating partially regulated distributing plant.***
>
> *(e) Any handler may elect partially regulated distributing plant status for any plant located within the California marketing area with respect to receipts of milk from farms located outside of the California marketing area. Such plant shall with respect to such receipts make an election provided for in Section 1051.76 and shall meet the reporting and payment requirements of paragraph (a) or paragraph (b) of this section with respect to such receipts.*

While the above is the proposed order language for a FMMO for the State of California, there may be concern about how the proposed California FMMO order might view receipts of out-of-state milk at California plants. Specifically, the concern is whether such milk receipts may be treated as "other source milk" as currently defined in Part 1000.14 of all current FMMOs. If that milk is downgraded to a lower classified valued use because it is treated as other source milk, then the objective of the Ponderosa proposal is defeated as the milk being shipped is for Class I use.

The Ponderosa proposal is structured after and incorporates paragraphs (a) and (b) of Part 1000.76, which is applicable to all FMMOs. Part 1000.76 never makes reference to other source milk. However, other source milk is referenced in Section 1051.60, but only to conditions specified in 1000.76(a)(4) as it relates to only plants that would utilize the option in 1000.76(d), which has never been used by any entity utilizing the partially regulated distributing plant provision.

The regulatory options provided in Part 1000.76 have worked well, and to my knowledge milk receipts by a partially regulated distributing plant have not been downgraded as other source milk. If you examine Section xxxx.30(b) of current

FMMOs, all provide that handlers operating a partially regulated distributing plant with respect to such milk receipts would be producer milk as if the plant had been fully regulated and is reported in lieu of producer milk.

This is rather technical and tedious. In the event that out-of-state milk may be treated as other source milk, then the regulatory language is proposed to read as follows:

> **Section 1051.76 Payments by a handler operating partially regulated distributing plant.**
>
> (e) Any handler may elect partially regulated distributing plant status for any plant located with[in] the California marketing area with respect to receipts of milk from farms located outside of the California marketing area. Such plant shall with respect to such receipts make an election provided for in Section 1051.76 and shall meet the reporting and payment requirements of paragraph (a) or paragraph (b) of this section with respect to such receipts. *The reporting and classification requirement in calculating the value of milk pursuant to Section 1051.60 pertaining to producer milk shall apply to the volume of milk subject to an election hereunder, and such milk shall not be treated as other source milk.*

(The testimony in italics and underlined is the additional language that may need to be added to the Ponderosa proposal and should settle any issues with the regulatory treatment of out-of-state milk as other source milk.)

Throughout my career at Dairy Programs I was relied upon to have a working knowledge of various court cases and the legal requirements for imbedding into milk marketing order provisions.

My previous participation with the Justice Department in a commerce clause violation before the U.S. Supreme Court and other lawsuits also gave me insight into the applicability of certain conclusions and requirements that are applied in promulgating or amending a FMMO. During my work in Dairy Programs, orders promulgated or amended by formal rulemaking needed to be consistent with, for example, Sections 608(c)(5) and 608(c)(18) of the Agricultural Marketing

Agreement Act ("AMAA"). I have in past decisions drawn direct reference to Section 608(c)(5), and every decision issued by the Department made specific findings related to Section 608(c)(18). The *Hillside Dairy v. Kawamura* case was a very recent and important case that went before the U.S. Supreme Court in 2004. It was not a case directly concerning FMMOs but I find it to be instructive for this proceeding in identifying the shortcomings of the Cooperative and DI proposals regarding out-of-state milk, giving rise to the need for Proposal 4.

The combination of the Supreme Court ruling and the District Court ruling on remand found that California's 1997 decision to pool and price milk received from out-of-state discriminated against such milk and was an impermissible trade barrier. Exhibit 173 reflects these decisions and the further discussion from the courts' ruling.

I am of the opinion that if the Cooperative's proposal for a California FMMO is promulgated without providing for the exclusion of out-of-state milk from pooling and pricing provisions, it would result in out-of-state milk's differential treatment and present an unfair trade barrier that burdens out-of-state milk producers. This would place an unwarranted burden on out-of-state producers and would needlessly force out-of-state milk producers, such as Ponderosa, to again seek redress on an issue that has already been decided by the nation's highest court. I do recognize why the Cooperatives take their position – they see themselves as the entities that balance the Class I needs of the marketing area/market, and, if that milk is not pooled, it will avoid or not share in the costs associated with balancing. This point may be valid if there were no quota pricing system that confers benefits only to milk that is produced within the boundaries of California, and if out-of-state producers could participate in transportation allowances that are funded from pool revenues.

Out-of-state milk can never opt into the State quota. Specifically, in-state producers can purchase/own quota and enjoy the pricing benefits conferred under the order. I contrast this to FMMOs that provided a degree of seasonal price differences for milk that did not meet certain criteria for a higher price. Base-excess plans are a good example. The last Federal order to provide for a

base-excess plan was the pre-reform Carolinas order. (No current Federal marketing order provides for such a plan, and the authority provided in the AMAA expired a while ago.)

Unlike California's quota system, in which out-of-state milk is denied the benefits of the State order program, milk that was priced at a lower "excess" price could graduate to receiving the higher "base" price when new base forming times were provided. Such milk had nothing to do with where or in what state the milk was produced. I do note that in the late 1960s, the State of Oregon temporarily administered a base-excess plan in conjunction with the Federal order until the termination of the order. I am of the opinion that this is not the same as the State of California continuing to administer its quota system, which is essentially a feature under the Cooperative proposal that makes it impossible for out-of-state milk to own quota. This is also true under the DI proposal depending on whether current quota holders would opt out of the quota system of milk valuation (an unlikely event given that the value of quota has been capitalized into the valuations of quota holder assets). The purpose of base-excess plans was to "even out" milk production during the year rather than face the large milk price swings that usually occur in the spring months, when milk production is usually higher and prices are lower, compared to the fall months, when production is usually lower and prices are higher.

As discussed in Dr. Scheik's testimony, the DI proposal shows a much higher sensitivity to the pricing requirements of the AMAA when compared to the Cooperative's proposal. Ponderosa chooses to avoid the complexities and arguments of whether or not the concept of two separate pools – a "traditional" Federal order pool and a California State order pool – that would exist to recognize/redistribute revenue and recognize quota value is the magic bullet that settles such a complex issue. The entire issue of quota is something that the State of California and its dairy farmers have been debating for a long time. It is not clear that offering a choice to "opt out" of quota/nonquota pricing will ensure the AMAA requirement of uniform pricing (Section 608(c)(5)(B)) simply because producers can choose the basis on which they are paid, versus being paid based on whether the order requires or that it similarly avoids the creation of a trade

barrier (Section 608(c)(5)(G)). It is an innovative idea for bringing an end to quota by looking at them as a sort of annuity payment that pays out the estimated $1.2 billion of quota value over time. However, the quota issue remains far from being settled.

As presented, the Cooperative proposal provides also for transportation credits or allowances on milk and is restricted only to milk produced within California. DI recently amended its proposal to allow out-of-state producers to qualify for transportation allowances, which we support in furtherance of equal treatment for producers. If transportation benefits were deprived to out-of-state producers, it would be another example of how pooling out-of-state milk may be viewed as, and found to be, discriminatory. Out-of-state milk paying into the pool provides the revenue that funds transportation credits and allowances – a benefit that is not available to out-of-state milk.

As I said earlier, my work experience in Dairy Programs required an understanding of Section 608(c)(5) of the AMAA. This has often been referred to as the pricing standard of the AMAA. It provides mandatory requirements that essentially prohibit using pricing methods as a way to erect trade barriers. In this regard, Congressional intent in the 2014 Farm Bill was to establish a separate FMMO for California and give California the right to reblend and distribute milk pooled under it so as to recognize quota value. Nowhere in the legislation does Congress suspend any of the requirements of what a milk marketing order must contain and adhere to with respect to the treatment of out-of-state milk and trade barriers – especially Section 608(c)(5). I have read many briefs of many lawsuits that discuss whether the intent of Congress is clear or silent in legislation. As I read and understand the Farm Bill, Congress has not suspended any requirement of the AMAA in promulgating a separate FMMO for California with respect to the treatment of out-of-state milk and trade barriers. It is my opinion, and seems to be DI's opinion, that Congress would have at least mentioned what part of the AMAA is being suspended or modified in promulgating a California FMMO if it had wanted to change the Supreme Court's ruling or the treatment of out-of-state milk. Why is this important here? Not excluding out-of-state milk from a FMMO

for California can be reasonably concluded to have used Section 608(c)(5) to erect a trade barrier, and we know what the Supreme Court has ruled about that.

As the Department is being asked to facilitate the operation of California law, it cannot realistically address discrimination on out-of-state milk by somehow allocating quota to out-of-state milk to "level the playing field." California law does not allow out-of-state producers to own quota or participate in transportation benefits. Accordingly, it is reasonable to conclude that the Department has limited options to avoid a trade barrier outcome in promulgating a California FMMO. These include denying a FMMO; "federalizing" quota that is not requested by any hearing participant; or eliminating from a FMMO the pooling of out-of-state milk. Ponderosa proposes elimination from FMMO pooling out-of-state milk. It is simple, clean, and consistent with California's current exclusion of out-of-state milk from being pooled under the State order.

It is important to note that the Ponderosa proposal is superior to how California excludes out-of-state milk from the pool. Because Federal orders have pricing authority across State lines, and Ponderosa's proposal would have California handlers buying out-of-state milk to satisfy one of the two pricing options (commonly referred to as the "Wichita option"), the unknown minimum price for milk excluded from the pool would be known under a Federal order. The Wichita option that California handlers receiving out-of-state milk would most likely utilize is the pricing option provided in paragraph (b) – that the receiving plant demonstrate that the price it pays for out-of-state milk is at least equal to what it would have paid if it had been fully regulated. (This price is currently "assumed" as being paid; otherwise it is unlikely such milk would have been delivered to the plant. Nevertheless, it would now be factually known.)

This concludes my testimony on behalf of Ponderosa Dairy in support of Proposal 4.