

**Testimony of Steven Rowe**  
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USDA Federal Milk Order Hearing Cincinnati, Ohio  
Beginning May 4, 2009  
Docket AMS-DA-09-0007

## I. Introduction

My name is Steven Rowe, and I am appearing at this hearing on behalf of Northwest Dairy Association (“NDA”), and its operating company, Darigold, Inc.

NDA is a cooperative association, of approximately 530 dairy producers located in Washington, Oregon, Idaho, Utah and Northern California. NDA acts as a handler in the Pacific Northwest Federal (“PNW”) order 124. A portion of our producers are located in the unregulated areas of Idaho and Utah.

Darigold Inc. which is wholly owned by NDA owns and operates eleven processing facilities. Four bottling plants and three manufacturing plants are located in the PNW FO 124. The bottling plants are located in Seattle and Spokane Washington, Portland and Medford Oregon. The manufacturing plants are located in Lynden, Chehalis and Sunnyside Washington. Darigold also operates a bottling plant in Boise Idaho and manufacturing plants in Caldwell and Jerome Idaho.

I have been Darigold’s General Counsel since 2005 and also NDA’s Senior Vice President since 2007. I received my Bachelor of Science Degree in Natural Resources from the University of Michigan and my Juris Doctorate from the University of Utah.

During the 2003-2006 producer handler hearings for the PNW and Arizona, NDA and Darigold were major proponents and appreciate very much the Secretary’s decision to address this issue nationally at that time.

## II. Evolution of PNW Cooperative Approaches to the Producer Handler Issue.

I am a relative newcomer to the industry, but I understand there is quite a history in the Pacific Northwest involving the Producer Handler (PH) exemption. I have discussed this history with Doug Marshall, who preceded me on our staff, and with Dan McBride who is one of the key members of my staff today and who has more than 30 years’ involvement with Federal Orders. Both Doug and Dan helped me prepare this testimony for this hearing.

During the early years of milk market regulation in our PNW region, and especially the 1960s, the cooperatives tried several times to get the Department to end

or limit the Producer Handler exemption. There were several contentious hearings, but the co-ops were unable to persuade the Department to significantly tighten the rules governing PH operations, even though as a group they were taking about 10% of the Class I sales in the market.

During the 1960s, 70s and 80s, the Dairy Division's basic position was that the PHs were "small businesses" which they were not inclined to regulate without good reason. I'm told that during those years, most PH operations were still focused on home delivery or farm-owned retail stores, and the Department felt they were typically too small to disrupt the business of regulated handlers who increasingly were focused on wholesale rather than home delivery business.

Many PH operations grew in size during the 1980s and 1990s, and that led up to our request in 2003 for a new hearing to address this issue in the Pacific Northwest as well as in Arizona. The 2006 result of that proceeding was to add an additional qualification for PH operations to be exempt from regulation, and that is today's 3,000,000 lb/month limitation.

By the time the last hearing process was requested during 2003, the typical size of PH operations had grown. Even though the aggregate Class I share of the PH operations hadn't increased much from what it had been during the 1960s (roughly 10% of the total), the market had many more people and there were fewer PH operations. They had become quite large, relative to the situation in the 1960s. Moreover they were aggressively competing for wholesale business, using their exemption from regulation to their full advantage and to what we saw as an unfair disadvantage of regulated plants. All this was demonstrated in detail at the 2003-04 hearings, and I ask that in this proceeding we take official notice of the recommended final decision of that proceeding, which accepted our argument that this was evidence of disorderly marketing.

Another thing that had changed by 2003, from the earlier PH rulemaking decades earlier, was development of more formal Federal policies to protect "small" businesses, including the 1980 passage of the Regulatory Flexibility Act. As applied by the Secretary to Milk Order proceedings, the term "small business" includes a producer who markets less than 500,000 lbs/month, and a plant which has less than 500 employees. During the 2003-06 proceedings, NDA argued that the 3,000,000 lb figure was so large, relative to this "small business" criterion, that our proposal would not impact "small" businesses.

Because we are now asking in effect to lower the 3,000,000 figure, to a figure just under the 500,000 lb/month threshold used for "small" businesses, I want to review how that 3,000,000 figure came to be proposed originally, rather than something smaller. I understand that there were several considerations:

1. I am told that the 3,000,000 lbs figure was picked in part because it already had been used as a "small plant" threshold for exemption from participation in

the fluid milk promotion assessment (7 USC 6402), known as MilkPep. That was a precedent that was helpful, but MilkPep had no relationship to the statutory mandates which govern Milk Orders.

2. Another factor which led to proposing a 3,000,000 lb threshold, rather than some other size, was that it takes more than 1,000 cows to produce that much milk. As is still the case today, a 1,000 cow farm was considered a “large” dairy, and not a small business. Again, I see that as a “political” argument intended to address in advance any possible criticism from “small business” advocates.
3. Another factor was that there were several regulated plants in the Pacific Northwest Order which were then smaller than 3,000,000 lbs, and we felt it made no sense to regulate them but not the PH operations given the statutory emphasis on competitive equity among handlers (I refer to the requirement for uniform pricing, which I will discuss further at a later point in my testimony). By the way, we estimate that one of those fully regulated plants is still today well under 3,000,000 lbs per month – Eberhard Dairy, in Bend, Oregon.
4. NDA also liked the 3,000,000 lb figure because it regulated three larger PH operations, but it would not impact several others who were still operating in a more traditional manner. One might say that the intended effect was to “grandfather” Lochmead and Country Morning Farm – as long as they remained under 3,000,000 lbs. Today we can accept Proposal No. 26 because there seems to be little market disruption in the way those PH operations market their products. We support “grandfathering” those operations only as long as they remain under 3,000,000 lbs.
5. Another factor in NDA’s thinking was our judgment that a plant of 3,000,000 lbs or more typically had economies of scale that allowed it to compete effectively without being exempt from regulation.

During the PH hearings in our region decades ago, the PH operators had emphasized that, due to their smaller size, they did not enjoy the operating efficiencies of the larger pool plants. It was argued that these inefficiencies offset some of the cost advantage which accrued from their exempt status, and therefore there was not as much damage to the concept of uniform pricing as the regulated handlers were arguing.

In reading the Recommended Decision in those proceedings, we noted with interest that the Department did not even mention the concept that the PH milk price advantage was offset by inefficiencies of production at levels below 3,000,000 lbs. Indeed, the Decision hints that a lower threshold would have been more appropriate, indicating that the Department did not find our arguments for 3,000,000 lbs persuasive, and did not adopt them. We conclude that this cost of production concept is no longer part of the rationale for the PH exemption, if it ever was. *We now see it,*

*instead, as solely a basis for establishing an appropriate threshold for a grandfathering concept and nothing more.*

### III. We Support Proposals No. 1, 2, and 26

In this 2009 proceeding, NDA and Darigold now urge the Secretary to phase out using 3,000,000 lbs as the maximum size operation which can be exempt under a PH concept. We feel this phase-out can best be accomplished through a "grandfathering" concept which protects those PH operations which currently are exempt, but establishes new rules for everyone else going forward.

We support Proposal No. 26 only out of some sympathy for operators who may have invested in their current level of production based on the PH exemption as it has existed in the past. I emphasize that this concept of "reliance" up on the past exemption is in our opinion the ONLY real justification for this proposal. As long as they continue to operate under the restrictions that existed when those investments were made, we can accept their continuing to enjoy a preferential exempt status.

That said, however, I would like to point out that such "grandfathering" represents unusually special treatment – by comparison, all of our plant operations are subject to future FO changes which impact their profitability. And let's also think about the perennial make allowance debate – manufacturing plants are subject to reduced profitability or even forced losses if make allowances are not increased to match increases in production costs (even though the plant investments may have been made when economic conditions were more profitable); and similarly, every producer member of our cooperative is subject to reduced profitability whenever the make allowances are increased (even though their farm investments may have been made when economic conditions were more favorable). My point is that "Life isn't always fair", and the Federal Order system simply cannot (and generally does not) protect producers or plants from economic change by "grandfathering" their status.

We urge the Secretary to phase out the general PH exemption, and instead to treat all small processors uniformly through the exempt plant provisions. Our cooperative is a member of both IDFA and NMPPF, and we fully support the joint effort of those two organizations in developing an impressive industry compromise around Proposals No. 1 and 2. We urge the Secretary to adopt those proposals.

As we understood it, small size was the traditional basis for the non-statutory exemption which PH operations have enjoyed, in spite of statutory language in the Agricultural Marketing Agreement Act that seems to apply equally to all handlers. More recent statutes and policies intended to promote small business now must be considered, also, including the Regulatory Flexibility Act which I described earlier.

We urge the Department to make clear in its decision whether small size is the appropriate rationale behind each and every one of the exemptions which may emerge

from this hearing process, whether for exempt plants or grandfathered PH operations. If there are other rationales, they should of course be clearly identified, as well, in the spirit of transparency. We suggest that the “small business” rationale is important to identify for three reasons:

1. If promoting small business is the criterion for FO language, then it should be drafted to ensure that it aids only small businesses. For example, it would not make sense for the Secretary to exempt from milk pricing conglomerates which may own a milk plant, but who might be very large businesses overall. The Secretary’s traditional interpretation of the Regulatory Flexibility Act acknowledges this principle.
2. If “small” is the criterion, then we see no obvious reason to distinguish between small plants which use their own farm production, versus those who do not. It is for that reason that we believe the “exempt plant” provision should be the only basis for exemption going forward, other than the specifically “grandfathered” PH operations.
3. If “small” is the criterion, then there simply is NO basis for the so-called “soft cap” approaches put forth in various proposals. Those proposals seek an advantage for a processor which (by definition) would be larger than the exemption threshold for “small” businesses, by allowing them to be larger than that threshold while still enjoying preferential pricing on milk from their own farm in quantities up to that threshold. Whatever rationales will be offered in support of those “soft cap” proposals, promoting small business can not be an acceptable rationale because there is no size limitation in the proposals.

Accordingly, the size limitations of 450,000 lbs per month and 3,000,000 lbs per month which we advocate should represent the entire volume of milk processed by the operation (that is, a measure of its overall processing size) if it is to be exempt under Proposals No. 2 and No. 26, which we support, or under any other concept which the Secretary may conclude should be implemented.

I would like to emphasize something here: we have seen disorderly marketing from PH operations prior to the 2006 Final Rule, and we can envision disorderly markets occurring in the future even from a PH operation which remains under 3,000,000 lbs/month in size. While we do not currently observe disorderly market conditions resulting from activities of the four PH operations in the PNW Market which remain under 3,000,000 lbs/month, in the event we should see disorder develop in the future we would then ask the Secretary to reconsider that threshold.

#### IV – We Oppose Individual Handler Pools and “Soft caps”

I would like to formally state our cooperative’s opposition to the proposals involving Handler Pools and so-called “soft caps”. The latter would provide more advantages

to being a producer handler, even beyond the limitations established in the 2003-2006 proceedings. There is no justification for doing so.

The concept of a handler pool is not new to Federal Orders, but as I understand it the Dairy Division's thinking evolved away from that direction many decades ago. In our view, a handler pool would do great damage to the concept of market wide pooling that is key to producer support for the milk order program.

We respectfully urge the Secretary to reject these two concepts. Neither should be adopted, in any form.

#### V – Closing Points

I would like to finish my testimony by putting into evidence a few points about the importance of this issue, and the approaches we urge the Secretary to take.

As a fluid milk processor, Darigold has been able to observe first hand the changes in our region's market for Class I products, since the 2006 implementation of the 3,000,000 lb threshold for regulating PH operations. We no longer see the sort of disorderly markets and "unfair competition" that we complained about at the hearings that led up to that change. The three PH operations impacted by the change all have continued in operation and each seems to be doing well even in today's challenging economic climate. One has sold its farm and cows. The producers in the market now receive a slightly higher blend price. Clearly, market conditions are more positive, and it is important that the Department continue improving the Federal Order system to ensure that new PH operations do not disrupt milk markets in the future.

Darigold believes the PNW is a very, very competitive market with very sophisticated buyers of both raw and packaged milk. Those buyers have watched the PH situation carefully, and shared their strong concerns. When we initiated the last rulemaking in 2003, we had been told things that led us to fear that some might solicit PH operations, if only to protect themselves from similar actions by their competitors. We think it is very likely that had action not been taken in 2006 to limit the PH exemption, we would have seen greater PH volumes today and many reactions to that which would be "disorderly" in nature. More importantly, we sincerely believe that had the situation worsened, support for the Federal Order system would have been seriously eroded.

We suggest that Proposals No. 1 and 2, and the concept of treating PH operations under the Exempt Plant provisions, are totally consistent with the AMAA provisions which provides that minimum pricing in Federal Orders "shall be uniform as to all handlers", subject only to potential adjustments for factors such as volume (quoting from Section 8c(5)(A) of the Act). Let's focus on the threshold size for regulating plants, without drawing a distinction among handlers based solely on whether they produce their own milk.

While we can accept Proposal No. 26, we note that it is not consistent with the uniformity of pricing that we advocate. We support “grandfathering” the 3,000,000 lb or less threshold for its current beneficiaries, only as a politically acceptable way to phase out that threshold and move to the 450,000 lb threshold for exempting bottling plants from regulation. To me, that is the only way to be fair to the currently regulated plants which process less than 3,000,000 lbs/month.

I thank everybody for listening to this testimony. I am prepared to answer questions.

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