



**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 CFR Part 1051
Docket No.: AO-15-0071;
AMS-DA-14-0095**

Clovis, California, September 22, 2015

**Testimony of Elvin Hollon
(Fourth statement)**

**In Support of Proposal 1 of California Dairies, Inc.,
Dairy Farmers of America, Inc., and Land O'Lakes, Inc.**

**Proposal to Establish a Federal Milk Marketing Order for the
State of California**

Cooperatives' Exhibit 8

COOPERATIVES' PROPOSAL 1 REGARDING PRODUCER-HANDLERS

The Cooperatives propose that producer-handlers ("PH") be regulated in the same manner in the proposed California Federal Milk Marketing Order (FMMO) as they are in other orders. E.g., 7 C.F.R. Section 1030.10 (Producer-handler definition in Order 30). As we understand their operations, all of the members of the California Producer-Handlers Association would become fully regulated handlers under our proposal. We consider the question of the treatment of exempt quota to be a separate issue and will discuss it separately.

My testimony opens with significant points from the Final Decision from the 2009 eleven-order PH hearing which set the stage for our proposal for regulating large PHs. Next is a summary of those points and a measure of the impact of not regulating large PHs. Finally, we present the language of our proposal regarding PHs.

A. The 2009 national hearing on producer-handlers

The 2009 eleven-Federal-order decision on producer-handlers established:

1. The Secretary has clear authority to fully regulate producer-handlers operating within FMMOs.

Prior rulemakings consistently articulated USDA's authority to subject producer-handlers to full regulation. For example, in a Final Decision for the Puget Sound order, a predecessor to the Pacific Northwest order, USDA found that producer-handlers should continue to be exempt from pooling and pricing provisions of the order with the caveat that producer-handlers could be subject to further regulation if justified by prevailing market conditions. This position was amplified in a subsequent Puget Sound Final Decision wherein USDA found that a hearing should be held to consider the regulation of producer-handlers if the marketing area was susceptible to being affected by producer-handlers or if producer-handler sales could disrupt or operate to the detriment of other producers in the market. Such policy was also articulated in another decision concerning producer-handlers in Texas and the Southwest Plains. That decision concluded that it would be appropriate to obligate producer-handlers to the pooling and

pricing provisions of the order if it could be shown that producer-handlers cause market disruption. **75 Fed. Reg. 10122, 10147 (2010) (footnotes omitted)**

2. The Secretary should apply his conclusions regarding producer-handlers to all FMMOs including this proposed California FMMO. The 2010 Decision noted specifically that establishing reasonable limits on the sales of fluid milk products from producer-handlers meets the policy objectives of the Agriculture Marketing Agreement Act (AMAA).

The record supports concluding that a direct relationship exists between producer-handler size and the potential for disorder. More specifically, the record supports the conclusion that adoption of a limit on producer-handlers' total monthly Class I route disposition and sales of packaged fluid milk products to other plants across all orders is necessary to maintain orderly marketing conditions. **75 Fed. Reg. at 10151 (2010)**

Establishing a reasonable limit on total Class I route disposition and sales of packaged fluid milk products in all producer-handler definitions for all Federal milk marketing orders unifies the policy objectives of the AMAA to establish and maintain orderly marketing conditions. **75 Fed. Reg. at 10150 (2010)**

The AMAA provides for "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." (7 U.S.C. § 608c(5) (B)(ii)). The historical exemption for producer-handlers was a matter of administrative convenience, and not a statutory entitlement in the federal system. As such, a clear limitation on the size of producer-handlers is consistent with and furthers the express language and purposes of the AMAA.

3. The definition of a producer handler:

Producer-handlers are dairy farms that process their own milk production. These entities must operate one or more dairy farms as a pre-condition to operating processing plants as producer-handlers. **75 Fed. Reg. at 10122 (2010)**

Producer-handlers are persons who operate dairy farms and generally process and sell only their own milk production. A precondition to operating a processing plant as a producer-handler is the operation of a dairy farm. **75 Fed. Reg. at 10147 (2010)**

Nevertheless, the common criterion of all producer-handler definitions for all orders is the requirement that the entire operation be under the sole risk and enterprise of the producer-handler. **75 Fed. Reg. at 10146 (2010)**

4. The establishment of uniform prices to producers is a fundamental objective of FMMOs.

The AMAA requires the setting of uniform prices to producers regardless of how the milk of any single dairy farmer is used and uniform prices to similarly situated handlers (section 608c(5)). Handlers who are similarly situated pay at least the class prices established under the orders for milk. Producers are paid at least the minimum uniform (blend) price that is determined through marketwide pooling. A marketwide pool, through the mechanism of a producer-settlement fund, equalizes the classified use-values of milk pooled on an order among handlers and determines a uniform price paid to producers. Marketwide pooling allows for equitable sharing of the cost of supplying and balancing the Class I market. These two key features of milk orders – classified pricing and marketwide pooling – provide the basic foundation for orderly marketing and address the AMAA’s primary objective of ensuring orderly marketing. **75 Fed. Reg. at 10145-46 (2010)**

Over the years, USDA has repeatedly concluded that marketwide pooling promotes orderly marketing conditions more completely and is one of the most important marketing order tools used to ensure uniformity in prices to producers. **(footnote omitted)**
75 Fed. Reg. at 10148 (2010)

5. The operations of producer-handlers can disrupt the establishment of uniform prices.

Of greater significance, the record of this proceeding indicates that all producer-handlers enjoy a competitive pricing advantage over fully regulated handlers because of their exemption from pooling and pricing provisions. This is not surprising as the exemption of any handler from the regulatory plan results in non-uniform prices to handlers and lower prices than would otherwise be uniform to producers. It is clear from this proceeding that as the Class I

marketings of a producer-handler increase, the order's ability to set prices that are uniform to handlers and producers is eroded.

Depending on the volume of Class I disposition and sales of packaged fluid milk products to other plants, the exemption from obligation to account for milk at minimum classified prices, and the exemption from payment into the producer-settlement fund of the difference between a producer-handler's use-value of milk and the blend price become critical factors that give rise to disorderly marketing conditions. Large producer-handlers become increasingly able to market fluid milk at prices below those that can be offered by fully regulated handlers because the classified prices set by the order are not uniform. The exemption from payment to the producer-settlement fund renders the order unable to set uniform prices to producers.

...

This final decision emphasizes that when any handler is exempted from pooling and pricing, regulated handlers and producers whose milk is pooled on an order are affected by that exemption. Regulated handlers are affected because they are obligated to make pool payments while producer-handlers are not obligated. Producers also are affected because handler exemption results in fewer dollars available in the pool, thus making the uniform price to producers lower. Market Administrator data in the record demonstrate this outcome. That data reveals that exclusion of producer-handler revenue affects the total pool value in any Federal order marketing area where producer-handlers are present. Total pool values are hundreds of thousands of dollars less every month than they would be which directly translates into lower uniform prices paid to producers. In markets where producer handlers are not present, no impact on total pool value occurs. **75 Fed. Reg. at 10146 (2010)**

6. The measure of the producer-handler advantage is calculated to be the difference between the Class I price and the blend price. The ability of the producer-handler to retain this value is detrimental to the objective of all producers receiving the minimum price from the Order.

As a result of their exemption from pooling and pricing, producer-handlers, as handlers, are not required to pay the minimum class prices established under the orders nor are they, as producers, granted minimum price protection for disposal of surplus milk. Producer-handlers, in their capacity as handlers, are not obligated

to equalize their use-value of milk through payment of the difference between their use-value of milk and the respective order's blend price into the producer-settlement fund. As such, producer-handlers retain the full value of milk processed and disposed of as fluid milk products by their operation within the marketing areas. **75 Fed. Reg. at 10124 (2010)**

While opponents to the elimination of the producer-handler definitions argue otherwise, this decision agrees with proponent arguments, presented by witnesses testifying in support of NMPF and IDFA positions, that the difference between the Class I price and the blend price is a reasonable estimate of the price advantage enjoyed by producer-handlers even if it is not possible to determine the precise level of the advantage for any individual producer-handler. This price advantage is compounded as a producer-handler's Class I utilization increases. In addition, allowing producer-handlers to have unlimited Class I sales will result in a measureable impact on the blend price received by pooled producers. **75 Fed. Reg. at 10147 (2010)**

7. The Decision concluded that the size of a producer-handler should be a controlling factor in determining the regulatory status of a producer-handler plant.

The size of individual producer-handlers will impact orderly marketing conditions in any of the Federal order marketing areas if left without limit. Size of operation will have a direct bearing on competitive equity between producer-handlers and fully regulated handlers. Producer-handler size, as discussed above, will increasingly affect an order's ability to set uniform prices to similarly situated handlers and to producers. Producer-handler size will increasingly magnify disorderly marketing conditions and practices where the burden of balancing and surplus disposal is effectively transferred to the regulated market. These examples of the presence and anticipation of disorderly marketing conditions can be largely mitigated by establishing a reasonable limit on a producer-handlers' Class I route disposition and sales of packaged fluid milk products to other plants.

Establishing a reasonable limit on total Class I route disposition and sales of packaged fluid milk products in all producer-handler definitions for all Federal milk marketing orders unifies the policy objectives of the AMAA to establish and maintain orderly marketing conditions. **75 Fed. Reg. at 10150 (2010)**

8. The Decision concluded that total route disposition and sales of packaged fluid milk products to other plants of more than 3 million pounds during a month would cause a producer-handler to be fully regulated and account to the pool for their uses of milk at the applicable minimum class prices and pay the difference between their use-value of milk and the blend price of the order to that order's producer-settlement fund.

If current producer-handlers have total route disposition and sales of packaged fluid milk products to other plants of more than 3 million pounds during a month, such producer-handlers will be regulated under the pooling and pricing provisions of the orders like other fully regulated handlers. Such large producer-handlers will account to the pool for their uses of milk at the applicable minimum class prices and pay the difference between their use-value of milk and the blend price of the order to that order's producer-settlement fund. **75 Fed. Reg. at 10122 (2010)**

9. The Decision noted that the change in regulatory status would have economic costs and benefits to the producer-handler and benefits to producers in the form of increased blend prices.

While this may cause an economic impact on those entities with more than three million pounds of total monthly sales that are currently considered producer-handlers under the Federal order system, the impact is offset by the benefit to other small businesses. With respect to dairy farms whose milk is pooled on Federal marketing orders, such dairy farms who have not heretofore shared in the additional revenue that accrues from the marketwide pooling of Class I sales by producer-handlers will share in such revenue. All producer-handlers who dispose of more than 3 million pounds of fluid milk, including sales of packaged fluid milk products to other plants per month will account to all market participants at the announced Federal order Class I price for such use.

To the extent that some large producer-handlers become subject to the pooling and pricing provisions of Federal milk marketing orders, such will be determined in their capacity as handlers. Such entities will no longer have restrictions applicable to their business operations that were conditions for producer-handler status and exemption from the pooling and pricing provisions of the orders.

In general, this includes being able to buy or acquire any quantity of milk from dairy farmers or other handlers instead of being limited by the current constraints of the orders. Additionally, the burden of balancing their milk production is relieved. Milk production in excess of what is needed to satisfy their Class I route disposition and sales of packaged fluid milk products to other plants may receive the minimum price protection established under the terms of the Federal milk marketing orders. The burden of balancing milk supplies will be borne by all producers who are pooled and handlers who are regulated under the terms of the orders. **75 Fed. Reg. at 10122-23 (2010)**

The foregoing clearly establishes that the Secretary of Agriculture has the authority to define and regulate producer-handlers who operate in any capacity. The Secretary should exercise that authority in promulgating a California FMMO and implement regulations similar to those in other orders controlling the actions of large producer-handlers.

The establishment of uniform prices for both producers and handlers is a prime objective of FMMOs and the operation of large producer-handlers disrupts this objective. The measure of the disruption can be calculated as the difference between the Orders' announced Class I price and blend price. Any difference between the two prices is evidence of disruption. The size of a producer handler should be the controlling factor for establishing regulation. For the purpose of establishing which producer-handlers should be fully regulated, the "bright line" of regulation has been determined to be producer-handler plants with 3,000,000 pounds of total route disposition and packaged sales of fluid milk products to other plants during the month. Those above that line become fully regulated and those below will not be fully regulated. The decision noted that there would be costs to the large producer-handler but that those costs would be offset by benefits to the producer-handler and benefits to the remaining pooled producers.

B. Financial Impact of Producer-Handlers

Table 8.1, Estimated Producer Handler Advantage 2000 – December 2014, demonstrates the impact to the pool based on the definition from the Producer–Handler hearing decision referenced above.

Financial Impact = Class I price minus Blend Price.

Since we do not have producer-handler sales volume data other than the pounds of exempt Class 1 sales reported by CDFA, we have used those volumes which would be reflective of certain market conditions but are primarily for illustrative purposes here. Using those numbers, estimates can be made of the per hundredweight price impact based on announced Class prices and our estimated blend prices.

Multiplying the per hundredweight difference times the volumes used results in an estimated dollar impact. Based on market commentary from customers and our own operations we understand that the California producer-handlers have sales volumes in excess of their known sales (based on exempt volumes), thus these results would represent the lower end of any potential impact from these producer-handlers.

In **Table 8.1 (Column E)** we used the monthly Blend prices from Exhibit 64 Table 5.C which we calculated earlier and reduced the calculation by 43 cents per hundredweight which represents the estimated per hundredweight costs of the net quota premium payments and the cost of the transportation credit payment. **(Column F)** This gives us the two numbers necessary to calculate a per hundredweight impact if producer-handlers with more than 3,000,000 pounds of total route disposition and packaged sales of fluid milk products to other plants during the month were not regulated.

We calculated impacts as if the producer-handlers were located in either the \$2.10 or \$1.60 Class I differential zone. (**Columns G and H**) For example, if all the producer-handler production volume was located in the \$2.10 differential zone the impact in January 2000 would have been estimated to be \$2.28 per hundredweight, and if all producer-handler milk was located in the \$1.60 zone, \$1.78 per hundredweight. The average producer-handler per hundredweight advantage for the entire period of 2000 – December 2014 would be \$2.55 for the \$2.10 zone, and \$2.05 for the \$1.60 zone per hundredweight. For a more recent period August 2012 – December 2014 the averages would be \$2.60 and \$2.10 for the \$2.10 and \$1.60 zones.

Multiplying the per hundredweight values by the published pounds of exempt Class 1 use (**Column I**) yields the dollars listed in Columns J and K. These totals for the period January 2000 – December 2014 average \$539,741.02 per month for the \$2.10 zone and \$433,795.82 for the \$1.60 zone. These translate to an average blend price impact of \$.018 per cwt and \$.014 per cwt for the January 2000 to December 2014 period, for the \$2.10 and \$1.60 zones respectively. For the August 2012 – December 2014 period the impact is \$.016 and \$.013, for the two zones respectively.

Although the data available for analysis is limited, the demonstrated impact meets the standard set out in the 2010 Final Decision:

While opponents to the elimination of the producer-handler definitions argue otherwise, this decision agrees with proponent arguments, presented by witnesses testifying in support of NMPF and IDFA positions, **that the difference between the Class I price and the blend price is a reasonable estimate of the price advantage enjoyed by producer-handlers even if it is not possible to determine the precise level of the advantage for any individual producer-handler. This price advantage is compounded as a producer-handler's Class I utilization increases. In addition, allowing producer-handlers to have unlimited Class I sales will result in a measureable impact on**

the blend price received by pooled producers. (75 Fed. Reg. at 10147 (2010) (emphasis added)

The resulting conclusion is that large size producer-handlers in the proposed California FMMO should be regulated in the same manner as they are in other FMMOs.

Our proposal would not require any producer-handler with less than 3,000,000 pounds of total route disposition and packaged sales of fluid milk products to other plants during the month, to account to the pool for milk use at Class prices, provided they meet with all the Order requirements. A producer-handler with more than 3,000,000 pounds of total route disposition and packaged sales of fluid milk products to other plants during the month would have to meet all the requirements of any regulated handler.

C. The Cooperatives' proposal

The regulatory language for our proposal is as follows:

§ 1051.10 Producer-handler.

Producer-handler means a person who:

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition and packaged sales of fluid milk products to other plants during the month does not exceed 3 million pounds;

(b) Receives fluid milk from own farm production or milk that is fully subject to the pricing and pooling provisions of the order in this part or any other Federal order;

(c) Receives at its plant or acquires for route disposition no more than 150,000 pounds of fluid milk products from handlers fully regulated under any Federal order. This limitation shall not apply if the producer-handlers own farm production is less than 150,000 pounds during the month;

(d) Disposes of no other source milk as Class I milk except by increasing the nonfat milk solids content of the fluid milk products;

(e) Provides proof satisfactory to the market administrator that the care and management of the dairy animals and other resources necessary to produce all Class I milk handled (excluding receipts from handlers fully regulated under any

Federal order) and the processing and packaging operations are the producer-handlers own enterprise and at its own risk; and

(f) Any producer-handler with Class I route dispositions and/or transfers of packaged fluid milk products in the marketing area described in § 1131.2 of this chapter shall be subject to payments into the Order 1131 producer settlement fund on such dispositions pursuant to §1000.76(a) and payments into the Order 1131 administrative fund provided such dispositions are less than three million pounds in the current month and such producer-handler had total Class I route dispositions and/or transfers of packaged fluid milk products from own farm production of three million pounds or more the previous month. If the producer-handler has Class I route dispositions and/or transfers of packaged fluid milk products into the marketing area described in §1131.2 of this chapter of three million pounds or more during the current month, such producer-handler shall be subject to the provisions described in §1131.7 of this chapter or §1000.76(a).

D. Exempt quota

As stated above, the Cooperatives' Proposal 1 will regulate the current California 'producer-handlers', whose operations will not comply with the definition of Producer-handler as we propose it. Such regulation, however, does not expressly address the status of exempt quota owned by these entities. With respect to exempt quota, we note:

1. Under California law, exempt quota can be sold and continue to have all the entitlements of "regular" quota, including the \$1.70 per hundredweight premium.

2. California handlers can own farms and own quota like any other producer; and at least some of the producer-handlers who hold exempt quota also own 'regular' quota which they supply to their own distributing plants.

3. The impact to the pool of exempt quota at a distributing plant is greater than the impact of other quota, but significantly less than the impact of fully unregulated supplies.

4. Transportation credits under Proposal 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 (although exempt quota is not entitled to transportation allowances under current California law).

The cooperatives are still evaluating these factors with respect to treatment of exempt quota, which we recognize reflects an investment by its owners. We will continue to evaluate our position on this issue in light of evidence presented further in this hearing.