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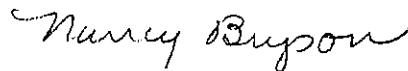
Hearing Clerk, OALJ
U.S. Department of Agriculture
South Building, Room 1031
1400 Independence Ave. SW
Washington, DC 20250-9203

Re: Hearing Docket AO-14-A78 et seq, Producer-Handler hearings.

Dear Sir or Madam:

Enclosed for filing with the Hearing Clerk is an original and three copies of post-hearing brief on behalf of American Independent Dairy Alliance.

Respectfully yours,



Nancy Bryson

cc: The Honorable Jill Clifton and Interested Parties (via email attachment only).

**UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE**

USDA
OFFICE OF THE
SECRETARY
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IN RE MILK IN THE NORTHEAST
AND OTHER MARKETING AREAS

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Docket Nos. AO-14-A78, AO-388-A23,
AO-356-A44, AO-366-A52, AO-361-A44,
AO-313-A53, AO-166-A73, AO-368-A40,
AO-231-A72, AO-271-A44

**BRIEF OF AMERICAN INDEPENDENT DAIRY ALLIANCE
AND PROPOSED FINDINGS AND CONCLUSIONS**

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I. Introduction

The issue presented in this national hearing is whether the Department of Agriculture should eliminate the long standing right of a dairy farmer to own his or her own cows, process the milk from those cows and sell it independent of the regulated pool or whether that right should now be conditioned upon payment of a tax to the regulated pool. Proponents ask the Department to shift this fundamental national policy and impose such a confiscatory milk tax to “close a regulatory loophole” that could possibly create a “disorderly marketing” condition in the future. Proponents allege that producer-handlers have a raw-milk cost advantage over regulated handlers which is allegedly an unfair competitive advantage that could be exploited by large farms. Proponents ask the Department to sacrifice all existing producer-handlers and foreclose future opportunities for large and small producer-handlers alike in the service of their version of what should be national policy.

The actual hearing record in this proceeding, however, does not support the proponent’s fundamental premise – it unequivocally disproves it. The linchpin of the proposal is theoretical - producer-handlers purportedly secure their raw milk at the regulatory blend price and do not have to account to the pool for the difference between the blend price and their Class I milk sales, as regulated handlers do. The evidence unequivocally demonstrates as a matter of economic fact, however, that the producer-handler raw milk cost is the cost of production on the farm. *USDA’s own statistics demonstrate that this cost of production exceeds both the blend and Class I price.* The producer-handler is thus already incurring costs of milk greater than the minimum blend and Class I prices.

Therefore, there is no “unfair cost advantage” to producer-handlers, as alleged by NMPF,

IDFA, and their member witnesses. Nor is there any “regulatory loophole,” nor any “disorderly marketing condition” that would justify such an extraordinary change in national policy. Instead, the imposition of the pool payment scheme sought by proponents would further increase producer-handlers raw milk cost and exacerbate the already unequal prices that producer-handlers and regulated handlers incur for raw milk. Payment systems that create such price inequities and which do not reflect the actual costs of the handlers involved are impermissible under the AMAA. Moreover, a national policy decision of this nature is manifestly at odds with the policy goals of this administration – as frequently expressed by Secretary Vilsack – to provide diverse opportunities in order for dairy farmers to succeed

The bulk of the other proposals that would establish producer-handler limitations or amend the definitions of exempt plants are effectively “piggyback” proposals to the proposals advanced by NMPF/IDFA. These proposals face the same problems with respect to their legality and with respect to the evidence in the record to support any change to the marketing order provisions as do the NMPF/IDFA proposals. In addition, those who testified about their alternative proposals stated that their proposals were offered **only** in response to those introduced by NMPF and IDFA. That is, they are “self-preservation” proposals that would not have been offered at all if USDA had not called for proposals in addition to the NMPF/IDFA proposals.

Moreover, the AMAA does not provide the Secretary with the legal authority to impose the minimum pricing and pooling provisions of the milk marketing orders on producer-handlers who do not purchase milk nor may the Secretary alter the regulatory status of producer-handlers. The AMAA authorizes the establishment of minimum prices and pool obligations on milk purchased from producers. The Department has long maintained this position by exempting producer-handlers from such regulations. Congress has on multiple occasions not only ratified

that interpretation but legislated that the “legal status of producer-handlers” (exemption from pricing and pooling) must remain unchanged. Congress has not amended or repealed these permanent statutes expressly or implicitly, a fact which the Department acknowledged and accepted in order reform. And in the passage of the Milk Regulatory Equity Act of 2005, Congress specifically carved out one marketing area for change while reiterating that the Secretary’s authority as to all other marketing areas remained unaltered.

AIDA, and each of its members individually, oppose all proposals that would impose limitations on producer-handlers.¹ But if the Department chooses to take action in this hearing, then AIDA supports the adoption of its alternative proposals, numbered 23, 24, and 25, as rational alternatives to the wholesale elimination of producer-handler status. The reasons for the positions and proposed findings and conclusions are provided in the following sections of this Brief.

II. AIDA Membership

American Independent Dairy Alliance (“AIDA”) is an association of producer-handlers and one exempt plant that was formed following USDA’s announcement that it was considering the NMPF/IDFA proposals to effectively eliminate producer-handlers and to change the definition of exempt plants for all federal milk marketing orders. The members of AIDA are Kreider Dairy of Pennsylvania, Snowville Creamery of Ohio, Heartland Dairy of Missouri, Braum’s Dairy of Oklahoma, GH Dairy-El Paso of Texas, Longmont Dairy of Colorado, and Aurora Organic Dairy of Colorado. With the exception of Longmont Dairy, whose schedule and

¹ The principal proposals concerning producer-handlers are Proposal 1, which would eliminate all future producer-handlers, and Proposal 26, which would “grandfather” current producer-handlers with less than 3 million pounds of Class I route sales, with additional restrictions. Proposals 3-22, which offer various restrictions on the sizes or activities of producer-handlers are also opposed by AIDA and its members.

distance from the location of the hearing precluded attendance, representatives of each of the AIDA members provided testimony in this proceeding.

The individual members of AIDA are diverse in both their geographic locations and in their businesses. What they share in common is that they operate independently of the traditional cooperative-handler model represented by NMPF/IDFA and their member organizations. As with NMPF and IDFA, AIDA presented economic experts on behalf of the group and individual member witnesses who testified about their own organizations and expressed support for the proposals of the group, but from the perspective of the member.

III. The Proponents of Proposals 1 and 26 Have Not Met Their Burden of Introducing Substantial Evidence to Show that The Producer-Handler Regulations Must Be Amended As A Matter of National Policy.

In this formal rulemaking proceeding under the Administrative Procedure Act (“APA”), NMPF and IDFA as the proponents of Proposals 1 and 26 bear the burden of proof.² This burden encompasses not only the production of evidence upon which a valid order can be based, but also the ultimate “burden of persuasion.”³ In other words, NMPF and IDFA are required to prove – on the formal record of the hearing – the essential facts of their case.⁴

Any such change to the orders must be premised on something more than the

² 5 U.S.C. §556(d) (“Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof.”). Since neither the AMAA nor the applicable rules of practice provide a specific burden of proof in this proceeding, the burden of proof standard is governed by § 556(d) of the APA.

³ Director, Office of Workers' Compensation Programs v. Greenwich Collieries, 512 U.S. 267, 276 (1994); see Kenneth Culp Davis and Richard J. Pierce, Jr., Administrative Law Treatise §10.7 (3d ed. 1994) (concluding that the combination of “burden of proof” and “substantial record evidence” standards in formal “on the record” hearings under the APA imposes a “preponderance of the evidence” standard of proof.).

⁴ See Fairmont Foods Co. v. Hardin, 442 F.2d 762, 767 (D.C. Cir. 1971).

unsubstantiated and self-interested assertions of the proponents.⁵ As the Department declared in rejecting one of the industry's earlier attempts to limit producer-handlers by size:

However, on the basis of the overall history of the treatment of producer-handlers, a size consideration, in and of itself, is not particularly relevant to the issue. Even large operations in relation to the markets they serve have continued to be exempt from full regulation. Consequently, **any decision to fully regulate a producer-handler type operation must be supported by substantial evidence of disorderly marketing that is a direct result of producer-handler activity.**⁶

As the proponents of Proposals 1 and 26, NMPF and IDFA bear the burden to present substantial evidence that the proposed changes in the producer-handler regulations that they advocate are required.⁷ Despite this evidentiary burden, NMPF and IDFA have failed to introduce evidence within their control and, instead, relied upon anecdotes that present an incomplete and misleading picture.⁸

Testimony and evidence that consists of extremely general and speculative opinions without specific examples of the alleged problems based upon actual evidence that such problems occur does not amount to substantial evidence which would support such a change in a marketing order.⁹ Similarly, the testimony of witnesses which consists of, "...hortatory, conclusory and speculative opinions and predictions" is not the type of substantial evidence that

⁵ Lehigh Valley Farmers v. Block, 829 F.2d 409, 414 (3rd Cir. 1987).

⁶ 54 Fed. Reg. 27179, 27182 (June 28, 1989) (emphasis added).

⁷ Minnesota Milk Producers Association vs. Glickman, 153 F. 3d 632, 642 (8th Cir. 1998).

⁸ See Abbotts Dairies Division of Fairmont Foods, Inc. v. Butz, 389 F. Supp. 1, 7-10 (E.D. Pa. 1975) (substantial evidence to support the implementation of any changes to Milk Marketing Orders must be based upon only facts introduced into the record or officially noted and justified by reference to objective evidence).

⁹ See Lehigh Valley Farmers v. Block, 829 F. 2d 409, 414 (3rd Cir. 1987).

would warrant a change in a marketing order.¹⁰ But nonspecific, conclusory, and speculative testimony is all that the proponents have presented. Such “evidence” does not meet their significant burden of proof, nor does it even suggest that disorderly marketing conditions caused by producer-handler activity are occurring in any marketing area.

IV. “Disorderly Marketing” is not about pool payments or competition by producer-handlers. Rather, it encompasses only those situations where the consuming public is denied a sufficient supply of fluid milk at reasonable prices.

The standard for adopting any of the producer-handler status elimination proposals or alternatives at issue in this proceeding is whether a change is required as a matter of national policy in order to correct “disorderly marketing that is a direct result of producer-handler activity.”¹¹ This term is not defined in either the AMAA or USDA’s implementing regulations for the Federal Milk Marketing Order program. NMPF and IDFA appear to assume that the relevant standard is the one relied upon by USDA in 2005 to impose the 3 million pound route disposition cap on producer-handlers in the Arizona-Las Vegas and Northwest orders – impact on blend price and ability to compete with regulated handlers. However, USDA has expressly disavowed those tests – and any others – applied in previous proceedings as the measure of

¹⁰ Borden, Inc., v. Butz, 544 F.2d 312, 319 (7th Cir. 1976).

¹¹ 54 Fed. Reg. 27179, 27182 (June 28, 1989); The proponents stated during their testimony and in statements from counsel that producer-handler status is a matter of “administrative convenience” that the Secretary may terminate without making a finding of disorderly marketing conditions. The decision from the West Texas marketing area, and its statement that disorderly marketing conditions directly attributable to producer-handler activity is a prerequisite to altering the regulations conclusively refutes the Proponents’ absurd notion that producer-handler status may be altered on a whim. Of course, neither the Secretary’s position from the West Texas hearing nor the proponents’ administrative convenience arguments address the Congressional prohibition on alteration of producer-handler status or the limited scope of the AMAA to only regulate purchases of milk.

disorderly marketing in this proceeding.¹² The statutory parameters for the test, however, are specified in the AMAA.

The Congressionally stated purpose of the AMAA is to “establish and maintain such orderly marketing conditions . . . as will provide, in the interests of producers and consumers, an orderly flow of the supply [of a commodity] to market throughout its normal marketing season to avoid unreasonable fluctuation in supplies and prices.”¹³ The AMAA defines the standards that govern the Secretary’s decision in this proceeding. The Secretary is legally bound: (1) to protect the interests of producers and consumers, (2) by ensuring an orderly flow of milk to market, (3) thereby avoiding unreasonable fluctuations in supplies and prices, and (4) ensuring a sufficient supply of milk to meet the public’s needs.

One of AIDA’s expert economists, Dr. Ronald Knutson, provided a cogent definition of disorderly marketing, drawing upon his substantial expertise, the Congressional intent of the AMAA, and key advisory reports to USDA on federal milk marketing orders. His definition is clear—supplying the public with enough quality milk at reasonable prices is the touchstone:

Now turning to what is disorderly marketing: At the time that the AMAA was enacted, the orderly marketing emphasis was, quote, to establish and maintain an orderly flow of products to markets...in the interest of consumers and producers...to avoid unreasonable fluctuations in supplies and prices, unquote.¹⁴

¹² AIDA requested from USDA the standard for measuring disorderly marketing that would be used in examining the proposals presented in this hearing. See Ex. 21, p. 4. That request was rejected by USDA. Instead, USDA informed AIDA that “what you seek cannot be articulated without the benefit of testimony and evidence that this hearing will examine.” The proposals in this hearing place at risk the existence of each member of AIDA, along with dozens of other producer-handlers across the country. Yet, when asked by those very businesses placed at risk, USDA could not describe what evidence it would be looking for or what those at risk dairies should seek to disprove at the hearing.

¹³ 7 U.S.C. § 602(4).

¹⁴ Knutson, Tr. 3039.

He was equally clear in stating that market disorder is not created by virtue of niche marketing, competitive pricing, or limiting a product line to private label milk.¹⁵

Dr. Knutson's definition of disorder relied on the language of the AMAA, the 1962 Federal Order Study Committee ("Nourse Report"), and the 1974 report of the Milk Pricing Advisory Committee. The Nourse Report, a seminal report to the Secretary of Agriculture which Dr. Knutson participated in drafting, describes the economic characteristics of orderly markets in the context of the Secretary's statutory authority and responsibilities under the AMAA. These include equalizing the market power of buyers and sellers, assuring adequate and dependable milk supplies, maintaining economic order in the industry, insuring equitable treatment of all parties, and maximum freedom of trade with proper protection against loss of outlets.¹⁶ These characteristics illustrate the dynamic nature of the general statutory provisions, the need to ground decisions in the economic reality of the marketplace at the time of decision, and the essential requirement for equitable (rather than equal) treatment of regulated parties.¹⁷

The emphasis [of the Nourse Report] is on maintaining a regulatory balance among all parties in the marketplace and treating all parties equitably, and by implication not necessarily equally. Certainly the Nourse Report concept of orderliness would not support regulations that put minority independent producer-handler interests at a competitive disadvantage.

The Milk Pricing Advisory Committee expands on this point by stating that, quote, orderliness implies protecting the rights of producers to choose their market outlet, free of coercion and unreasonable barriers to market entry, unquote. Surely a producer-handler falls within the definition of a producer.

This review of the origins of disorderliness, the definition of orderly marketing as contained in the Agriculture Marketing Agreement Act of 1937, as amended, and of its adaption to the changing structure of the milk industry has particular

¹⁵ Id.

¹⁶ Federal Order Study Committee, pp. I-21-22; Exhibit 89 (testimony of Dr. Ronald Knutson) at ¶ 10.

¹⁷ See Fairmont Foods Co. v. Hardin, 442 F.2d 762, 766 (D.C. Cir. 1971).

relevance to the outcome of this hearing in the following ways: Never once in either the Nourse or the Milk Pricing Advisory Committee Reports was there a mention of producer-handlers as a source of disorderly marketing.

Available Dairy Division data would suggest that when the Nourse Report was written in 1962, there were about 370 producer-handlers, and in 1972 about 360. Today there are 37. In 1962 and in 1972, most of these producer-handlers were niche marketing firms delivering milk to homes and struggling to compete and to survive. Today, most producer-handlers are also niche marketing firms and struggling to compete in a much more complex markets and to survive. Yes, some of today's producer-handlers are larger, but so are both cooperatives and conventional processors.¹⁸

Dr. Knutson's definition is not novel. Instead, it is, as would be expected, rooted in the statutory authority granted to the Secretary by the AMAA, the stated goals of the statute, and authoritative reports to the Secretary on the issue.

In this rule making hearing, there is no evidence of any supply disruptions in any market or that consumers have not had adequate and regular supplies of milk.¹⁹ There is no evidence that the price or supply of milk has fluctuated unreasonably as a direct result of producer-handler activity. To the contrary, the nation has experienced a steady supply and growing surplus of milk.²⁰ The record thus lacks the kind of evidence necessary for USDA to find that orderly marketing conditions do not exist under the criteria established by the AMAA and described in either the Nourse Report or the Milk Pricing Advisory Committee Report.

By any measure, there is enough milk in the United States. The quantity of milk pooled

¹⁸ Knutson, Tr. 3073-75.

¹⁹ In fact, the only evidence in the record of consumers not having access to adequate supplies of milk available was the testimony of Warren Taylor of Snowville Creamery who testified that it was difficult to keep milk on the shelves of certain stores due to the monopolization of the dairy case by dominant regulated handlers and unresponsive retailers. Taylor, Tr. 3576.

²⁰ Knutson, Tr. 3043, Taylor, Tr. 3565 (describing the current federal order Class I utilization at 39% and describing the efforts of Snowville Creamery to increase Class I sales that have declined from levels of greater than 60% due to per capita declines in milk consumption).

on federal milk marketing orders has steadily increased.²¹ As a percentage of the total pooled milk, the quantity of milk utilized for Class I uses has steadily decreased, a dual function of declining consumption of fluid milk and increases in the total milk produced.²²

The proponents called four different paid staff economists to testify in support of their proposals. Neither Dr. Cryan, Dr. Yonkers,²³ nor Dr. Schiek²⁴ provided an objective, factual standard of “disorderly marketing.” Dr. Cryan’s testimony on the subject was particularly vacuous:

Q. First question I have for you. In your experience as a dairy economist, how would you define disorderly marketing?

A. I will -- I will say that I -- I think disorderly marketing is the result of something that disrupts the market in the context of the current system, current Federal Order System.

Q. Okay. So what is disruptive then?

A. Large producer-handlers are disruptive.

Q. Okay. In what manner are large producer-handlers disruptive?

A. There’s been quite a bit of testimony last week.²⁵

Ultimately, Dr. Cryan stated that the alleged market disorder caused by producer-handlers exists

²¹ See Dairy Market Statistics, 2008 Annual Summary, Table 30 “30--Measures of Growth in Federal Milk Order Markets, Selected Years, 1947-2008.”

²² Id.

²³ See Ex. 80, making only the conclusory statement that, “Having some but not all fluid milk plants subject to the Class I minimum price clearly creates disorderly marketing conditions.” Dr. Yonkers’ statement does not take into account, at all, the fact that the cost of producing milk for producer-handlers exceeds the Class I price.

²⁴ See. Ex. 75, discussing competition in the California milk market, including activity by producer-handlers.

because he believes that producer-handlers “pay a price [for milk] that is substantially lower simply by virtue of not contributing to the producer settlement fund, and that creates disorderly marketing because there’s an unjustified competitive disadvantage to people who are participating in the system.”²⁶ But the actual record evidence establishes the opposite. Even in the absence of a payment to the producer settlement fund, the milk costs of a producer-handler plant exceed the minimum Class I prices in most instances.

The fourth proponent economist, Elvin Hollon of Dairy Farmers of America (“DFA”), and a self-described summary witness for the proponents of Proposals 1 and 26, offered the following simplistic and flawed definition of disorderly marketing, which he urged the Secretary to adopt:

- Q. Hang on a second. So it’s a combination of two things, then, it’s that they don’t pay into the pool and that they’re a certain size, correct?
- A. That they don’t pay into the pool and they have a certain competitive factor in the marketplace.²⁷

His definition was, nevertheless, the closest thing to an actual definition that any of the four economists offering testimony in support of Proposals 1 and 26 presented. But putting definitions of disorderly marketing aside, proponent witnesses throughout the course of the hearing admitted that disorderly marketing is not occurring as a result of any producer-handler activity:

- “Muller and Mid-West are not competing with any producer-handlers today.”²⁸

²⁵ Cryan, Tr. 1691.

²⁶ Cryan, Tr. 1692.

²⁷ Hollon, Tr. 3902-03. The fact that the proponents cannot point to current disorder in Order 1 is particularly important, since some witnesses pointed to the volume of producer-handler milk sold in Order 1 as a basis for the Department to conduct this hearing in the first instance.

²⁸ Tonak, Tr. 521.

- “Q: Do you have any producer-handlers you compete with in Order 1? A. It’s not an issue at this time, as I stated before. Q. Right. A. It’s something we’re looking at. Q. And how about Order 5, do you have any producer-handlers you compete with there? A. No, none at this time.”²⁹
- “Q: Currently, there is no issue with regard to competition between St. Albans and these producer-handlers, that you’re aware of? A. That is correct. Q. So it’s a prospective concern only, not a current concern, in that order with regard to those producer-handlers, correct? A. Yes.”³⁰
- “Q: Am I correct in reading your report to state that you don’t know of any disorderly conditions in Order Number 1? A: In the states that we have contacted and discussed, I would concur with that statement.”³¹
- “. . . we do not currently observe disorderly market conditions resulting from activities of the four producer-handler operations in the Pacific Northwest Market which remain under 3 million pounds per month . . .”³²

The proponents of the elimination or limitation of producer-handlers have failed to meet their burden of proof to show that producer-handlers cause disorderly marketing conditions. The hearing record, comprised of both testimony and evidence, demonstrates a total lack of any objective, factual basis to adopt Proposals 1, 26, or any of the responsive variants.

V. NMPF’s stated bases for the adoption of Proposals 1 and 26 are not supported by actual record evidence.

The principal rationale in support of Proposals 1 and 26 was offered by Roger Cryan, NMPF’s on-staff economist.³³ The expert witness from co-proponent International Dairy Foods Association, Robert Yonkers, did not introduce additional evidence, analysis, or rationale in

²⁹ Asbury, Tr. 590.

³⁰ Berthiaume, Tr. 667-78.

³¹ Bothfeld, Tr. 1164.

³² Rowe, Tr. 1247.

support of the proposals. Instead, he restated much of the testimony of Dr. Cryan.³⁴ The factual witnesses sponsored by NMPF and IDFA, likewise, did not introduce additional rationale for the adoption of the proposals. Instead, their testimony parroted the conclusory statements from Dr. Cryan regarding the alleged “price advantage” of producer-handlers and offered unsupported or incomplete anecdotes or hypothetical fears about prospective problems that fit neatly within the framework of the NMPF/IDFA case laid out by Dr. Cryan. Elvin Hollon, a summary witness for the proponents, relied almost entirely on the prior testimony of other witnesses, offering but one additional half-story about one producer-handler’s activities.

In short, Dr. Cryan’s testimony constitutes the case in chief for Proposals 1 and 26. The problem for the proponents is that the six bases set out by Dr. Cryan crumbled under the cross-examination and the weight of the factual record.

Dr. Cryan testified that producer-handlers should be eliminated because (1) the producer-handler can allegedly pay effectively the uniform price for milk at the plant, thereby giving the producer-handler a cost advantage; (2) there are a growing number of large farms which must be prevented from becoming producer-handlers; (3) producer-handlers do not balance their own milk supplies; (4) the dairy industry never contemplated the size of today’s producer-handlers; (5) under the licensing scheme enacted under the unconstitutional Agricultural Adjustment Act, producer-handlers were exempted merely for administrative convenience; and (6) producer-

³³ NMPF also proposes the concurrent adoption of Proposal 2, which is addressed as separate issue by AIDA in this brief.

³⁴ “Since my testimony today follows that of Dr. Roger Cryan of NMPF in support of Proposals 1 and 2, I do not plan to restate all the facts in his testimony, but rather will supplement his testimony from the perspective of IDFA.” Tr. 2434.; See also, Cross-examination of Dr. Yonkers by John Vetne, “I don’t have any cross-examination for Dr. Yonkers. I probably won’t because his testimony more or less adopts NMPF’s and so unless there’s a wrinkle added by co-proponents in more quasi direct, I don’t think I will have any.” In fact, there was no cross-examination by Dr. Yonkers, at all by anyone.

handlers do not contribute to the producer settlement fund and have an impact on blend prices.³⁵

Each of these alleged bases are discussed below.

A. Producer-handlers' cost of milk is the cost of production, not a theoretical transfer price or regulatory statistical reference.

Producer-handlers are dairy farmers who process milk from their own cows in their own plants and market their packaged fluid milk and other dairy products themselves.³⁶ While regulated handlers purchase milk from farmers, each producer-handler produces its milk supply from its own-farm production, as part of a single integrated operation.

Regulated handlers must pay a USDA established minimum price for the milk purchased and used at the plant. That price is defined with certainty. But the producer-handler incurs the actual economic cost of producing its milk.

<p>Cost of Milk to a Producer-Handler Plant = Cost of Production at the Farm</p> <p>Cost of Milk to a Regulated Handler = Producer Payment + Pool Payment = Class I Price</p>

The regulated price and the actual cost of production do not correlate over time. While NMPF and the other proponent witnesses testified that a producer-handler has an advantage in the cost of milk, the measurement cannot be based on a theoretical "transfer price," but must be premised on whether the cost of milk for the producer-handler plant exceeds the regulated Class I price.

³⁵ Cryan, Tr. 400-406.

³⁶ USDA-AMS-Dairy Programs website,
<http://www.ams.usda.gov/AMSV1.0/ams.fetchTemplateData.do?template=TemplateD&navID=IndustryMarketingandPromotion&leftNav=IndustryMarketingandPromotion&page=ProducerHandlers&description=Producer-Handlers&acct=dinkford>.

1. The arbitrary assignment of a transfer price at the blend price does not reflect the economic reality of any producer-handler's operation.

NMPF argues that the producer-handler's cost of milk is, or should be found to be, the federal order blend price. This is premised on the invented notion that the blend price is "the appropriate transfer price" for a producer-handler, and therefore should be the basis for the calculation of a compensatory payment that would be assessed to producer-handlers.³⁷ This unsupported proposition was articulated and repeated without any corroboration, proof, or peer reviewed economic analysis by witnesses supporting NMPF and IDFA. This dual fallacy, that the producer-handler's milk cost is the blend price and that there is an actual commensurate cost advantage that accrues to the producer-handler, is a key linchpin to the NMPF and IDFA case. However, in a fully-integrated operation like a producer-handler, the assignment of an arbitrary transfer price does not reflect any economic reality of what is actually happening within the business. Such a theoretical notion is antithetical to the actual economic evidence which must be the basis of any change mandated by the Department.³⁸

As AIDA's expert economists testified:

In this environment, dominated by the NMPF cooperative members, it is asserted that the appropriate transfer price is the difference between the Federal Order blend price, which does not exist in the market, and the Federal Order Class I price, which also does not exist in the market. This reasoning defies economic logic not only because these Federal Order prices are not market prices but also because in the real world, transfer prices are based on costs.³⁹

MR. MILTNER: Transfer price, compensatory payment base, how are those concepts linked, if at all?

³⁷ Cryan, Tr. 407.

³⁸ See Fairmont Foods Co. v. Hardin, 442 F.2d 762, 766-67 (D.C. Cir. 1971).

³⁹ Knutson, Tr. 3044.

DR. KNUTSON: They're directly linked to one another because the proposal links the transfer price to the -- the blend price, the uniform blend price. So the -- the proposal is directly linked to compensatory payment. In other words, the difference in the payment between the uniform price and the Class I price is the compensatory payment.

MR. MILTNER: And from a -- from an economic perspective, does it -- does it make sense to -- to assign the transfer price at the same point as the base price for the compensatory payment? In other words, you criticized the transfer price is set at the blend, and why is that?

DR. KNUTSON: Because that's -- that's what they propose. That's their proposal.

MR. MILTNER: And from your perspective, as an economist, the rational point to set that is not at the blend price but at their production?

DR. KNUTSON: Is at the cost of production of the producer-handler. I mean, the rationale is that you base the transfer price on the market price. You don't base a transfer price on a regulated Federal Order price that doesn't exist in the market. So, you know, the best basis that you've got for what that transfer price is by a producer-handler is the producer-handler's cost of production.⁴⁰

MR. MILTNER: If the purpose is to determine whether a milk plant -- a plant processing milk into fluid milk products, that pays a Class I regulated price, is at a disadvantage to a producer-handler plant that bottles the milk produced on its own farm, is it economically sound and rational to use the cost of milk production for the producer-handler plant as its transfer price?

DR. KNOBLAUCH: To use its full cost of production, I think that's reasonable.

MR. MILTNER: Okay.

DR. KNOBLAUCH: You might also add the caveat that operating a farm, you would like to have profits above just covering all your costs. So in some circumstances, you could say that it should be the cost of production plus some value. And we could talk about what or how you might calculate what that some value may be.⁴¹

The intended conclusion from Dr. Cryan's assumed theory is that the producer-handler has an actual advantage over regulated handlers in the cost of milk to the plant. The actual

⁴⁰ Knutson, Tr. 3119-20.

⁴¹ Knoblauch, Tr. 3411-12.

evidence in the record establishes exactly the opposite. Regulated handlers can now and have historically been able to purchase milk for less than it costs producer-handlers to produce.

2. The cost of production for a producer-handler exceeds the Class I price.

The cost of the milk used by producer-handlers at their plants is the cost of production. Matt Shatto of Shatto Farms perhaps best responded to the unfounded theory that producer-handlers have an unfair competitive advantage when he called the failure to consider actual costs of production for the producer-handler “misleading and unjust.”⁴² Even the proponents of eliminating producer-handlers ultimately agreed that equating a producer-handler’s costs to the blend price was theoretical and speculative:

A. . . . we’re talking here in my testimony about the regulated minimum prices and the type of advantage that can accrue to a producer receiving, if you will, the uniform price and charging himself, if you will, the Class I price.

Q. We have no evidence at this point that that’s occurring at all. That’s a theoretical notion that you have put together in your statement, correct?

A. Yes.⁴³

What the proponents are characterizing as the alleged “advantage” of producer-handlers in their total cost of milk is actually the unarguable proposition that producer-handlers do not have the added and unnecessary additional expense of a pool payment.

Q. And producer-handlers, on the other hand, would not experience any billing from --

⁴² Shatto, Tr. 1188.

⁴³ Tonak, Tr. 545-46.

A. That's right.

Q. -- the Market Administrator?

A. Their expense would be their cost. That would be correct.

Q. Okay. So when you calculate the possible advantage that the producer-handlers would have in your orders, such as in Order 1, a difference of 23 cents per gallon, basically that's the -- the bill that regulated plants have to the Market Administrator which producer-handlers would not have?

A. That is correct.⁴⁴

But the distinction between whether a producer-handler makes a pool payment and whether a producer-handler has a cost of milk that is actually less than the regulated minimum price is critical. The cost of milk which is purchased by the regulated handler is the federal order Class I price—comprised of the payment of the blend price to the producer and the payment to the pool. In contrast, since the producer-handler never actually purchases any milk for the integrated operation, the cost to the producer-handler is the cost of production. And it is the total measure of those costs that would determine whether a cost advantage exists; not whether the producer-handler has a pool payment.

At least one proponent witness explicitly acknowledged that a producer-handler incurs a cost of production for its milk rather than actually paying a price for a raw milk supply:

. . . the cost of milk for an exempt entity is their cost of producing milk at the farm. And, you know, the current situation is pretty interesting, because currently it would not favor producer-handlers. The cost of producing milk at the farm is -- is less than -- certainly less [sic, more]⁴⁵ than the blend is providing in most

⁴⁴ Asbury, Tr. 576-77.

⁴⁵ Counsel corrected Mr. Krueger's misstatement in a follow-up question. Tr. 1356-57.

orders.⁴⁶

While Mr. Krueger is correct that producer-handlers are at a cost disadvantage to regulated handlers, he is wrong about the uniqueness of the situation. The cost of production for the producer-handler routinely exceeds both the blend and Class I prices. In referring to the testimony of AIDA's expert witnesses, this spread is clear:

The USDA, Economic Research Service cost of milk production data represents the costs for the average producer. Thus, their data shows costs that are higher per hundredweight of milk produced than the Dairy Farm Business Summary. The ERS average data demonstrates that even when measured against the Class I price, the cost of production exceeds the Class I price by 5 to 8 dollars per hundredweight.⁴⁷

The testimony from other dairy farmer witnesses corroborated the conclusions drawn from Dr. Knoblauch's observations and research.⁴⁸

The following tables, compiled from testimony, hearing exhibits, and USDA data, demonstrate that, the imposition of the payment scheme demanded by NMPF and others, would place producer-handlers at a further decided competitive disadvantage to handlers purchasing milk at the Class I price.

The data on these tables are prepared from USDA ERS Cost of Production data for each marketing area, using state costs of production. The states utilized for each marketing area are indicated on the charts and are the same states selected by the state Departments of Agriculture⁴⁹

⁴⁶ Krueger, Tr. 1356.

⁴⁷ Knoblauch, Tr. 3022-23.

⁴⁸ See, e.g. Damm, Tr. 746.

⁴⁹ The represented States were Vermont, Wisconsin, New Hampshire, New York, and Pennsylvania. They are referred to as "States" hereafter.

in compiling data incorporated into charts contained in Exhibit 36.⁵⁰ Costs of production were averaged for each of the states listed for each marketing area. Data for Class I prices and blend prices are the annual averages taken from Dairy Programs' website. For 2009, both costs of production and milk prices were utilized for January through May 2009.

The charts demonstrate that in most federal orders, the cost of production exceeds both the blend prices and Class I prices consistently. This is consistent with the 2006 data supplied by the States, and the testimony and chart supplied by AIDA economist expert witness Dr. Wayne Knoblauch. While the data shows that in the high-price years of 2007 and 2008, the Class I price may exceed the cost of production for areas with low costs of production, these prices are inconsistent and on average the cost of production exceeds federal order minimum prices.⁵¹

These charts confirm the conclusion of the States that, "The fact that the Class I price is lower than the total cost of production without question takes away the argument that producer-handlers enjoy any milk price advantage and clearly warrants a continued exemption."⁵² The States also correctly observed that, "If producer-handlers were required to take part in the pooling and payment provisions of the federal order - the statistical uniform price would not meet the cost of production for the majority of farms. Therefore there is not [a] raw milk cost

⁵⁰ The testimony from the States endorsed a producer-handler limit of 2 million pounds of Class I sales per month. But in a letter to Kreider Farms, the Secretary of the Pennsylvania Department of Agriculture clarified that the Department did not intend for any limit to adversely affect Kreider Farms and that the Department "supports [Kreider Farms'] efforts to retain the current producer-handler exemption." Ex. 86-A.

⁵¹ See Ex. 36, p. 6 (noting that while some orders will show returns exceeding the Class I price in certain high price environments, "prices fluctuate.")

⁵² Ex. 36, p.6.

advantage for producer-handlers but in fact a cost disadvantage.”⁵³

⁵³ Ex. 36, p.6.

	2007					
	Operating Cost of Production	Total Cost of Production	Blend Price	Blend Price Less Total Cost of Production	Class I Price	Class I Price Less Total Cost of Production
Northeast (VT, NY, PA)	15.56	25.77	19.92	(5.85)	21.39	(4.38)
Appalachian (VA, TN, KY)	16.57	30.41	20.36	(10.05)	21.19	(9.22)
Florida (FL)	14.57	21.44	21.29	(0.15)	22.01	0.57
Southeast (GA, MO, TN)	15.70	28.63	20.09	(8.54)	21.20	(7.43)
Upper MW (MN, WI, IL)	12.78	22.74	18.41	(4.33)	19.94	(2.80)
Central (IA, IL)	13.33	23.77	18.67	(5.10)	20.12	(3.65)
Mideast (OH, IN, MI)	12.93	22.74	18.75	(3.99)	20.12	(2.62)
Pacific NW (WA, OR, ID)	13.24	20.43	18.62	(1.81)	20.04	(0.39)
Southwest (TX, NM)	11.92	16.49	19.35	2.87	21.09	4.61
Arizona (CA)	11.91	16.00	18.95	2.95	20.47	4.47

	2008					
	Operating Cost of Production	Total Cost of Production	Blend Price	Blend Price Less Total Cost of Production	Class I Price	Class I Price Less Total Cost of Production
Northeast (VT, NY, PA)	17.52	28.06	18.63	(9.43)	21.21	(6.85)
Appalachian (VA, TN, KY)	21.09	35.87	19.87	(16.00)	21.28	(14.59)
Florida (FL)	16.87	24.02	21.84	(2.18)	22.89	(1.13)
Southeast (GA, MO, TN)	19.75	32.62	20.15	(12.47)	21.54	(11.08)
Upper MW (MN, WI, IL)	16.12	26.46	17.59	(8.87)	19.76	(6.70)
Central (IA, IL)	16.93	27.58	17.39	(10.19)	19.97	(7.61)
Mideast (OH, IN, MI)	16.89	26.46	17.92	(8.54)	19.94	(6.52)
Pacific NW (WA, OR, ID)	16.78	24.62	16.99	(7.63)	19.86	(4.76)
Southwest (TX, NM)	14.09	18.62	18.40	(0.22)	20.96	2.34
Arizona (CA)	16.27	20.82	17.43	(3.39)	20.31	(0.51)

	2009					
	Operating Cost of Production	Total Cost of Production	Blend Price	Blend Price Less Total Cost of Production	Class I Price	Class I Price Less Total Cost of Production
Northeast (VT, NY, PA)	15.60	26.22	12.35	(13.87)	14.73	(11.49)
Appalachian (VA, TN, KY)	17.28	31.20	13.60	(17.60)	14.89	(16.31)
Florida (FL)	12.98	19.16	15.82	(3.34)	16.87	(2.29)
Southeast (GA, MO, TN)	15.45	26.95	13.70	(13.25)	15.28	(11.67)
Upper MW (MN, WI, IL)	14.14	24.47	10.67	(13.80)	13.28	(11.19)
Central (IA, IL)	14.84	25.41	11.01	(14.40)	13.49	(11.92)
Mideast (OH, IN, MI)	14.14	24.47	11.47	(13.00)	13.49	(10.98)
Pacific NW (WA, OR, ID)	15.29	23.33	10.97	(12.36)	13.38	(9.95)
Southwest (TX, NM)	12.87	17.52	12.06	(5.46)	14.49	(3.03)
Arizona (CA)	14.81	19.45	11.20	(8.25)	13.76	(5.69)

While AIDA agrees with the States that the ERS cost of production data demonstrates that producer-handlers have no cost of milk advantage, AIDA disagrees with the methodology used by the States to estimate the costs of production for farms of certain sizes. As the ERS data reports average costs for a state, and each state has differing farm sizes applying an across the board 15.4% reduction to costs of production to normalize the results by herd size leads to imprecise results of no validity.⁵⁴ For instance, farms in those areas reporting the lowest costs of production already have the largest average farm size. In any event, the testimony of individual producer-handlers confirms that costs of production for producer-handlers exceed Class I prices.

Individual producer-handlers testified to their costs of production, and in each of those instances, their costs far exceeded the applicable Class I prices. Jock Gibson of Lochmead Dairy testified to a cost of production of \$18.03 per hundredweight, which is just his cash costs, compared with a Class I price of \$12.⁵⁵ Matt Shatto of Shatto Farms described a cost of production of \$25-\$30 per hundredweight, and explained that becoming an integrated producer-handler was the only means to save the Shatto family farm because, “the price that we were being paid for our milk did not cover the cost to produce it.”⁵⁶ Howard Hatch of Hatchland Farms testified that his plant’s milk cost is the cost to produce it and that “I’m in a real disadvantage going to my cost of production. I could buy milk on the market and save money. But I can’t guarantee – make the guarantees that I can when I have my own.”⁵⁷ Aurora Organic

⁵⁴ See Ex. 36, p. 7.

⁵⁵ Gibson, Tr. 639-40.

⁵⁶ Shatto, Tr. 1183, 1189.

⁵⁷ Hatch, Tr. 290-91.

Dairy testified to a cost of production exceeding \$30 per hundredweight.⁵⁸

3. **A pool payment assessed to a producer-handler premised on anything except the actual cost of production at the producer-handler's own farm would place them at a further price disadvantage to regulated handlers, in contravention of the AMAA.**

NMPF's "transfer price" theory ignores the actual economic costs of producer-handlers and instead imposes a theoretical proxy intended to raise the costs for producer-handlers. A pool payment as described by NMPF, et al. would actually result in non-uniform pricing, which is prohibited by the AMAA.⁵⁹ The tariff which NMPF and IDFA advocate does not "level the playing field" between regulated handlers and producer-handlers, rather it places producer-handlers at a further, substantial disadvantage by piling an extra charge on top of the already higher costs of production of producer-handler milk.

The payment scheme urged by NMPF is based on the difference between the uniform price for the marketing area and the Class I price. Such a scheme hinges on imputing a theoretical cost of milk to the producer-handler at the order's uniform price.⁶⁰ But any such payment must be founded in economic realities, not presumptions.⁶¹

For producer-handlers who produce their milk supplies from their own farms, any pool

⁵⁸ Keefe, Tr. 2911.

⁵⁹ See Sani-Dairy, a Div. of Penn Traffic Co., Inc. v. Espy, 939 F. Supp. 410 (W.D. Pa. 1993) aff'd 91 F.3d 15 (3d Cir. 1996).

⁶⁰ See Knutson, Tr. 3119-20.

⁶¹ Lehigh Valley Cooperative Farmers, Inc. v. United States, 370 U.S. 76 (1962) (rejecting compensatory payments to the pool by non-pool handlers as demonstrably unsound as a mechanism to subsidize the pool milk and insulate the pool milk from competitive impact); Sani-Dairy v. Espy, 939 F. Supp. 410 (W.D. Pa. 1993) aff'd 91 F.3d 15 (3d Cir. 1996).

obligation based on the blend price is hardly compensatory. Instead, it is confiscatory.

If the proposal put forth by NMPF and IDFA is adopted by the USDA, affected producer-handlers in the Northeast would find themselves with an untenable disadvantage. Far from removing the price advantage, as stated by IDFA, this producer-handler would be faced with a cost of over \$20 a hundredweight, compared to his pooled competitor's cost of under \$14 per hundredweight for the current month of May.⁶²

Mr. Rooney later described Monument Farm's operating (cash) costs at \$19.65 per hundredweight.⁶³ Likely, the total cost of production for Monument Farms approaches \$25 per hundredweight, consistent with the data from USDA-ERS.

The adoption of an irrebuttable presumption that the milk from the producer-handler's own farm was produced at the blend price would put producer-handlers at a further competitive disadvantage to pool handlers. Since the actual cost of production for the producer-handler exceeds the blend price, the additional pool charge would result in a cost of milk far in excess of the Class I price. The resulting unequal cost of milk to handlers in the same marketing area would result in the certain loss of customers and valuable milk outlets to the producer-handler.

Even if the Secretary accepts the NMPF/IDFA definitions of disorderly marketing (thought he should not), none of the NMPF/IDFA Proposals can be adopted unless NMPF/IDFA can demonstrate the existence of an alleged "economic advantage" enjoyed by producer-handlers by offering probative evidence that the actual cost of the milk processed by producer-handlers is less than the Class I price. This they cannot do. But AIDA and other producer-handlers did demonstrate at the hearing that the cost to the integrated producer-handler is its actual cost of production, and therefore, the imposition of additional pool payments would do nothing other

⁶² Rooney, Tr. 1520.

⁶³ Rooney, Tr. 1521.

than punitively increase the cost of the producer-handler's milk supply beyond that of its competitors in direct contravention of the AMAA.

When a "compensatory" payment bears no relation to the actual costs of a handler's milk, the effect is to make the milk more expensive and thereby protect the established pool handler from competition. The Supreme Court noted in Lehigh Valley, that any compensatory payments must bear a relationship to the actual costs of the milk.⁶⁴ The Supreme Court mandated that compensatory payments place, ". . . pool and non pool milk on substantially similar competitive positions at source."⁶⁵ But in Lehigh Valley, the actual effect of the compensatory payment was to, "make it economically unfeasible for a handler to bring such milk into the marketing area."⁶⁶ The same is true for NMPF's "transfer price" theory for imposing an additional "compensatory" payment on producer-handlers.

The additional costs related to the non-uniform pricing certain to result from the acceptance of NMPF's transfer price scheme would effectively eliminate at least some producer-handlers from the federal milk marketing order system.⁶⁷ Those that remain would have to overcome a regulatory barrier to entry due to the mandated price disadvantage.

Therefore, Proposals 1 and 26 would make it economically unfeasible for producer-handlers to market dairy products on the same terms as other handlers in the same markets.⁶⁸

⁶⁴ Lehigh Valley, 370 U.S. at 87 n. 13; See also Sani-Dairy v. Espy, 939 F. Supp. at 415.

⁶⁵ Lehigh Valley, 370 U.S. at 84 (internal citations omitted).

⁶⁶ Id.

⁶⁷ Hatch, Tr. 259, 269. Gibson, Tr. 630, Shatto, Tr. 1207, Kreider, Tr. 2644.

⁶⁸ See Lehigh Valley, 370 U.S. at 97; Sani-Dairy vs. Espy, 939 F. Supp. 410, 416 (W.D. Pa. 1993), aff'd, 91 F.3d 15 (3d Cir. 1996). (invalidating a compensatory payment provision making non-pool milk more expensive and impermissibly limiting the marketing of dairy products).

The payment scheme that would attach to Proposals 1 and 26 cannot be distinguished from those previously struck down as illegal in Lehigh Valley and in Sani-Dairy.

4. Regulated handlers can and do successfully compete with producer-handlers for customers.

Other than their unsupported “transfer price” theory, the proponents’ “evidence” of a competitive advantage came in the form of anecdotes from competitors of producer-handlers. That testimony, all from persons with vested interests in eliminating producer-handlers as competitors, is little more than a description of healthy competition. Each claim that the producer-handler had taken customers solely due to an unwarranted price advantage was proven to be a distortion, an incomplete account, or was simply disproven by reliance on actual facts, including price data.⁶⁹

a. Heartland Dairy

Warren Erickson testified that Heartland dairy placed its product on the shelves of Kansas City area Hy-Vee⁷⁰ stores, which Hy-Vee priced to the customer at ten cents below the price of a private label milk (“PL2”) supplied by Anderson-Erickson Dairy. Ultimately, Hy-Vee discontinued stocking the PL2 milk, but continues to utilize Anderson-Erickson to bottle another

⁶⁹ See Cumberland Farms, Inc. v. Lyng, 1989 WL 52697 (D.N.J. May 15, 1989) (proposed changes to marketing orders must be premised on actual supportive evidence and not, “conclusory and speculative opinions and predictions...”).

⁷⁰ Mr. Erickson would not provide the name of the supermarket chain that he was testifying about, nor would he provide any specific information about the prices at which he supplied the Hy-Vee chain. As with all of the witnesses alleging that producer-handler competition was disorderly, it fell upon the producer-handlers defending their businesses to either shadowbox the information not provided or inject actual evidence into the record on their own in order to provide an accurate picture for the Secretary. Here, the identity of the Hy-Vee chain was supplied by Heartland witnesses, although the information could be determined with near certainty from publicly available information from Anderson-Erickson’s own website. Button, Tr. 3616-17, Exs. 100, 101.

private label milk for Hy-Vee (“PL1”) and to supply branded milk to the Hy-Vee stores. Mr. Erickson alleged that the only way that Heartland could place its milk in the Hy-Vee stores was due to the “unfair competitive advantage” that Heartland has as a producer-handler.

The facts actually demonstrate that the introduction of Heartland milk into Hy-Vee supermarkets does not constitute market disorder, or result from a competitive price advantage attributable to Heartland’s producer-handler status. First of all, the introduction of Heartland’s product in the Hy-Vee stores that Mr. Erickson complained of occurred in 2007, when Heartland was still a regulated handler.⁷¹ What Mr. Erickson complains of is competition from a regulated handler. If Heartland could place its product in the Hy-Vee stores as a regulated handler, its continued ability to do so as a producer-handler cannot be construed as evidence of any competitive advantage.

In addition to having no real evidence about the wholesale price relationships involved,⁷² the Secretary should note that what Mr. Erickson described was the introduction of a new product into the Hy-Vee dairy case, not a situation where Heartland outbid Anderson-Erickson to supply a product. Heartland successfully placed a competitive, differentiated product on the shelf that appealed to customers.

As NMPF stated in its “Talking Points” memorandum, and as DFA’s staff economist testified, the price on the shelf tells us nothing about the wholesale price relationship or the costs of the handler.⁷³ But even if Heartland’s milk retailed at 20 cents below the “PL1” product that

⁷¹ Erickson, Tr. 2278. Button, Tr. 3604, 3613, Ex. 13.

⁷² Mr. Erickson admitted no evidence about the wholesale invoicing of Heartland’s product to Hy-Vee. Tr. 2297.

⁷³ Ex. 105; Hollon, Tr. 3889-90.

Anderson-Erickson was still supplying Hy-Vee stores,⁷⁴ the cooperative over-order premiums paid by Anderson-Erickson amount to approximately 30 cents per gallon.⁷⁵ Even if one imputed the entire 20-cent price difference on the shelf to the wholesale price, there remains a ten-cent advantage to Heartland by virtue of not paying over-order premiums. These premiums are not, however, costs imposed by the federal milk marketing order system and are therefore irrelevant to the issues in this hearing. And Anderson-Erickson is also selling its own branded product at Hy-Vee stores at prices higher than the identical milk bottled in “PL1” labeled jugs.

There are several reasons why Hy-Vee could have elected to stock Heartland’s milk that have nothing to do with price. It might be of a higher quality than Anderson-Erickson’s milk.⁷⁶ Hy-Vee could have been looking for an alternate supplier of product, as many customers do.⁷⁷ Hy-Vee might have found that its customers prefer the taste profile of Heartland milk or identified with the Heartland story and mission.⁷⁸

Even the alleged price difference can be attributed to a number of factors. The transportation costs from Heartland’s plant to the Hy-Vee stores are, in fact, lower than those for Anderson-Erickson by virtue of the distance to market.⁷⁹ The market may have been contestable, as Dr. Knutson describes:⁸⁰

⁷⁴ Erickson, Tr. 2286.

⁷⁵ Erickson, Tr. 2276, 2286.

⁷⁶ Sharpe, Tr. 3597.

⁷⁷ Keefe, Tr. 2976.

⁷⁸ Button, Tr. 3605.

⁷⁹ Erickson, Tr. 2289.

⁸⁰ Knutson, Tr. 3122-3123.

I would say there are niche markets that serve particular segments of consumers and then there are markets that are contestable markets; economists refer to them as contestable markets, where the margins are sufficiently high. The prices charged are sufficiently high that they invite competition. And that's the other circumstance. I wouldn't refer to that necessarily as a niche market. It's a contestable market concept.⁸¹

Anderson-Erickson would have the Department believe that Heartland is placing product on shelves merely because it does not pay into the pool. What the evidence actually shows is that Heartland sold milk to Hy-Vee as a regulated handler and continues to do so as a producer-handler. The evidence shows lower transportation costs for Heartland, and the absence of over-order premium charges. There is no factual foundation to support claims of a price advantage in Heartland's cost of milk. In fact, like every other regulated handler, Anderson-Erickson has a raw milk advantage over Heartland because it does not bear the costs to produce its own milk supply.

What Anderson-Erickson complains of is competition. Its complaint is that a regulated Heartland got its foot in the door at Hy-Vee by selling a unique product and, in Anderson-Erickson's subjective opinion that led Hy-Vee to stop selling another product supplied by Anderson-Erickson. Conjecture, supposition and unsupported theories never equate to actual evidence. Anderson-Erickson, like the other supporters of NMPF and IDFA, is long on the former and substantially short of the latter.

Gary Lee from Prairie Farms testified his company also competed with Heartland and "in order for Prairie Farms to maintain some retail accounts, we have had to lower prices 30 to 40 cents per gallon just to maintain our shelf space."⁸² Mr. Lee's testimony was not that Prairie Farms lost accounts, or could not compete against Heartland, and was devoid of any specific

⁸¹ Knutson, Tr. 3122-3123.

⁸² Lee, Tr. 945.

evidence regarding the stores at issue, the prices at which products were sold at wholesale, or the volumes of milk being discussed.⁸³ When asked for specific stores, prices, and volumes, Mr. Lee declined to provide the information.⁸⁴ The only specific testimony about the competition from Heartland is that prices had to be lowered to maintain shelf space.⁸⁵ Moreover, Mr. Lee did not testify that he had to sell at a loss in order to compete with Heartland; rather he testified that he could not charge as much as he wanted when he operated without Heartland as a competitor for Hy-Vee's business. If the Anderson-Erickson example is any indication, Heartland's competition with Prairie Farms has saved consumers untold thousands of dollars in unwarranted high milk prices charged by the DFA-Prairie Farms Roberts Dairy joint venture.

While Prairie Farms and DFA may not like the price pressure created by competition, Roberts Dairy was able to meet the Heartland price as a regulated handler. And as Dr. Knutson testified, competition is not disorderly marketing.⁸⁶

b. Country Dairy

A witness from Bareman Dairy testified that Country Dairy, a producer-handler in Michigan, balanced its milk supply by offering to sell milk at prices that Bareman Dairy could not match. As with the Anderson-Erickson anecdote, the facts in the record reveal a wholly different situation. According to the Bareman Dairy witness, Country Dairy offered milk for sale at \$1.90 per gallon wholesale, with the requirement that the milk be retailed at \$1.99 per gallon.⁸⁷

⁸³ Lee, Tr. 954-55.

⁸⁴ Id.

⁸⁵ Lee, Tr. 945.

⁸⁶ Knutson, Tr. 3069.

⁸⁷ Wernet, Tr. 2310-11.

But the testimony from one of the managing owners of Country Dairy showed that Mr. Wernet was just plain wrong. First, Country Dairy's milk pricing follows federal order prices.⁸⁸ Second, Country Dairy operates through an exclusive distributor, who was approached by a chain of convenience stores for a promotional price to compete with large retailers who were selling milk from fully regulated handlers at \$1.99 per gallon or less.⁸⁹ This is exactly the opposite of what the Bareman Dairy witness had testified to—i.e. that Country Dairy has conducted a “fire sale” on its milk to balance its production.

Perhaps most striking is that regulated handlers can certainly provide milk for sale at retail at \$1.99 per gallon. For May 2009, the raw milk cost in Order 33 for whole milk was \$1.116 per gallon. For skim milk the cost was \$0.775 per gallon.⁹⁰ At the two percent average butterfat content of milk in Michigan,⁹¹ the raw milk cost for May milk at federal order minimums was \$0.943 per gallon. Mr. Wernet testified that Bareman Dairy has processing costs of \$0.33 per gallon⁹² and has estimated distribution costs of \$0.50 per gallon.⁹³ At the average butterfat content of milk in Michigan, the federal order minimum prices, plus packaging, plus distribution equals \$1.773 per gallon, which would still leave over twelve cents in profit if milk

⁸⁸ Arkema, Tr. 3668.

⁸⁹ Arkema, Tr. 3672-73, 3687-89 (describing that retailers supplied by Dean Foods regularly sell milk for as low as \$1.70 per gallon).

⁹⁰ The Class I skim milk price for May 2009 in Order 33 at locations with a \$1.80 location differential was \$9.01/cwt, including the processor assessment and the butterfat price was \$1.2219, including processor assessments. Source: Price Announcement of the Mideast Market Administrator <http://www.fnmacleev.com/Releases/AdvancePrice/Adv2009.pdf>.

⁹¹ Wernet, Tr. 2352-54.

⁹² Wernet, Tr. 2336.

⁹³ Wernet, Tr. 2330.

was sold at wholesale for \$1.90 per gallon.

If processing and distribution costs were actually lower than Mr. Wernet realizes at Bareman Dairy, then the profit would only be greater. The bottom line is that if Bareman Dairy chooses not to meet the prices in that market described by Mr. Wernet, it is attributable to something other than the producer-handler status of Country Dairy, such as the \$2.00 in over-order premiums that Bareman pays for its milk supply⁹⁴ or the proximity of the County Dairy independent distributor to the customers described.⁹⁵

The final point relative to the Country Dairy example is that the actions that the Bareman Dairy witness described were the not even those of Country Dairy, but those of Country Dairy's distributor.:

Q. Now, the recent communications with the convenience store -- between the convenience store and Cedar Crest, were you personally involved in any of those communications or is this just something you learned about from Cedar Crest, or how'd that go?

A. That was something that I learned about through being made aware of the testimony from Mr. Wernet.

Q. Okay. So you weren't aware of it before that time?

A. I was not.⁹⁶

If we look just at the cost of the milk and processing, a gallon of 2% milk can be sold at the plant for \$1.27 per gallon, which would leave a huge amount of room for an independent distributor to price milk to customers, perhaps even selling at a low profit or loss to gain a customer, a point

⁹⁴ Wernet, Tr. 2329.

⁹⁵ Wernet, Tr. 2334.

⁹⁶ Arkema, Tr. 3686, 3694 (describing that all pricing decisions to retailers are the purview of its distributor).

that both Mr. Wernet and Mr. Arkema agree upon.⁹⁷

Country Dairy became a producer-handler to ensure the long-term viability of the family farm.⁹⁸ It sells milk at profitable prices.⁹⁹ It seeks to put out a high quality product that meets the specific needs of its customers. It was a leader in providing rbST-free milk.¹⁰⁰ And it has grown incrementally over time in response to customer demand.¹⁰¹ It balances its milk through spot sales to cooperatives at low-value prices, and those sales increase during the flush months.¹⁰² Country Dairy seeks to sell its milk at premium prices because it produces a unique, premium product.¹⁰³ And the real evidence and actual data demonstrates that even the isolated sales complained of by Country Dairy's competitor are, just as the case with Heartland Dairy and Anderson-Erickson, healthy competition between market participants.

c. GH Dairy-El Paso

A witness from Dean Foods-Price's Creameries testified that it lost business to GH Dairy-El Paso. Once again, the Dean Foods witness did not provide any evidence about the wholesale prices involved, the name of the customer involved, or the volumes of milk involved, even when directly questioned regarding the identity of the account. The only "evidence" provided by the Dean Foods' witness was that the shelf price for milk fell by \$0.34 when the

⁹⁷ Wernet, Tr. 2341-42, Arkema, Tr. 3674.

⁹⁸ Arkema, Tr. 3665.

⁹⁹ Arkema, Tr. 3669.

¹⁰⁰ Arkema, Tr. 3670.

¹⁰¹ Arkema, Tr. 3670

¹⁰² Arkema, Tr. 3666, 3677, 3683.

¹⁰³ Arkema, Tr. 3671.

customer switched suppliers from Dean Foods to GH—from \$2.62 per gallon to \$2.28 per gallon.¹⁰⁴ When asked questions in order to provide a fuller picture to allow the Secretary to draw a true comparison of the wholesale prices, the witness refused:¹⁰⁵

Q. Can you tell me, sir, what the processing costs at the Dean's plant that you serve was in March of 2009?

A. Proprietary information. No, sir.

Q. So you are not going to tell me that?

A. No, sir.

Q. Can you tell me what the product cost was for the -- for obtaining the milk in March of 2009?

A. No, sir. I'm not going to tell you that.

Q. And obviously you have no clue with regard to either the product costs or the processing costs for GH processing, correct?

JUDGE CLIFTON: I'd like you to reword that. No clue is a little bit extreme.

Q. You have no information about that?

A. No, sir, I don't.

Q. All right. So with regard to this information that you did provide in the statement, the only thing that you know is that there's a -- there was a difference in retail of 34 cents, you say, between March 17 and March 16th, right?

¹⁰⁴ Carrejo, Tr. 1483-84.

¹⁰⁵ Claims of proprietary or sensitive information do not relieve the proponents of their obligation to present evidence within their knowledge and control to prove their case. See e.g. Hearn v. Rhay, 68 F.R.D. 574, 581 (E.D. Wash. 1975) (holding that a party may not assert a privilege to shield relevant facts "if (1) assertion of the privilege is the result of some affirmative act, such as filing suit, by the asserting party, (2) through the affirmative act, the asserting party has placed the protected information at issue by making it relevant to the case; and (3) application of the privilege would deny the opposing party access to information vital to his defense.").

A. Yes, sir.¹⁰⁶

As with Country Dairy and Heartland, the retail price in the El Paso market alone reveals nothing about wholesale prices and provides an incomplete and misleading picture at best.

The minimum raw milk value for March 2009 in El Paso was a fraction of the shelf price testified to by Mr. Carrejo. The raw milk cost for whole milk was \$1.005 per gallon, not including processor assessments, and skim was \$0.694 per gallon. At two percent fat, the cost would be \$0.872 per gallon.¹⁰⁷ The spread between the reported GH shelf price of \$2.28 and the raw milk cost of whole milk equates to \$1.255. With a spread between the reported Dean Foods shelf price and raw milk minimum price of almost \$1.60, what was occurring in El Paso was monopolization of the market by Dean Foods. The record indicates that for the four years before the entry of GH Dairy, there were no other local milk processors competing for business.¹⁰⁸

The success of GH Dairy was due to the market being contestable.¹⁰⁹ In fact, Mr. Hettinga testified that the same retail customer is supplied in Arizona by his regulated plant in

¹⁰⁶ Carrejo, Tr. 1494-95.

¹⁰⁷ Source for data: Southwest Milk market Administrator's website: http://www.dallasma.com/fd?file_map=prices&downfile=2009/1and2/1%262MAR09.pdf.

¹⁰⁸ Carrejo, Tr. 1468.

¹⁰⁹ Prairie Farms complained that it, "lost some business with a large national, even international retailer, who will remain unnamed [Wal-Mart]. The business was taken away from Prairie Farms and given to a large national fluid milk processor, a competitor of ours [Dean Foods]. The logic that we were given for the loss of business was that because [Dean Foods] lost business in El Paso, Texas, that [Wal-Mart] felt an obligation to help them maintain their volume with them, so they took business away from Prairie Farms." But the real issue is whether GH Dairy has a milk cost advantage over Dean Foods in El Paso, and the evidence shows that they do not. The ancillary responses of other retailers or bottlers are wholly irrelevant. Moreover, the idea that GH Dairy has some type of advantage over a publicly traded nationwide handler with sales in excess of \$12 billion is ludicrous on its face.

Arizona at prices 8-15 cents per gallon less than the prices at which GH Dairy-El Paso sells to that same customer in El Paso.¹¹⁰

Similarly, GH Dairy-El Paso garnered school milk business from Dean Foods in El Paso by virtue of excessive profits taken by Dean Foods in the absence of competition. As Mr. Hettinga described the situation regarding the school milk business when Dean Foods was the only local processor, Dean Foods was “ripping the general public off.”¹¹¹ Mr. Hettinga was able to source milk from an unrelated plant in Nevada, transport it to El Paso, and still make a profit.¹¹² The El Paso Independent School District realized lower prices in part due to falling Class I prices, but primarily due to the reduction in the “spread” between the bid price and the total cost of production and processing. This “spread” was lowered by 10 cents per half-pint unit once GH Dairy entered the El Paso market (an excessive profit by Dean Foods of \$18.59 per hundredweight).¹¹³ Just like with Heartland, this occurred before GH Dairy became a producer-handler.¹¹⁴ Because of the total absence of meaningful competition in El Paso, the Hettingas’ regulated plants in Arizona were also able to deliver milk to Fort Bliss in El Paso at a profit, which led the Hettingas, in part, to open the GH Dairy plant in El Paso:

Q. There’s also an issue that was raised by Mr. Carrejo about serving the military base at Fort Bliss. And he indicates -- he says that GH had been selling some milk there beginning in early 2008. Did GH, even before the plant was operational, go ahead and sell milk in El Paso on Fort Bliss?

A. I believe I hauled milk out of Yuma, Arizona into El Paso, probably 14 months

¹¹⁰ Hettinga, Tr. 2700.

¹¹¹ Hettinga, Tr. 2965.

¹¹² Hettinga, Tr. 2696-97.

¹¹³ Hettinga, Tr. 2764.

¹¹⁴ Hettinga, Tr. 2694.

before I ever started bottling in there. And that was part of the reason that I built the plant there, because it worked. I mean, if I had 35 cents freight and able to compete in that market, I was going to play there.¹¹⁵

The actual record evidence demonstrates that consolidation of handlers in the El Paso market invited competition on the basis of price but that the competition was neither unfair nor attributable to GH Dairy's status as a producer-handler.

Under scrutiny, the patterns and practices alleged in the testimony about Heartland, Country Dairy, and GH Dairy-El Paso are simply a collection of anecdotes, innuendo, and half-truths that wilt away. The Dean Foods witness, as with almost every other proponent witness refused to provide on cross-examination complete testimony on the facts and evidence at issue.

The Secretary is called upon to provide his administrative expertise in arriving at a decision regarding the proposals at issue. But to perform this task, Secretary must recognize that the NMPF and IDFA witnesses and member witnesses have drawn only a small bit of the picture because the full view destroys their arguments. Mr. Carrejo's testimony is another prime example of this sleight of hand. NMPF and IDFA and the other proponent witnesses are not permitted to hide the facts behind a facade so their testimony could not be challenged and tested. To do so, frustrates the Congressional intent of the AMAA as well as the Administrative Procedure Act. The basic principle is that all parties should have the opportunity to meet in the appropriate fashion all materials that influence decisions. Nothing short of the opportunity for full cross-examination and presentation of rebuttal evidence is appropriate for disputed adjudicative facts that are at the center of the controversy. By acting in this fashion, NMPF and

¹¹⁵ Hettinga, Tr. 2698-99.

IDFA perverted the administrative integrity of this hearing.¹¹⁶

d. Aurora Organic Dairy

Unlike Heartland Dairy, Country Dairy, and GH Dairy-El Paso, no testimony was directly offered about competition from Aurora Organic Dairy. A number of witnesses, however, insinuated that Aurora's status as a producer-handler caused market disruption. But the sole issue regarding market disruption is whether an actual price advantage exists for producer-handlers, measured against the regulated minimum Class I price. The undisputed testimony from Aurora establishes that its costs of production exceed \$30 per hundredweight, which is far in excess of the Class I price. Therefore, Aurora enjoys no cost advantage over regulated handlers.¹¹⁷ Instead, the opposite is true.

Rather, the competitors of Aurora and their representatives premise their arguments on their perception that if Aurora was put out of business, there would be a larger market for organic milk for them to supply. The fact is, however, that from a federal order perspective, Aurora already incurs production costs multiple times the Class I prices. And, for better or worse, the federal milk marketing orders are indifferent as to organic or conventional milk in terms of minimum prices.

As to the specific information about the ability of regulated organic processors to compete with Aurora, the only evidence comes from J.T. Wilcox, the witness retained by the processor-proponents,¹¹⁸ and Aurora's witness, Sally Keefe. Ms. Keefe testified that Aurora

¹¹⁶ See Abbotts Dairies Division of Fairmont Foods, Inc. v. Butz, 389 F. Supp. 1, 10-11 (E.D. Pa. 1975); 2 K. Davis, Administrative Law, § 15.10, at 402-404 (1958).

¹¹⁷ Keefe, Tr. 2910-11.

¹¹⁸ Mr. Wilcox's testimony suffers from the same deficiency as the other proponent witnesses in that he provided the Secretary only that evidence that he and the proponents deemed appropriate.

does not have an actual price advantage at their high cost of production, and that the growth of Aurora has been attributable to quality and service, even where Aurora was not the lower cost supplier.¹¹⁹ Her testimony describes several instances where other suppliers had attempted and failed to supply private-label organic milk to stores, and Aurora was able to meet the customer's expectations with respect to the quality and service demanded:

One regional customer launched its organic milk brand with another vendor who could not fulfill its orders completely. The customer pulled the products because of high out-of-stock conditions risked potential damage to its store brand image with customers. Over a year later, we were hired to relaunch the products, and the business succeeds today.

A national account customer hired us for a secondary supply role after being initially supplied by a national brand vendor. Our service levels continuously exceeded those of the national brand. This, in turn, made it clear to the customer that the branded supplier simply did not value the customer's private-label business the way we did. We were awarded additional roles with the customer, even at higher prices than the other vendor, until all the business was awarded to us.

One customer launched its private organic milk with another vendor and discontinued the products after suffering spoilage problems. After being reassured by our product quality and reliability, the customer relaunched the products and has been successful.¹²⁰

Both Ms. Keefe and Mr. Wilcox testified that Aurora lost accounts because its regulated competitors offered lower prices. Ms. Keefe freely admitted that Aurora was not always the low-cost supplier, "Based on our experience, we have not observed the producer-handlers to

He refused to provide testimony about the specifics of his experience with customers of Wilcox Dairy. Yet the proponents paid him to explain to the Secretary certain aspects of Wilcox Dairy's experience as a producer-handler (over 20 years ago) without providing AIDA, the Secretary, or other participants an opportunity to identify those to whom he referred or the dealings he described. Moreover, evidence regarding the marketplace 20 years ago is entirely irrelevant to whether there is disorderly marketing today.

¹¹⁹ Keefe, Tr. 2913-14.

¹²⁰ Keefe, Tr. 2912-13, 19.

have any price advantage resulting in a competitive advantage in the marketplace. We have lost customers to other organic milk suppliers who are able to provide what the customer perceived to be a better value. These suppliers are not producer-handlers.”¹²¹ Mr. Wilcox testified that as a regulated handler, Wilcox Dairy, LLC was able to take away business from producer-handlers.¹²² In the instance of Mr. Wilcox’s fully-regulated operation, it was able to take away sales at Costco Wholesale from Aurora on the basis of price, although Mr. Wilcox alleged that other factors were involved, as well.¹²³

Mr. Wilcox’s testimony illustrates two important points. First, regulated handlers do compete with producer-handlers for sales, including on the basis of price. Second, there is a litany of other factors as to why a customer would choose to source milk from any handler, including a producer-handler. Price is only part of the equation.

The hearing evidence establishes that pool handlers can and successfully do compete with producer-handlers. It demonstrates that healthy competition exists in the form of competition for retail accounts between regulated handlers and producer-handlers. It also demonstrates that retail prices provide no determinative evidence about the pricing by the processor or the cost of raw milk to the processor.

As Dr. Knutson, one of AIDA’s expert economists testified, the federal orders are not intended to limit or eliminate competition, “Disorderly marketing is not the same as being competitive. Being competitive involves being able to sell products you produce and yet be

¹²¹ Keefe, Tr. 2913.

¹²² Wilcox, Tr. 1323.

¹²³ Wilcox, Tr. 1324.

profitable.”¹²⁴ The proponents have tried to dress up healthy competition as a disorderly marketing condition. However, the two are not the same, and the proponents have wholly failed to carry their burden of proof to show that disorderly marketing conditions actually created by producer-handlers exist in every order.

B. The increasing size of dairy farms and speculation about what might happen cannot be a basis for changing the regulatory status of producer-handlers.

Fundamentally, NMPF and others seek to regulate producer-handlers based upon their size as producers,¹²⁵ and to place them at a competitive disadvantage by mandating that producers above a certain size who wish to operate a fluid milk plant incur both the cost of producing that milk and an unjustifiable additional payment. These producers, to the delight of NMPF, will likely remain members of their cooperative rather than place themselves in this economically untenable position.¹²⁶ Alternatively, the producer could attempt to operate as Diamond D Dairy and Dakin Dairy do—producing their milk on their farm, selling it to the cooperative at a loss, and then repurchasing the plant’s needs from the cooperative at a price \$4 or more higher than what it was sold for. This places the producer in the position of perpetual serfdom by eliminating the option of control of their own destiny. As Matt Shatto testified, “[T]he price that we were being paid for our milk did not cover the cost to produce it. . . . we lost

¹²⁴ Knutson, Tr. 3067, See also Tr. 3057.

¹²⁵ In the decision regarding the Arizona and Pacific Northwest producer-handler regulations, the Department determined that it was the size of the farm that is determinative of a producer-handler’s status under the Regulatory Flexibility Act. In addition, this record contains no less than 12 references from proponents and their supporters where they explicitly stated that their goal is to prevent farms of a certain size from ever becoming producer handlers. Cryan, Tr. 408, 1878; Tonak, Tr. 556; Asbury, Tr. 574, 592, 95; Berthiaume, Tr. 648; Damm, Tr. 696-98, 715; Daniels, Tr. 793; Buelow, Tr. 902; Lee, Tr. 944; Bothfeld, Tr. 1089; Rowe, Tr. 1245; Latta, Tr. 1404; Hollon, Tr. 3775-76.

money every year in the '90s, that there was not a way that we could survive on the amount of money that a cooperative, at that time DFA, was paying us for our milk."¹²⁷

The NMPF proposals seek to limit larger producers' options and little more. But the Department is not authorized to regulate producers.¹²⁸ These proposals would result in the regulation of producers who are also handlers by relying principally on the size of their farms. As Elvin Hollon's testimony made clear, the proponents are more interested in limiting the ability of producers above a certain size to operate a plant than limiting the aggregate impact of producer-handlers.¹²⁹ Virtually the same argument was made by Mr. Hollon—that the size of an individual producer-handler should be determinative—in the hearing that proposed producer-handler limitations in the Appalachian and Southeast Orders in 2004.¹³⁰ That hearing resulted in no decision being reached by the Department.¹³¹

Ultimately, these theories about the existence of larger dairy farms are little more than prospective arguments about what might happen in the future. From the outset, NMPF and IDFA have couched this hearing as one focused on what might happen if producer-handlers are not eliminated. The testimony of NMPF's staff economist, Roger Cryan, virtually mirrors the NMPF request for a hearing. Both are replete with instances of speculation and conjecture:

¹²⁶ Based on the membership chart attached to the testimony of Roger Cryan, NMPF's members include the majority of very large farms.

¹²⁷ Shatto, Tr. 1183, 1200.

¹²⁸ 7 U.S.C. § 608c(13)(B) ("No order issued under this chapter shall be applicable to any producer in his capacity as a producer.").

¹²⁹ Hollon, Tr. 3907-11.

¹³⁰ Testimony of Elvin Hollon in proceeding to limit producer-handlers to 3,000,000 pounds in Appalachian and Southeast Marketing Areas, February 25, 2004, p. 722-25 (testimony online at: <http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRDC5057110> and attached hereto).

- Collectively, they **could capture** a large share of the Class I sales in an individual market or nationally, if many of them adopted this model.¹³²
- Producer-handler provisions **increasingly threaten** orderly marketing.¹³³
- Although several Federal Order markets are **not now substantially disrupted** by the operations of large producer-handlers, it is good policy to establish uniform provisions which address this issue proactively, before such a clearly foreseeable problem develops.¹³⁴
- The market-by-market approach should also be avoided because the larger consideration here is **whether a proliferation of exempt plants is probable** and whether that proliferation **could cause** disorderly marketing, rather than what the impact of an individual handler may be.¹³⁵

The testimony from the various supporters of Proposals 1 and 26 echoed that they are not experiencing any actual problem with producer-handlers, but are looking for a prospective “fix.”

- “Muller and Mid-West are not competing with any producer-handlers today however over the last decade a number of large dairy farms have been built and began operating in our area.”¹³⁶
- “Q. I’m correct in assuming from your speech that you haven’t actually had any

¹³¹ 74 Fed. Reg. 10842 (March 13, 2009).

¹³² Cryan, Tr. 405

¹³³ Cryan Tr., 408.

¹³⁴ Cryan, Tr. 415.

¹³⁵ Cryan, Tr. 421.

¹³⁶ Tonak, Tr. 521.

disruption in your, market from producer-handlers? A. That would be correct.”¹³⁷

- “Q. Your testimony implies to me that there are existing large producer-handlers that currently have a price advantage over your three plants. Is that correct? A. There’s no large producer-handler in our area at this time. What I should have said: Would have. Q. Would have, okay. A. Yes. Q. So this is -- you’re projecting something happening in the future? A. Yes, sir.”¹³⁸
- “In my local area, we don’t have any problems with them at the moment. There’s what I see as a potential threat, that it could happen, and we’re looking at this as a big proactive.”¹³⁹
- “One of my biggest concerns with the Federal Order hearing process is that quite often we hold hearings to fix last year’s problems. At this hearing, we have a chance to address a concern before it becomes a large problem.”¹⁴⁰
- “Based on prior hearing deliberations and the ongoing one here, the issue of producer-handler regulation is a difficult one for the Secretary of Agriculture and the Order system. Order hearings deal with change and there are always divergent opinions with regard to change. In order to deal with the issues raised in this hearing the Secretary will need to act in a proactive way.”¹⁴¹

This Chicken Little argument to regulate producer-handlers is nothing new to NMPF,

¹³⁷ Tonak, Tr. 535.

¹³⁸ Asbury, Tr. 578.

¹³⁹ Newell, Tr. 714.

¹⁴⁰ Lee, Tr. 943.

¹⁴¹ Hollon, Tr. 3789.

DFA, Dean Foods, or the other participants in this hearing that made similar dire predictions about producer-handlers in Orders 5 and 7 over five years ago. Now, just as then, there is no forthcoming wave of producer-handlers, despite what the proponents would suggest. Any potential for producer-handler growth has existed in the market for many years, and the current situation is no different. In the federal order system overall, and in most marketing areas, the number of producer-handlers is actually declining or stagnant. Evidence in the exhibits presented by USDA show a decrease in the number of producer-handlers from 421 in 1967 to 37 in 2009.¹⁴²

And while the volume of milk handled by producer-handlers has increased over time, the percentage of milk handled by producer-handlers is little different now than it has been historically. USDA statistics show that the percentage of Class 1 sales by producer-handlers is 1.3%, the lowest level since 1959, according to the available USDA data.¹⁴³ In fact, the number of producer-handlers relative to the number of producers and number of handlers is decreasing:

It can readily be determined from Table 1 that in 1969 there were 343 producers for every producer-handler; in 2008 there were 1,018 producers for every producer-handler. . . . In 1969 there were producers for every handler. In 2008 there were 143 producers for every handler. In 1969 there were 3.9 handlers for every producer-handler; in 2008 there were 7.1 handlers for every producer-handler. The conclusion I draw from these data is that by every one of these measures, the position of producer-handlers is slipping.¹⁴⁴

¹⁴² Ex. 7-A, Ex. 13.

¹⁴³ Ex. 7-A. Even if 23 million pounds of milk were added to the figures for December 2008 in Exhibit 7-A to account for former producer-handlers in the Pacific Northwest and Arizona marketing areas, the percentage of Class 1 sales by producer-handlers would be 1.9%, the same as it was in 1992 and below the peak level reported in 1969. AIDA does not believe that the modification of producer-handler volumes for Orders 124 and 131 by proponents' counsel, reflected in Exhibits 74 and 74-A, is correct. Neither does AIDA's economic expert, Dr. Knutson, who opined that there was no economically sound or reasonable way to modify the plant volumes actually provided by USDA for meaningful analysis. Knutson, Tr. 3388.

¹⁴⁴ Knutson, Tr. 3075-76.

The most basic economic analysis holds that if being a producer-handler provided a cost advantage over other handlers or other producers, their numbers would be greater and increasing.¹⁴⁵ The fact that the numbers of producer-handlers have not grown underscores the fact that producer-handlers do not have the alleged cost advantage claimed by the Proponents.

C. Producer-Handlers bear the burden of balancing their milk supplies and demands.

The status of producer-handlers has been made clear in prior decisions concerning producer-handler regulations and has nothing to do with administrative convenience, efficiency of operations, retail prices of milk, competition among different handlers to service accounts, the types of accounts that are or can be serviced, or the product lines sold by regulated handlers and producer-handlers. In a decision concerning the former Texas and Southwest Plains Marketing Orders, the Department found that the self-sufficiency of producer-handlers, including their burden of balancing their milk supply, supported the existence of producer-handlers:

. . . [T]he policy has been to exempt such types of operations. Such policy has been based, generally, on findings in regulatory proceedings that producer-handlers have no significant advantage in the market in their capacity as either handlers or producers as long as they are solely responsible for their production and processing facilities and assume essentially the entire burden of balancing their production with their fluid milk requirements.¹⁴⁶

In the decision limiting producer-handlers in the Pacific Northwest and Arizona Marketing Areas, the Department based its decision on the perceived ability of producer-handlers to utilize unregulated areas to shift the burdens of balancing onto pooled producers:

[P]roducer-handlers in both the Pacific Northwest and the Arizona-Las Vegas marketing areas with route disposition of more than 3 million pounds per month enjoy sales of fluid milk products into unregulated areas such as Alaska and

¹⁴⁵ Knutson, Tr. 3387-88.

¹⁴⁶ 54 Fed. Reg. 27179, 27182 (June 28, 1989).

California. These examples contribute to demonstrating a shifting of the burden of balancing their milk production onto the order's pooled producers.¹⁴⁷

The decision in Orders 124 and 131,¹⁴⁸ does not stand for a wholesale departure from prior decisions of the Department but was premised on the unique marketing conditions of those two particular marketing areas.

Under the longstanding "balancing" policy, USDA applied "the principle of self-sufficiency."¹⁴⁹ As USDA explained in 1958, 1974, and 1995:

The economic theory of the 'producer-handler' exemption is that the 'producer-handler' is a self-contained production, processing and distribution unit which does not share its [fluid] milk utilizations with other producers supplying milk to the area, and does not count on the other producers to meet any of its needs (see 23 F.R. 6050, 6050-6053 (1958)) If the 'producer-handler' were permitted to receive milk from other sources, he could produce the exact quantity of milk for which he could find Class I utilizations, and then draw on the pool's surplus milk to meet his peak demands. In such circumstances, he would be 'riding the pool,' i.e., counting on the pool to produce enough surplus milk to take care of his peak needs while not sharing the benefits of his [fluid milk] utilizations with other producers.¹⁵⁰

¹⁴⁷ 70 Fed. Reg. 74166, 74187 (December 14, 2005).

¹⁴⁸ No court or administrative body has ever had the opportunity to review the propriety of the Department's decision related to the Pacific Northwest and Arizona producer-handler regulations. The decision in Arizona was pre-empted by the terms of the Milk Regulatory Equity Act, and the legal challenge to the provisions in the Pacific Northwest was determined without reaching the merits of the producer-handlers' challenge. See 7 U.S.C. § 608c(5)(M)-(O), and Edaleen Dairy, LLC v. Johanns, 467 F.3d 778 (D.C. Cir. 2006). The arguments in this brief related to the imposition of compensatory payments and the authority of the Department to impose regulations where no purchase of milk occurs. And the authority to regulate producer-handlers, at all, have not been judicially determined.

¹⁴⁹ In re Kreider Dairy Farms, Inc., 54 Agric. Dec. 805, 1995 WL 598331 at *32 (USDA 1995).

¹⁵⁰ In re: Mil-Key Farm, Inc., 54 Agric. Dec. 26, 1995 WL 321502 *5 (USDA 1995), quoting In re Yasgur Farms, Inc., 33 Agric. Dec. 389, 403-404 (USDA 1974).

The factors traditionally considered by USDA in this “balancing” analysis are whether the producer-distributor bears the entire risk and cost of the production of milk, the operation of the processing plant, the marketing and sale of milk, and the disposal of any milk that is surplus to its needs.¹⁵¹

The evidence at the hearing demonstrates that producer-handlers bear the burden of disposing of all their surplus milk whether by manufacturing other products, utilizing surplus on the farm, or selling surpluses at substantial losses.¹⁵² Bulk sales at less than classified prices are a fact of life for producer-handlers.¹⁵³ Producer-handlers selling surplus milk are price takers.¹⁵⁴ For one of the producer-handler witnesses with 20% Class IV utilization, the impact of bulk milk sales is \$2.20 per hundredweight on all milk—not just the bulk milk volumes.¹⁵⁵ Impacts of such a magnitude only add to the costs of the producer-handler operation. Not only do they bear a cost of production in excess of the federal minimum prices, but because they are not guaranteed the federal minimum prices on milk not processed, they incur additional disadvantages.

¹⁵¹ See Kreider Farms, 1995 WL 598331 at *27, quoting 23 Fed. Reg. at 6052 (the producer-handler exemption provides “full exemption from regulation for handlers who depend entirely on their own production as a source of supply and who do not burden the pool with any surplus or excess milk . . .”).

¹⁵² Some witnesses suggested that unless a producer-handler supplies a full line of Class I products to its customers, it has somehow shifted its burden of balancing. But this illogical argument ignores the fact that under the regulations now in existence, the producer-handler must bear all balancing costs. The fact that customers have choice in where they can purchase milk, or that not all handlers produce all Class I products is not an element of balancing as USDA has characterized the burden in prior decisions.

¹⁵³ Hatch, Tr. 254 ; Gibson, Tr. 630; Gilbert, Tr. 2462; Flanagan, Tr. 2565; Keefe, Tr. 2910; Kreider, Tr. 2633; Button, Tr. 3602.

¹⁵⁴ Keefe, Tr. 2931 (Aurora receives the Class IV price less expenses).

¹⁵⁵ Flanagan, Tr. 2565.

Dr. Knutson reported that, on average, the AIDA members sold 13% of their milk supplies in balancing sales.¹⁵⁶ But this does not take into account all non-Class I uses. For instance, Aurora Organic Dairy produces butter and powder, and Braum's Dairy fortifies its lower fat milk with additional milk by removing water through a vacuum evaporation process and also produces ice cream products, cottage cheese, and yogurts.¹⁵⁷ The non-Class I volumes of Kreider Farms are as high as 36%¹⁵⁸ and 50% for Heartland Dairy.¹⁵⁹

On the other side of the ledger, when demands of customers exceed the available milk, the producer-handler is faced with the difficult decision to decline additional business. The balancing requirement imposes an effective limit on the growth of producer-handlers. If the operation must balance too much of its milk supply, it will not be profitable.¹⁶⁰ If it runs its fluid sales too close to its production, it would disappoint customers. And when the operation cannot any longer support its customer base from its own farms, it transitions to a regulated handler, buying milk from other producers.

The costs of balancing are so great that they function as a real world deterrent to adopting producer-handler status.¹⁶¹ Only when the integrated producer-handler can sufficiently manage its balancing requirements does producer-handler status become a viable option. Until that point, the value-added producer relies on, and pays for, the balancing services of the regulated pool.

¹⁵⁶ Knutson, Tr. 3080.

¹⁵⁷ Keefe, Tr. 2909; Bostwick, Tr. 2851.

¹⁵⁸ Kreider, Tr. 2672.

¹⁵⁹ Button, Tr. 3637.

¹⁶⁰ Sharpe, Tr. 3639.

¹⁶¹ Dakin, Tr. 881-82; Docheff, Tr. 2592-93; Taylor, Tr. 3570.

D. Producer-Handlers have increased in size commensurately with the size of handlers and producers, and have not grown relative to the overall consolidation in the industry.

NMPF argues that the drafters of the AMAA never contemplated in 1937 that producer-handlers would reach the size seen in 2009. The argument is a red herring and draws a comparison between two industries separated by 72 years of technological progress and development. In 1937, there was no contemplation that any milk would service a market other than its close-in customers—whether a producer-handler or otherwise. Milk simply could not move to broader geographic areas. It was not that producer-handlers would be assumed to service exclusively small, local markets while other handlers would have a larger reach. Every handler was assumed to service exclusively small, local markets. Farms were decidedly smaller than today, as were both cooperatives and handlers. The notion that a single cooperative, let alone several cooperatives, would have a nationwide reach was unfathomable. The concept of a nationwide handler possessing over \$12 billion in sales was unknown. The formation of a cooperative of cooperatives to export milk powder to China using a marketing agent based in New Zealand was an unimaginable concept.

Much has changed in the overall dairy industry, including the absolute size of producer-handlers. But the relative size of producer-handlers remains unchanged. Producer-handlers have always been larger than the average producer.¹⁶² And the average fluid handler has always been significantly larger than the average producer-handler.¹⁶³ And the share of the fluid market serviced by producer-handlers has declined dramatically from what was described in the 1952

¹⁶² Ex. 7-A.

¹⁶³ Ex. 7-A.

report on Depression-era milk markets.¹⁶⁴ In fact, over the limited time period for which USDA has been able to produce meaningful data, the share of fluid sales by producer-handlers has stayed within a narrow range and is virtually unchanged since 1959 and is currently only 1.3% of all Class I sales.

E. The reasoning for adoption of producer-handler regulations under the former Agricultural Adjustment Act is irrelevant to the current dairy industry.

NMPF relies on an isolated section from a 1952 recitation of the conditions of the Kansas City milk market in the 1930's to "prove" that the status of producer-handlers in all marketing areas in 2009 is a carry-over for the sake of administrative convenience.¹⁶⁵ This "fact" reappears in the testimony of other witnesses who urge the Secretary to act on this basis alone. Unfortunately, the Department has no statistical data available to document the actual role of producer-handlers during the origin of the AMAA, nor does it have any contemporaneous documents to provide a nationwide context to the Kansas City situation or describe how that situation played into the nationwide adoption of producer-handler status.

Two things can be said with certainty about producer-handlers in the 1930's Kansas City market. First, their opposition, as described in the cited report, was to the licensing scheme authorized by the Agricultural Adjustment Act, not to the AMAA, under which the federal milk marketing orders are based.¹⁶⁶ The Agricultural Adjustment Act was ruled unconstitutional, and

¹⁶⁴ Compare "Early Development of Milk Marketing Orders" with Ex. 7-A (demonstrating markets with 50% of milk processed by producer-handlers and current producer-handler sales of 1.3% of all Class I sales).

¹⁶⁵ Cryan, Tr. 401.

¹⁶⁶ "Early Development of Milk Marketing Plans in the Kansas City, Missouri Area" pgs. 35-41.

its licensing scheme for milk handlers differed from the milk marketing orders.¹⁶⁷ Accordingly, any decision to exempt producer-handlers from the licensing requirements under a different predecessor statute does not provide real context to the rationale for the producer-handler status in place under the AMAA. Second, the 1952 report recites the bases for the opposition of producer-handlers to the licensing requirements of the Agricultural Adjustment Act. They are, almost entirely, the same rationale that the Secretary has long adopted for the continuance of producer-handler status under the self-sufficiency rationale discussed earlier:

The major point of dissatisfaction with the license, on the part of producer-distributors, stemmed from their economic position in the market. Almost all of them operated dairy farms which were located close to the city. These farms were in most cases substantially larger than those owned by producers shipping to pasteurizing distributors. Most of the producer-distributors had long followed the practice of controlling their production to keep their supplies of milk in a close relationship to the needs of their customers at all times of the year. This practice was an essential factor in their ability to survive as milk distributors in competition with the large pasteurizing distributor. The producer-distributor considered that problems of seasonal production and seasonal surpluses were not their problems and they did not see why they should be compelled to pay a toll, through the equalization pool, to subsidize producers who supplied the pasteurizing distributors.¹⁶⁸

The position explicitly stated by Elvin Hollon and implicitly adopted by NMPF and IDFA that a producer-handler presence is *per se* disruptive to the marketplace cannot be accepted. The mere fact that producer-handlers have been a part of the federal milk marketing order system since its inception, at times accounting for half of the handlers and fluid milk sales, mandates that such a fanciful notion be rejected. Regardless of the reasons for the origin of the producer-handler status, accepting Hollon's argument that their presence is in and of itself disruptive to the orderly marketing of milk suggests that the Department has tolerated a

¹⁶⁷ See Zuber v. Allen, 396 U.S. 168, 174-178 (1969).

¹⁶⁸ "Early Development of Milk Marketing Plans in the Kansas City, Missouri Area," p. 36.

nationwide disorderly milk market for over 70 years.

Q. And how long have producer-handlers been exempt under the Act?

A. Since the beginning.

Q. Does that mean that the market has been disorderly in Order 1 since the beginning?

A. It means that now there are changes in the marketplace that we think require a hearing, or we request a hearing for the Secretary to consider them.

Q. And what are the changes in Order 1 that require any attention?

A. First of all, there are larger producer-handlers. There are -- they do not pay into the pool, they have a competitive factor in the marketplace. And we also think this is an issue that should be dealt with on a nationwide basis.

Q. Hasn't that been the situation in Order Number 1 for 70 years?

A. It has.¹⁶⁹

Obviously, the Department would not have sanctioned market disorder for 70 years. What was not market disruption for seven decades or more cannot be transformed into market disruption by "whim . . . or [in] response to the influence of major farm interests."¹⁷⁰ This absurd notion that producer-handlers have been disruptive since the inception of the AMAA is refuted not only by force of logic, but by decisions from the Department stretching back over decades, in which it was held that producer-handlers are not disruptive as long as they remain self-sufficient.

F. The lack of pool participation by producer-handlers provides no justification for the adoption of Proposals 1 and 26.

It is a truism that if producer-handlers do not make pool payments, the blend price to producers differs from what it would be if such payments were made. The fact that blend prices

¹⁶⁹ Hollon, Tr. 3946-47.

¹⁷⁰ Fairmont Foods, 442 F.2d at 766.

are different but for the lack of a pool payment by producer-handlers does not speak to market disorder, especially because the producer-handler's costs of milk exceeds that of regulated handlers. The non-pooling of milk by producer-handlers is nothing new, nor does it meet the statutory definition of disorderly marketing, especially in light of the Department's self-sufficiency standard.

And in any event, producer mailbox prices are affected by a litany of factors such as the amount of milk that is eligible to be pooled, the buying habits of consumers, and the opportunistic depooling of milk by cooperatives and manufacturers, which has an impact on the blend price on an annual basis far greater than any impact of producer-handlers. In fact, even the highest estimates of blend price impact by producer-handlers do not rise to a level of significance. The impact on the blend price of the national promotion program, which USDA is responsible for administering, reduces producer incomes by \$0.15 per hundredweight, which USDA recently characterized as "relatively small when compared to producer revenue."¹⁷¹ Similarly, opportunistic depooling reduces producer revenue by as much as 41 cents per month, based on the limited unrestricted data that USDA was able to provide.¹⁷² In fact, the average impact of depooling in the Central Order during 2008 was far greater than the average impact of all producer-handler activities in the Order.¹⁷³ And this was after USDA had implemented regulatory changes to ensure that any depooling of milk in the Central Order would not be disorderly. The aggregate impact of all producer-handlers was estimated by one of AIDA's

¹⁷¹ 74 Fed. Reg. 23349, (May 19, 2009).

¹⁷² Ex. 59, p. 4.

¹⁷³ Compare Ex. 59, p. 4 (average impact of \$0.113 per month) and Ex. 56 (average impact of \$0.058 per month).

economists at one to two cents per hundredweight.¹⁷⁴

These myriad price impacts, coupled with variations of magnitudes multiple times greater than the impact of producer-handler activity are inherent in milk markets and thus cannot be evidence of disorderly marketing.¹⁷⁵ Therefore, any suggestion that impact on blend price is per se evidence of disorderly marketing simply cannot be supported based on the record of this proceeding.

In the decision applying a limitation on producer-handlers in the Pacific Northwest and Arizona marketing areas, USDA devised a new test, under which “the absence of equity among producers and handlers . . . should be deemed to” constitute disorderly marketing conditions.¹⁷⁶ But absolute price equality among producers is not a requirement of the AMAA, not a reality in the marketplace, nor is it a measure for determining whether disorderly marketing conditions exist.¹⁷⁷

Numerous factors affect the prices that dairy farms receive independent of the composition and quality of their milk. As Dr. Knoblauch explained, “There is also a \$2.00 spread in what we call the Net Marketing Margin, which takes the Producer Price Differential

¹⁷⁴ Knoblauch, Tr. 3026.

¹⁷⁵ See Cumberland Farms v. Lyng, 1989 WL 52697 (D.N.J. May 15, 1989) (holding that amending a market order to add 2% to the order’s Class I volumes is “too small to support a change in regulation”) and compare with the 1.3% of the Class I volumes serviced by producer-handlers, Ex. 7A).

¹⁷⁶ 70 Fed. Reg. at 74185.

¹⁷⁷ Knoblauch, Tr. 3024 (the concept that dairy farmers delivering milk to pool handlers receive uniform prices, even after taking into account components and location differentials, is not reality); See also Rowe, Tr.1267-68 (describing that Northwest Dairy Association, which controls 90% of the milk in Washington, depools milk to the advantage of its producers, and to the detriment of other producers and Class I plants).

plus all premiums minus all expenses (including hauling).”¹⁷⁸ He later explained that identical producers receive different prices due to unexplained actions of cooperative intermediaries:

Q. And based on the data that you’ve seen and you worked with Dr. Stephenson in these studies, after you strip out variations in the butterfat and the protein and the other solids, the somatic cell count and the producer price differential, you strip all that out, are those producers in reality receiving a uniform price for their milk?

[Objection from Mr. Beshore overruled.]

DR. KNOBLAUCH: Those two producers are hypothetical. In reality, if that makes sense, the answer is no. I have received many phone calls from farmers that get the copies of their data sent back and the comparison to the three closest neighbors, and when they start comparing it on the basis that you’re talking about, they’re rather irate, first with us, and then with who they’re selling their milk to, because they’re not getting the same prices.¹⁷⁹

Dr. Knutson also explained that producer income does not correlate to blend prices, and the concept of producer price equality is a mere statistical measure. Part of what impacts the income ultimately received by individual farmers are the give-up charges,¹⁸⁰ over-order premiums,¹⁸¹ and gains from depooling¹⁸² that various cooperatives receive. These payments inure to the benefit of those members of the benefitting cooperative, but not to other producers.

Furthermore, producer-handlers are not “producers” under the terms of any marketing order. Under the federal milk marketing orders, “farmers” are not synonymous with “producers.” To be considered a “producer” certain regulatory requirements must be met, most

¹⁷⁸ Knoblauch, Tr. 3025-26.

¹⁷⁹ Knoblauch, Tr. 3415-18.

¹⁸⁰ Knutson, Tr. 3062-63.

¹⁸¹ Id.

¹⁸² Knutson, Tr. 3091.

notably delivering milk to a pool plant.¹⁸³ Farmers not delivering to a pool plant are not producers. The Secretary is under no obligation and, in fact, has no authority to create equity among “producers” in a marketing order and other dairy farmers who are not “producers.” The orders affirmatively exclude producer-handlers from the definition of “producer.”¹⁸⁴ Accordingly, even if there was a mandate for absolute equality among all “producers.” There is no basis for comparing the returns of producer with those of producer-handlers, who are by regulatory definition not producers.

Furthermore, an impact of pennies per hundredweight of milk, in a regulatory scheme where the Class I base craters from \$20.78 in July 2008 to \$9.43 in March 2009 is not disruptive.¹⁸⁵

In fact, USDA acknowledged that as to the impact on the blend price by exempting milk from the pool, “this has always been the case.”¹⁸⁶ USDA has repeatedly found that this pricing factor was counterbalanced by the greater degree of risk that producer-handlers bear in assuming full responsibility for production, processing and distribution. And the cross-examination of Elvin Hollon establishes that it is not the blend price impact that the proponents are concerned about, but about eliminating competitive factors in the market, which is not a permissible factor to be considered in formulating marketing orders.

¹⁸³ See e.g. 7 C.F.R. § 1001.12(a).

¹⁸⁴ See e.g. 7 C.F.R. § 1001.12(b)(1).

¹⁸⁵ See Cumberland Farms, 1989 WL 52697 (D.N.J. May 15, 1989); Fairmont Foods Co. v. Hardin, 442 F.2d 762, 770-71 (D.C. Cir. 1971).

¹⁸⁶ 70 Fed. Reg. 74186 (December 14, 2005).

Nor may the Secretary impose regulations in excess of the defined provisions of the AMAA, which are each premised on the existence of an arms-length sale between a producer and a handler and the purchase of milk.

VI. Congress Has Not Authorized USDA To Regulate Producer-Handlers

A. The Secretary's authority under the AMAA is limited to the regulation of handlers who purchase milk from producers.

Under the AMAA, the Secretary is authorized to apply milk marketing orders only when milk is "purchased" by a handler:

In the case of milk and its products, orders issued pursuant to this section shall contain one or more of the following terms and conditions and . . . no others: . . . Classifying milk in accordance with the form in which or the purpose for which it is used, and fixing . . . minimum prices for each such use classification which all handlers shall pay . . . for milk purchased from producers or associations of producers.¹⁸⁷

No such purchase occurs within an integrated producer-handler entity.

The sole point of application for the FMMO regulatory scheme is a purchase of milk by a handler from a producer. The word "purchase" is defined as to obtain something, "in exchange for paying money or its equivalent; [to] buy."¹⁸⁸ For a producer-handler there is no transfer of ownership and no payment of money within the enterprise. Producer-handlers do not "purchase" their own product, they produce it.¹⁸⁹ There is no basis on which producer-handler own-farm milk may be subjected to the requirements of the Order.

The totality of the language in Section 608c(5) confirms that the Department's authority is tied to the occurrence of a "purchase" by a handler and a transfer for value from one entity to another:

¹⁸⁷ 7 U.S.C. § 608c(5)(emphasis added).

¹⁸⁸ American Heritage Dictionary of the English Language, p. 1061 (1969).

¹⁸⁹ Gibson, Tr. 640.

- Section 608c(5)(B) authorizes USDA to provide for uniform payments to all producers delivering milk to handlers, regardless of the actual uses made of that milk by the handler, subject to adjustment “to encourage seasonal adjustments in the production of milk through equitable apportionment of the total value of milk purchased by any handler, or all handlers, among producers on the basis of their marketings of milk . . . and . . . a further adjustment, equitably to apportion the total value of milk purchased by any handler, or by all handlers, among producers on the basis of the milk components contained in their marketings of milk.”
- Section 608c(5)(C) authorizes USDA to provide “a method for making adjustments in payments, as among handlers (including producers who are also handlers), to the end that the total sums paid by each handlers shall equal the value of the milk purchased by him at the prices fixed in accordance with paragraph (A) of this subsection.”
- Section 608c(5)(D) provides for determination of the price to be paid for “all milk purchased by handlers from any producer who did not regularly sell milk” during the prior 30 days.
- Section 608c(5)(E) provides for the assurance of, and security for, “the payment by handlers for milk purchased.” (Emphasis added).

In each part of Section 608c(5), the operation of the provision is expressly tied to a “purchase.” The introductory language of Section 608c(5) makes clear that a FMMO may contain no other provisions other than those authorized by these Subsections. The explicit language of the statute thus demonstrates that Congress’ use of the term “purchased” in Section 608c(5)(A) was not inadvertent, but rather was a deliberate manifestation of its decision to make the application of federal price controls depend upon the occurrence of a “purchase.”

Further, the Department may, “fix minimum prices to be paid to producers or modify [such prices.]”¹⁹⁰ The ordinary meaning of “price[]” is “the sum of money or goods asked or given for something” or “the cost at which something is obtained.”¹⁹¹ Further, the statutory text reinforces the ordinary meaning of “price” by providing that section 608c(18) applies to all terms that, “fix minimum prices to be paid to producers.” This further supports the conclusion that Congress intended that there be an arms-length transaction between separate and distinct entities for the transfer of milk. It is undisputed that there is no money actually paid and therefore no purchase consummated by an integrated producer-handler. To find otherwise would be to ignore the critical statutory language of the AMAA.

There were many different ways that Congress could have established the FMMO system. Congress could have directed that the producers of all fluid milk sold within a marketing area would receive the same price for their product, regardless of whether they sold milk directly to customers or sold milk to a middle man such as a handler. Congress also might have elected to give USDA authority to limit the total quantity of milk produced, as it did for other covered agricultural products in 7 U.S.C. § 608c(6).

Congress, however, chose a different approach. It decided to authorize USDA to impose price controls only upon milk “purchased” by a handler from a producer. At the time Congress enacted the AMAA, it was well understood that producer-handlers who did not sell their milk to middlemen, but sold directly to customers, were important participants in many markets.¹⁹² Congress nonetheless decided to establish a system in which the pricing and pooling regulations

¹⁹⁰ 7 U.S.C. § 608c(18).

¹⁹¹ American Heritage Dictionary of the English Language, p.1038 (1969).

¹⁹² See, e.g., “Early Development of Milk Marketing Plans in the Kansas City, Missouri Area,” Marketing Research Report No. 14 (USDA May 1952), Official Notice taken, Tr. 455.

would apply only to transactions in which a handler “purchased” milk from a producer. Thus, under the plain language of the AMAA, there is no jurisdictional predicate for the application of the pricing and pooling requirements for milk produced by an integrated producer-handler that sells only milk that is produced by its own cows.

1. Caselaw Does Not Support the Regulation of Producer-Handlers.

*United States v. Rock Royal Co-operative, Inc.*¹⁹³ does not hold that the Secretary has authority to regulate producer-handlers. *Rock Royal* considered whether the AMAA created a difference in treatment between “sale” cooperatives, which technically purchased milk from their producer-members before reselling it, and “agent” cooperatives, in which title technically did not pass to the cooperative before sale.¹⁹⁴ Applying Section 608c(5)(F) which explicitly defined the treatment of milk cooperatives, the Court held that Congress had not differentiated between the two types of cooperatives and that both were required to comply with the pooling provisions of a FMMO. It was in this context that the Supreme Court stated that “[a]s here used” – that is, in the context of an agency cooperative – “the word ‘purchased’ means ‘acquired for marketing.’”¹⁹⁵ This resolution of the subsidiary “cooperative” aspect of the case does not support an interpretation reading the word “purchased” out of the AMAA in other contexts.

In any event, even if “purchased” could be interpreted to mean “acquired for marketing” in other contexts, milk produced by producer-handler dairies would not be covered, because it is not “acquired” from any other entity. The “agent” cooperatives involved in Rock Royal obtained their milk from one entity – a producer member – and caused its sale and delivery to another

¹⁹³ 307 U.S. 533 (1939).

¹⁹⁴ 307 U.S. 579-80.

¹⁹⁵ *Id.* at 580.

entity, the processor, and shared in the revenue. No such “acquisition” or transfer occurs in the case of a producer-handler.

In reality, Rock Royal dealt with a device to avoid the pooling requirement. If the producers who were members of the cooperative had sold their milk directly to the handler, the handler would have had to account to the pool. The Court simply held that the result must be the same if the producers inserted between themselves and the handlers an agent that shared in the revenue flows from the sale. No such avoidance device is involved in the case of an integrated producer-handler.

2. Two appeals cases in particular, addressed the instance of producers who were also handlers, but were not producer-handlers who utilized only their own farm production.

In Freeman v. Vance,¹⁹⁶ the Fifth Circuit held that an entity that produced some, but not all, of its own milk was subject to the pricing and pooling requirements of a FMMO, based on the Third Circuit decision in Ideal Farms, Inc. v. Benson.¹⁹⁷ The decisions in both *Vance* and *Ideal Farms* demonstrate that the entities involved in those cases purchased and marketed substantial quantities of milk from third parties. Thus, those decisions do not support the regulation of a producer-handler, as the term is used in today’s regulatory context.

In Vance, USDA amended the Central Mississippi FMMO to define “producer-handler” as an entity that “received no other source milk (except own production)”¹⁹⁸ The decision was challenged by entities that produced some of their own milk but also purchased “a relatively large volume of milk from pool plants [separately owned handlers] for processing and sale as

¹⁹⁶ Freeman v. Vance, 319 F.2d 841 (5th Cir. 1963).

¹⁹⁷ Ideal Farms v. Benson, 288 F.2d 608 (3rd Cir. 1961), cert. denied, 372 U.S. 965 (1963).

¹⁹⁸ In re L.B. Vance, 18 Agric. Dec. 563, 567 (USDA 1959).

well as producing milk.”¹⁹⁹ The district court invalidated the agency action. The Fifth Circuit reversed in a brief opinion that simply noted its agreement “with the reasoning and conclusion of the Third Circuit [in Ideal Farms].”²⁰⁰

In Ideal Farms, USDA was found to have authority to refuse a handler with both own-farm production and purchases from pool sources “to exempt . . . own-produced milk in the calculation of [] net pool obligations.”²⁰¹ Thus, the decisions in Ideal Farms and Freeman applying Section 608c(5) are distinguishable from the situation presented by a fully integrated producer-handler. Those decisions represent reasonable applications of the provision in Section 608c(5)(C) concerning the pricing of milk for “producers who are also handlers” to reflect “the value of the milk purchased by him,” but do not address the issue of how that Section applies to true producer-handlers.

The opinion in Ideal Farms contains dicta regarding the scope of USDA’s regulatory authority. This aspect of the discussion is exactly that – dicta – as the Third Circuit itself has recognized. In United States v. United Dairy Farmers Cooperative Ass’n, the Court stated, “This Court long ago held that producers who also function as handlers, even those who deal partially in milk produced at their own facilities, are subject to regulation under [the AMAA].”²⁰²

¹⁹⁹ Id.

²⁰⁰ 319 F.2d at 842.

²⁰¹ Ideal Farms, Inc. v. Benson, 181 F. Supp. 62, 73 (D.N.J. 1960). The two plaintiffs that produced some of their own milk were: (1) Ideal Farms, which “does handle and sell milk produced on farms which it rents, and also buys milk from other milk plants”; and (2) Franklin Lakes, which owned a plant “where it collects milk from dairy farms owned by others, together with milk produced on its own farms, and thereafter sells to other handlers.” 181 F. Supp. at 64.

²⁰² United States v. United Dairy Farmers Cooperative Ass’n, 611 F.2d 488, 491 n.7 (3rd Cir. 1979) (emphasis added).

United Dairy Farmers thus confirms that the decision in Ideal Farms is limited to the regulatory status of entities that process and sell their own milk in combination with milk produced by other parties.²⁰³

In relying on the Third Circuit's decision, the Fifth Circuit in Vance adopted its holding, not its dicta. Thus, Ideal Farms has no bearing on the question of USDA's authority to regulate a producer-handler that sells only its own milk.

B. Repeated Congressional statements, culminating in the Milk Regulatory Equity Act, affirmatively instructed the Secretary that the regulatory status of producer-handlers may not be changed.

Because the producer-handler is a single operation, any regulations that limit the ability of the producer-handler to produce additional quantities of milk will necessarily affect the producer-handler in its capacity as a producer. Congress has repeatedly expressed that the ability of the producer to produce milk shall not be regulated.²⁰⁴ To assess a producer-handler on its own farm production will necessarily regulate the operation of its farm. To do so violates the AMAA's prohibition on marketing orders that regulate producers.

²⁰³ The dicta in Ideal Farms suggested that USDA could ignore the literal meaning of "purchased" and read this term to mean "acquired for marketing" in all situations, based on Elm Spring Farm v. United States, 127 F.2d 920 (1st Cir. 1942), and Shawangunk Cooperative Dairies v. Jones, 153 F.2d 700 (2d Cir. 1946). In each case, the entity involved was a milk marketing cooperative, which was subject to the pooling requirements under the part of Rock Royal that dealt with cooperatives. For the reasons set forth in the discussion of Rock Royal, those decisions have no bearing on the regulatory treatment of Sarah Farms.

See also, Chevron U.S.A., Inc. v. National Resources Defense Council, Inc., 467 U.S. 837 (1984), where the Supreme Court established that federal courts must apply the literal language actually adopted by Congress and may not depart from that language in pursuit of their own notion of the appropriate policy.

²⁰⁴ See 7 U.S.C. § 608c(13)(B) ("No order issued under this Chapter shall be applicable to any producer in his capacity as a producer.").

In seven laws enacted beginning in 1965 that amended or reauthorized the AMAA, Congress repeatedly and explicitly provided that the “legal status” of producer-handlers “shall be the same” after enactment of the law as it had been previously.²⁰⁵

In 1996, Congress directed the Secretary to undertake a major revision of the FMMOs.²⁰⁶ The statute expressly directed the Secretary to establish the new principles through an informal rulemaking. This was a significant development because, prior to passage of this statute, the rules governing FMMOs had been established in formal rulemakings, where the agency’s ability to establish policy was limited by the facts submitted by the parties. The FAIR process thus afforded the Secretary an opportunity to exercise his own policy judgment as to the appropriate content of FMMOs.

In the course of order reform, USDA was asked to abolish or severely limit the longstanding exemption of producer-handlers from the pricing and pooling provisions. The Secretary rejected that proposal on the ground that Congress had manifested its intention that

²⁰⁵ The first law in this series, Section 104 of the Food and Agriculture Act of 1965, Pub. L. No. 89-321, 79 Stat. 1187, § 104, (Nov. 3, 1965), as amended by Pub. L. No. 90-559, § 1(3), 82 Stat. 996 (Oct. 11, 1968), provided:

The legal status of producer handlers of milk under provisions of the Agricultural Adjustment Act, as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended, shall be the same subsequent to the adoption of the amendments made by this title as it was prior thereto.

Similar provisions were enacted in 1970 (Pub. L. No. 91-524, § 201(b), 84 Stat. 1358 (Nov. 30, 1970)); 1973 (Pub. L. No. 93-86, 87 Stat. 221 (Aug. 10, 1973)); 1977 (Pub. L. No. 95-113, § 202, 91 Stat. 913 (Sept. 29, 1977)); 1981 (Pub. L. No. 97-98, § 102, 95 Stat. 1213 (Dec. 22, 1981)); 1985 (Pub. L. No. 99-198, § 134, 99 Stat. 1354 (Dec. 23, 1985)); and 1990 (Pub. L. No. 101-624, § 115, 104 Stat. 3359 (Nov. 28, 1990)).

²⁰⁶ Federal Agriculture Improvement and Reform Act of 1996 (“FAIR”), 7 U.S.C. § 7253(a) (Supp. 1999).

producer-handlers must remain exempt:²⁰⁷

Public comments were received regarding the extent of regulation that should apply to producer-handlers. The majority of public comments supported the status-quo regarding the regulatory treatment of producer-handlers, emphasizing that they should remain exempt from regulation in accordance with current order provisions and that the provisions should be regional in nature so as not to affect or change the current regulatory status of producer-handlers.

One of the public comments received proposed that the exemption of producer-handlers from the regulatory plan of milk orders be eliminated. **This proposal is denied.** In the legislative actions taken by the Congress to amend the AMAA since 1965, the legislation has consistently and specifically exempted producer-handlers from regulation. The 1996 Farm Bill, unlike previous legislation, did not amend the AMAA and was silent on continuing to preserve the exemption of producer-handlers from regulation. However, past legislative history is replete with the specific intent of Congress to exempt producer-handlers from regulation. If it had been the intent of Congress to remove the exemption, Congress would likely have spoken directly to the issue rather than through omission of language that had, for over 30 years, specifically addressed the regulatory treatment of producer-handlers.²⁰⁸

The only Congressional statement on producer-handlers since the Department's correct assessment in 1999 came in the form of the Milk Regulatory Equity Act of 2005. That statute enacted a cap on the size of producer-handlers in the Arizona marketing area only. Importantly,

²⁰⁷ In the Final Rule concerning the Pacific Northwest and Arizona marketing areas, however, USDA changed its legal interpretation that producer-handlers are exempt without mentioning its prior, contrary construction of the statutes. "[A]n agency must cogently explain why it has exercised its discretion in a given manner." Motor Vehicle Mfrs. Assn. of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 48-49 (1983). USDA did not acknowledge its prior legal interpretation, nor try to explain why it had changed its construction of the law. This "unexplained inconsistency" in the agency interpretation of the law on which its action is based makes the Final Rule arbitrary and capricious. See National Cable & Telecomm. Ass'n v. Brand X Internet Services, 545 U.S. 967, 981(2005) ("Unexplained inconsistency is . . . a reason for holding an interpretation to be an arbitrary and capricious change from agency practices under the Administrative Procedure Act.") Since no Court has reviewed the Department's failure to explain its policy departure, it is incumbent on the Department to explain its reasoning for departing from its 1999 position should it elect to change any of the producer-handler regulations.

²⁰⁸ 64 Fed. Reg. 16135 (April 2, 1999) (emphasis added).

it contained a “Rule of Construction” that made it clear to the Secretary that his authority with respect to all other marketing areas was not altered by the MREA.²⁰⁹ Accordingly, it necessarily follows that if the Secretary did not have authority to change producer-handler regulations in 1999 based on Congressional instruction and Congress has not altered those instructions for any marketing area save Arizona, no restriction or change to the status of producer-handlers may result from this proceeding.²¹⁰ In fact, Rep. Frank Lucas of Oklahoma, the ranking member of the House Agriculture Committee submitted a letter to the Secretary making this exact point that restricting producer-handlers would be contrary to the intent of Congress.²¹¹

VII. USDA Policy Should Support Producer-Handlers as A Vital Economic Organizational Model

A. The Option of Becoming a Producer-Handler Benefits Consumers and Producers.

Cooperative consolidation has left most, if not all, marketing areas with one dominant cooperative or marketing agency.²¹² Today, a producer who is mistreated by the dominant cooperative in his marketplace has limited recourse. The choices available to milk producers are vanishing. Likewise, a milk handler has limited options for sourcing its milk supply. With one cooperative, as is the case in Colorado and Arizona, or a marketing agency in common, as is the

²⁰⁹ 7 U.S.C. § 608c(5)(O) (“Subparagraphs (M) and (N) shall not be construed as affecting, expanding, or contracting the treatment of producer-handlers under this subsection except as provided in such subparagraphs.”)

²¹⁰ The MREA is currently being challenged by Hein and Ellen Hettinga and GH Dairy as an unconstitutional act.

²¹¹ Letter from Rep. Lucas to Secretary Vilsack dated March 26, 2009; posted to the USDA website for this hearing, <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELPRDC5076248>.

²¹² Docheff, Tr. 2593; Rowe, Tr. 1266; Hollon, Tr. 860; Shatto, Tr.1183; Sharpe, Tr. 3600; Traweek, Tr.751-52.

case in orders 126, 5, and 7, a plant must source its milk supply from the monopoly or be left without an option.

One option that has always been available to the producer, and remains an option today, is for that farmer to bottle his own product and take on the significant risk of farming and marketing. Proposals 1 and 26 remove this last check on the power of a cooperative, including a cooperative that the producer may consider corrupt, unresponsive, or unable to meet the producer's needs.

Despite the availability of the producer-handler option, it is one fraught with risks. The testimony from two witnesses, one a long-standing producer-handler and the other a new entrant encapsulate the entrepreneurial risk involved:

HOWARD HATCH: I saw a lot of combat, but one of the decisions that I feel I made in my life was one night on guard duty, I kind of made a vow to myself. If I got back alive, I want to try farming myself. So I don't look at Vietnam as a total loss to me. I had issues to deal with since I came back. And to cope with those, I put a hundred percent into my farming. I don't actually have a savings account. When I got back, I started milking six cows by hand. I had enough money to buy six old scrub cows, milked them by hand and shipped the milk in a neighbor's tank. Always had to stay busy. If I could stay busy, the issue of Vietnam didn't -- didn't really bother me.

* * *

But I shipped out milk for about 20 years, what I felt a quality product. And I never got paid what I figured it was worth. I always had to do supplemental work to keep the farming going. I either did custom work, or for 20 years we had a sawdust business, hauling bedding for other farmers to -- starting with nothing and wanting things faster. And I carried quite -- my debt was pretty heavy. You have heavy debt to pay the bills, you do what it takes to keep going. But after doing this for 20, 22 years, I felt if I was ever going to get a quality product that I put in a bulk tank, I can't get any more for it, I'd have to try to do it on my own.²¹³

WARREN TAYLOR: For the last two years I've worked 100 hours a week, and I can count the days I've had off on the fingers of one hand. And when I received

²¹³ Hatch, Tr. 247-48, 249-50.

the letter from the Federal Milk Market Order Administrator in February explaining what was coming in these proposals, it was extremely daunting. And the amount of time, effort, and money that's been involved in defending my right to continue doing what the law said I could do when I put my million dollars on the line has nearly broken me and our business.²¹⁴

The producer-handlers place the entirety of their personal and professional assets at risk in exchange for a chance at success and the opportunity to provide customers with different and better products. The continued development of innovative and differentiated products is placed at risk by Proposals 1 and 26 as much as the businesses that produce them.

The record reveals that producer-handlers are leaders in providing innovative products to the market. In the instance of Aurora Organic Dairy, before their formation, the market for private label organic milk was virtually nonexistent.²¹⁵ Aurora, a producer-handler, provided the innovation and dedication to expand that market for milk, which has significantly benefitted consumers. For Braum's Dairy, no other handler in the federal milk marketing order system has chosen to develop of fully autonomous operation that starts with growing crops and finishes with a retail fresh-market concept. It is Braum's Dairy's status as a producer-handler that has allowed it to continue that business model since the pool cannot provide milk of a quality consistent enough to meet Braum's needs.²¹⁶

These innovations are not confined to larger producer-handlers, either. Kreider Farms and Heartland Dairy both have been able to secure rigorous kosher milk certifications made possible by the fact that a single entity controls the farm and bottling operation. While the record reflects that other regulated handlers do have kosher certifications, the record also reflects that

²¹⁴ Taylor, Tr. 3587-88.

²¹⁵ Keefe, Tr. 2908, 46, 86.

²¹⁶ Bostwick, Tr. 2838.

different Jewish sects have different kosher preferences and restrictions. The letter accompanying Kreider Farms' testimony from the Star K certifying organization explains that the particular rigorous certification by Star K for a regulated handler would be both expensive and logistically difficult.²¹⁷ The same applies to the certification from Star-K for Heartland Dairy.²¹⁸

Snowville Creamery, with its minimally processed milk from grass-fed cows also fills a niche in the market that is completely ignored by regulated handlers. The testimony from Mr. Taylor and the accompanying letters from his consumers demonstrate that when given the opportunity to compete for customers, his business can succeed against businesses far larger than Snowville. His testimony also demonstrates that Class I sales can be increased with innovative products, and that increasing the cost of milk by imposing a pool payment on operations like Snowville would stifle that innovation and differentiation.

And this speaks nothing of the roles that producer-handlers occupy in providing local milk (like Kreider Farms, Hatchland Dairy and Dunajski Dairy), home delivery of milk (like Longmont Dairy), milk in differentiated flavors and packaging (like Heartland Dairy and Shatto Farms) or specialty organic milk (like Aurora Organic). Further, many if not most regulated handlers began as producer-handlers and eventually grew to the point where they needed to purchase milk from other sources because they could no longer serve their customers from their own herds. Dean Foods' Price's Creameries, Sarah Farms, and Wilcox Dairy are only three such

²¹⁷ Ex. 84-A (“To produce fluid cholov Yisroel milk through a milk cooperative is prohibitively expensive and nearly impossible. The numbers of supervisors needed to oversee such an operation for fluid milk would be staggering. Furthermore, if the dairy would make specialty runs of cholov Yisroel milk, the practicality from both a practical and financial standpoint would be more than impossible.”).

²¹⁸ Ex. 99.

examples from this hearing.

Rather than find ways to restrict the producer-handler option, the Department should encourage the establishment and growth of these important entrepreneurial businesses. At a very minimum, the current policies toward producer-handlers should remain. If the milk producer is to have any control over his or her own destiny, independent of the cooperative structure, producer-handler status must continue to be a viable option.²¹⁹

B. The continued viability of Producer-Handlers is consistent with Secretary Vilsack's stated policy goals.

Secretary Vilsack has identified key priorities for the Department of (1) promoting a sustainable, safe, sufficient and nutritious food supply; (2) revitalizing rural communities by expanding economic opportunities; and (3) providing diverse opportunities for farmers and ranchers to succeed.²²⁰ Maintaining the producer-handler economic model is consistent with each of these priorities. Foreclosing the opportunity for the integration of dairy farms and fluid milk processing in a manner that benefits both farmers and consumers is not.

The small but diverse group of producer-handlers responds to consumer demand for differentiated types of fluid milk (and milk products). They exemplify opportunities for future diversification and economic benefit. They represent competition, but it is fair and equitable competition. As integrated operations they manage the risk of on-farm production and marketing together. They do not benefit from the full supply contracts and over-order premiums negotiated for the cooperative members by the cooperative. They cannot benefit from pool support because

²¹⁹ In fact, the addition of producer-handlers to many orders, including Florida, Appalachian, and Southeast Order areas would actually help to foster the policy of the AMAA of ensuring an adequate supply of local milk.

²²⁰ See., e.g., May 13, 2009 testimony of Secretary Vilsack before the House Appropriations Sub-Committee on Agriculture, Rural Development, Food and Drug Administration, www.usda.gov.

pool supply milk is not a substitute for their products, and they do not engage in depooling of milk, as do “organizations that can to the maximum of their ability to do so.”²²¹

Aurora Organic Dairy highlights this predicament. Aurora could not, even if it wanted to, contact the cooperative that controls the milk in the area where Aurora has located its plant, and obtain a supply of organic milk sufficient to meet its needs. In other words, the proponents want Aurora to pay into a pool from which Aurora cannot draw meaningful benefits. The same can be said for Snowville Creamery, Kreider Farms, and the other producer-handlers whose milk is differentiated from the pool or marketed to customers as single-sourced.

Very simply, the issue here is whether a dairy farmer should be able to own cows, process the milk from those cows and sell its product, or whether the government will impose regulations that effectively prohibit such operations through the addition of mandatory pool payments that result in total milk costs to producer-handlers that are higher than the established minimum prices.

The consumer answer, as demonstrated by product selection and purchasing power, is overwhelmingly yes, as is the answer of the present and future hopeful independent producers. Why? First, in the face of historic declines in the consumption of fluid milk, and the commoditization of milk, a new market for differentiated milk has emerged. It is the producer-handlers who are serving that market. Second, federal law does not prohibit competition, it does not guarantee the milk market to cooperatives or regulated handlers, nor should it.

1. Producer-Handlers provide a safe, sustainable, and nutritious supply of milk.

The producer-handler organizational model was the model of choice for up to half of all farmers in certain parts of the country prior to the enactment of the AMAA.²²² Today, 37

²²¹ Lee, Tr. 949.

producer-handlers exist in the entire federal milk marketing order system.²²³ For the most part, they sell differentiated milk through value-added on-farm management (organic, local, natural, kosher, grass-fed, rBST-free) and processing activities directly connected to niche market consumer demands (including reviving demand for home delivery and glass bottles).²²⁴ These are growth areas in fluid milk consumption, reversing the continuing downward trend in fluid milk consumption in the United States.²²⁵ Others are able to compete in contestable markets created by the monopolizing effects of industry consolidation.

A number of witnesses testified in this proceeding that they chose to become producer-handlers because their farms were not economically viable as members of cooperatives.²²⁶ The producer-handler option offered the opportunity to secure more value for their on farm production from customers seeking the characteristics of their specific milk products – for freshness, knowledge of the farm operation from which it was produced.

2. Producer Handlers provide economic opportunities for Rural Communities

Producer-handlers are often the engines of economic productivity in underserved rural communities, and they are providing such productivity on an independent basis, without federal assistance. For example, Heartland Creamery operates in a very depressed section of northeast Missouri and provides a hub of economic activity for the surrounding community, while

²²² Early Development of Milk Marketing Plans, 35.

²²³ Ex. 13.

²²⁴ Knutson, Tr. 3045.

²²⁵ See Exhibit 89, Para. 73 citing FAPRI 2009 U.S. and World Outlook, p. 130 (Fluid milk utilization has shrunk from a national average 64.3% in 1969 to a national average 38.7% in 2008, with continuing decline projected through 2017).

²²⁶ Shatto, Tr. 1183; Docheff, Tr., 2592.

providing job training for many.²²⁷ Braum's Dairy sustains multiple economic activities in the Oklahoma and the surrounding 5-state area, providing jobs in farming, milk processing, and multiple retail outlets.²²⁸ Aurora Organic Dairy partners with multiple organic producers throughout rural Colorado and Texas for feed production.²²⁹ GH Dairy-El Paso has created over 30 new jobs for the El Paso community since it began processing milk in late 2008. Snowville Creamery has created seven full-time and seven part-time jobs in an economically depressed area of Southeast Ohio.²³⁰ Country Dairy also operates in an economically depressed area of Michigan.²³¹ The jobs that Kreider Farms provides for people in Lancaster County, Pennsylvania would not have been created if there were a producer-handler cap when Kreider Farms became a producer handler, and those jobs may well disappear if Proposal 1 is adopted.²³²

The same can be said for the operations of Hatchland Dairy, Dunajski Dairy, Shatto Dairy, Dakin Dairy, and Diamond D Dairy, and Brunton Dairy. Each one of these operations is at risk if the regulations change.

The experience of Mallories Dairy provides a real example of the human and economic impact of changes to the producer-handler regulations. After the imposition of a cap in the Pacific Northwest in 2006, 25 people at the operation lost their jobs and over \$3 million in

²²⁷ Sharpe, Tr. 3618-19.

²²⁸ Bostwick, Tr. 2835.

²²⁹ Keefe, Tr. 2930.

²³⁰ Taylor, Tr. 3556.

²³¹ Arkema, Tr. 3665.

²³² Kreider, Tr. 2634, 2689.

annual purchases from Mallories' local economy vanished.²³³ The specter of the changes in Proposals 1 and 26 threaten to impact 37 producer-handler operations in the same way that Mallories dairy was affected in 2006.

3. Producer-handlers provide diverse opportunities for the long-term viability of dairy farms.

As made clear from the testimony of multiple dairy farmers in this hearing, as well as the data related to costs of production and federal order prices, the traditional model of operating a dairy farm exclusively, regardless of size, is under constant pressure. The testimony from several producer-handlers establishes that the addition of a processing facility preserved the viability of their farm business.²³⁴ These are operations that, in most instances, have Class I volumes in excess of the limits of Proposal 2 and might not qualify for the anti-competitive "grandfather" restrictions in Proposal 26. How many other dairy farms that are similarly situated today would have this option foreclosed by the adoption of Proposal 1?

Even at a capped level of 3,000,000 pounds of Class I sales, the record evidence shows that for several marketing areas where herd sizes are above average, the ability to begin or to continue operation of any producer-handler plant would be forever foreclosed.²³⁵

Q. Do you have any statement as to whether there would be an opportunity to create and explore, develop niche markets in areas where the average farm size is significantly different from Wisconsin and New England?

MR. HUGHES: Probably not at the caps that we're talking about.²³⁶

²³³ Flanagan, Tr. 2414.

²³⁴ See n. 233, *supra*.

²³⁵ As integrated operations that would have costs of production for their milk at or above the Class I price, these new market entrants would be rendered entirely non-viable with the imposition of pool payment obligations.

²³⁶ Hughes, Tr. 1127.

Such a position would hinder the creation of new market entrants in states such as Florida, where it is not feasible to operate a dairy with less than 800 cows.²³⁷ As integrated operations that would have costs of production for their milk at or above the Class I price, these new market entrants would be rendered entirely non-viable with the imposition of pool payment obligations.

VIII. AIDA Proposals 23, 24, and 25 constitute rational and less-burdensome alternatives to the restriction or elimination of producer-handler status.

Following the announcement from USDA-AMS, Dairy Programs that it was considering holding a national hearing on the producer-handler proposals from NMPF and IDFA, AIDA and its member organizations submitted three alternative proposals for consideration at the hearing. Each of those alternatives was offered solely in response to the NMPF/IDFA proposals as alternatives to the elimination of producer-handlers, as were virtually all of the other hearing proposals.²³⁸ This brief has explained why there is no basis for any change to the producer-handler regulations, and if the Department finds that there is no need to amend the FMMO, the AIDA supports the rejection of all proposals, including 23-25.

A. AIDA supports the two variations in Proposal 23, which would exempt the own-farm produced milk of all handlers from pricing and pooling.

The first alternative AIDA proposal, proposal number 23, would exempt the own-farm produced milk of any handler from inclusion in the handler's computation of milk value. This alternative would permit any handler who utilizes the milk from farms owned and controlled by the handler to exempt those volumes from regulation. The handler would still be treated as a fully-regulated handler or partially-regulated handler, pursuant to the terms of the applicable marketing order. But when calculating the handler's producer settlement fund obligations, the

²³⁷ Dakin, Tr. 893.

²³⁸ Hatch, Tr. 256; Dunajski, Tr.357, Shatto, Tr. 1197, Rooney, Tr.1554.

handler would down-allocate the volumes of own-farm produced milk to the handler's lowest value use.

This alternative would serve two purposes. First, it serves as an alternative to the draconian and unsupported proposals from NMPF and IDFA to eliminate producer-handler status in all marketing areas. While Proposal 23 would eliminate the need to continue designating producer-handlers as such, it still requires that those handlers who utilize own-farm produced milk demonstrate to the satisfaction of the Market Administrator that the processing facilities and production facilities are under the same ownership and control of the same entity. AIDA intends that the Market Administrator be vested with the authority to conduct such audits of the handler's facilities and record to ensure that there is commonality of ownership and control of those facilities used to produce milk claimed as exempt. It would remain the burden of the handler to demonstrate entitlement to this exemption, as is currently the case with producer-handler designation. Proposal 23 would permit the handler with own-farm production to purchase milk from pool sources. But all such purchased milk would be up-allocated to the handler's highest value use, ensuring that pool producers receive the full benefit of all Class I markets served by the handler's purchase of milk from pool producers.

Proposal 23 would allow producer-handlers to continue to exist and continue to compete in an orderly manner. It would allow producers and cooperatives to benefit from producer-handlers' sales in excess of their production. This change in Federal order regulatory policy would reduce incentives for surplus production. It would also allow any handler who produces milk from a farm that owns and controls to relieve itself from the penalty payment to the pool, which unduly increases its cost of milk beyond that of the Class I price.

Proposal 23 was also noticed with a second provision, which permits a handler with own-

farm production to elect partially-regulated distributing plant status for the volumes of its own-farm produced milk. This provision was intended as an alternative to the full exemption of own-farm produced milk. AIDA intends this be treated as a distinct proposal. This proposal includes language intended to ensure that the handler with own-farm production markets its products at or above its costs, which for purposes of this Proposal would be the applicable Class I price plus costs of manufacturing, processing, handling, marketing, and delivery. Because of this restriction on pricing milk below the Class I price, regulated handlers would be ensured that the handler with own farm production could not under price the federal order Class I price.²³⁹ It would also avoid the situation that was alleged by the California witnesses about producer-handlers using exempt volumes to undercut prices. Handlers with own-farm production could not price milk below cost.

Volumes of milk acquired from sources other than the handler's own farm, those volumes would be treated according to the handler's regulatory status as a regulated or partially regulated plant. But by treating own-farm production in the same manner as USDA currently permits partially regulated plants to treat their milk purchases, this provision allow producer-handlers to continue to exist and continue to compete in an orderly manner. It would allow producers and cooperatives to benefit from producer-handlers' sales in excess of their production. This change in Federal order regulatory policy would also reduce incentives for surplus production by producer-handlers.

²³⁹ As we have explained earlier, the economic reality of milk production is that milk is rarely produced at less than the Class I price. Accordingly, regulated handlers are not at a disadvantage to producer-handlers. But the transparency of such a provision as this would allay any remaining fears of regulated handlers.

B. AIDA Supports Proposal 24, which would exempt retail sales by producer-handlers from pricing and pooling.

Proposal 24 is intended for adoption only if USDA adopts restrictions on the volumes of producer-handlers. If USDA eliminates the designation of producer-handler, it is intended that Proposal 24 be incorporated into the marketing orders to have the same effect as if incorporated into a producer-handler definition that contains a volume limitation.

Under Proposal 24, a producer-handler who disposes of its milk products in retail outlets controlled by the handler or sales direct to the consumer by the handler would be exempted on those volumes. The rationale for this proposal is that under any legitimate construct, such sales are entirely controlled by the handler and do not have an impact on the regulated pool. Handlers who control the milk supply chain from production through processing and through to its final disposition, operate autonomously from the orders. AIDA intends that this exemption be liberally construed. For example, if a producer-handler utilizes independent contractors to complete home delivery of its products, but it is the handler who is responsible for the maintenance of those home delivery customers, then the exemption should apply, even if title to the product may pass to the intermediate contractor before delivery to the consumer. In this setting, it is the handler who maintains principal responsibility for the retail sale. As with all of the AIDA alternative proposals, it is proposed only as an alternative to the NMPF/IDFA proposals.

Proposal 24 would apply directly to AIDA members Braum's Dairy and Longmont Dairy. Braum's Dairy sells its milk exclusively through its Braum's Ice Cream and Dairy Stores.²⁴⁰ Longmont Dairy sells its milk through home delivery to over 19,000 home delivery

²⁴⁰ Botswick, Tr. 2832.

customers. The sales by Longmont Dairy to other than home delivery customers are extremely small.

C. AIDA supports the adoption of individual handler pooling as an alternative to marketwide pooling.

During FMMO reform, a paper issued by the Cornell Program on Dairy Markets and Policy summarized the alternatives that USDA might consider in reforming the federal orders.²⁴¹

Among those proposals was the use of individual handler pools. The Cornell paper identified the following benefits and disadvantages to individual handler pools, which Dr. Knutson incorporated into his analysis and discussion of individual handler pools:

In contrast to market-wide pooling, the individual handler pool does provide substantial incentive to sell class I milk to handlers. Individual handler pools mean that producers selling to the same plant get the same blend price, but each plant has its own blend price, calculated according to its own milk utilization. Consequently, producers have a much stronger incentive to sell milk to the plants paying the higher prices. The drawback of this approach is that it moves away from the objective of equal treatment of producers. That is, it may be a good way to achieve one objective of orderly marketing, but is counter-productive to another which is producer price equity. Nevertheless, it has two distinct advantages. One, it channels all class I revenues to those plants and producers who are actually serving the class I market. There is a substantial incentive for all milk in the supply area to be readily available to meet class I requirements. There is little or no need for qualification requirements or call provisions. Second, there is little incentive for the supply area to expand beyond that which is sufficient to meet class I needs of the market. Milk producers and buyers who are not selling milk for class I use do not participate in the class I revenues.²⁴²

If the primary disadvantage to individual handler pools is that producers in geographic proximity to each other would receive differing prices for their milk production, then we should examine (1) whether the federally guaranteed minimum prices are sufficient for producers who would receive the lower value classified prices; (2) whether the current system actually ensures

²⁴¹ Robert Cropp, "Alternative Order Provisions to Facilitate the Orderly Movement of Milk to Fluid Markets," Dairy Markets and Policy Issues and Options, Cornell University, Feb. 1997.

²⁴² See, Knutson, Tr. 3092, Ex. 89.

comparable returns to producer in a given geographic area; and (3) whether in a regulatory system that ensures a fair minimum price to all producers equality in producer returns is a preferred or feasible alternative.

The adoption of individual handler pools would have the added benefits identified by the Cornell study—ease of association of producers with plants and a strong incentive to supply the fluid market. There would be no need for further hearings regarding pool qualification, and no longer would an entire marketing area be subjected to the economic damage caused by opportunistic depooling. In short, many of the recurring problems with the marketing orders would be addressed and resolved. Dr. Knutson's testimony explained that "there are significant economic benefits to individual handler pools over marketwide pools."²⁴³

First, manufacturing plants, unless they affiliate with a distributing plant, will not pool their milk. That is no different than under the current marketwide pooling scenario, where manufacturing plants in many instances elect to pool only when it is economically advantageous to do so.²⁴⁴

Second, the negative effects of opportunistic depooling, which continue to damage producers to the tune of millions and millions of dollars each year, will cease.

Third, and perhaps most important, milk in higher use Classes will move to the locations where it is needed, thus eliminating the need for call provisions and related regulatory incentives.

Fourth, and closely related to the third benefit, all Class I revenues are channeled to those producers who are actually serving the Class I market.

Fifth, there is little incentive for the supply area to expand beyond that which is sufficient to serve the needs of the market, thus saving transportation costs.²⁴⁵

²⁴³ Knutson, Tr. 3088.

²⁴⁴ But on cross-examination, it was clarified that the individual handler pool regulations could be constructed in such a way that manufacturing handlers would be included in the scheme. Knutson Tr. 3172-75.

²⁴⁵ Knutson, Tr. 3092.

The Class I utilization of the entire FMMO system now stands at approximately 39%. Under the current marketwide pools, more than two times the amount of milk needed to serve the fluid market is receiving the benefits of the fluid market, which would unduly penalize those producers serving the Class I market. In the testimony from the Braum's Dairy witness, it was explained how the expansion of the Central Order during order reform that depressed the Class I utilization of the Central Order leading to increased incidences of depooling.²⁴⁶ The intent of the FMMO system should not be to allow all milk to be pooled, but to ensure that the consuming public has access to a sufficient supply of fluid milk at reasonable prices. That goal can and would be accomplished by individual handler pools.

The proponents of marketwide pooling will likely assert that individual handler pooling is a move away from equal treatment of producers. But the testimony from AIDA's economists demonstrates that producers do not now receive equal prices. Even under individual handler pooling, a cooperative will have the option of continuing to blend its returns among its members.

D. AIDA supports the expansion of exempt plant limitations, but at a level reflective of competitive inequities.

While AIDA opposes elimination of limitation of the producer-handler exemption, we support the expansion of those plants that qualify as exempt plants. Proposal 2 was introduced in conjunction with Proposal 1, but its proponents noted that it is a "distinct proposal."²⁴⁷

NMPF's witness explained that, "Given growth in farm size and growing economies of size in milk processing, it is reasonable to increase the size exemption to 450,000 pounds per month, and we propose to do so." NMPF argues that even at that level, such plants have

²⁴⁶ Bostwick, Tr. 2838-39 (not coincidentally, this was the same time that Braum's elected to become a producer-handler).

²⁴⁷ Cryan, Tr. 412.

difficulty competing even if exempted.²⁴⁸ NMPF bases its proposal on the fact that since the limit was set at 150,000 pounds; the size of the average farm has tripled.²⁴⁹

AIDA agrees that the current exempt-plant size is archaic. But setting the limit at 450,000 pounds, or on the basis of farm size, as set forth by NMPF will not permit such operations to succeed. The peer reviewed dairy literature in the record demonstrates that:

Fluid milk plants have closed due to inefficient economies of scale, and because the product – beverage milk – is essentially an indistinguishable commodity. It is very difficult for a processor to position a fluid brand to strategic advantage. The exceptions seem to prove the rule.

The 5-farm (644,000 pounds per month) fluid plant would need a 6% increase in present value of reserves, which translates to a \$0.24 increase in the price received per gallon of milk sold.

It is unlikely that the fluid processing plants would be able to overcome the baseline revenue shortfalls or the high level of expenses to reach a break-even point.²⁵⁰

As Warren Taylor who just built a new-small scale fluid milk processing plant for Snowville Creamery testified, “While I agree with the basic premise, in today’s world a fluid milk plant of only 450,000 pounds per month cannot be economically constructed and operated. Instead, I believe that 1 million-pounds per month is more realistic in providing sufficient volumes for an economical operation.”

Accordingly, while there are arguments for expanding the outdated exempt plant limitations, the proposed expanded limit will not achieve that stated goals of NMPF that the exempt plant limitation “alleviate the administrative and regulatory burden of regulating small

²⁴⁸ Cryan, Tr. 413.

²⁴⁹ Cryan, Tr. 415.

entities.”²⁵¹ Expanding the limit to 450,000 pounds will leave an administrative and regulatory burden on plants too small to compete with regulated handlers. Based on Mr. Taylor’s testimony, the adoption of an exempt plant limit at 1,000,000 pounds independent of any changes to producer-handler regulations would afford these very small plants opportunities to compete in the marketplace.²⁵² Data in the record concerning indicates that there are currently 22 regulated plants with volumes between 150,000 pounds and 1 million pounds of milk volumes, although the volumes of actual Class I usage is undetermined.²⁵³ Accordingly, the pool impact of these exemptions could be expected to be quite small.

E. AIDA opposes all other proposals.

All proposals related to producer-handlers other than 1, 2, 26, and AIDA’s 23-25, were offered as additional proposals from producer-handlers or those who are at least partially supportive of producer-handlers. Each of the proposals was offered following the initial submission of Proposal 1, which would eliminate all producer-handlers and Proposal 2, which would raise the exempt plant limitation to 450,000 pounds. When NMPF and IDFA submitted those proposals, the regulatory status of every producer-handler with more than 150,000 pounds of Class I sales was placed at risk. Accordingly, many of the potentially affected businesses submitted alternative proposals. These “self-preservation” proposals are subject to the same burdens of proof as are applicable to Proposals 1, 2, and 26.

²⁵⁰ Taylor, Tr. 3562-63 (referring to “A Cost and Returns Evaluation of Alternative Dairy Products to Determine Capital Investment and Operational Feasibility of a Small-Scale Dairy Processing Facility,” from the Journal of Dairy Science, 2007).

²⁵¹ Cryan, Tr. 420.

²⁵² Proposals 6, 9, and 12 would raise exempt plant limitations beyond 450,000 pounds.

Because the record lacks substantial evidence related to the existence of disorderly marketing as a direct result of producer-handler activity, each of these proposals should be denied as well. AIDA notes that certain aspects of Proposals 17, 20, and the testimony from National All-Jersey incorporate an exemption for limited volumes of own-farm production. Accordingly, those proposals share certain similarities with AIDA Proposal 23. Proposal 23 is superior because it recognizes that producers bear the cost of production for all own-farm produced milk, not just a limited volume.

IX. Proposed Findings and Conclusions

AIDA's proposed findings and conclusions, drawn from this brief, follow.

A. Governing Legal Standards

Proposed Conclusions

1. In a formal rulemaking proceeding under the Administrative Procedure Act, the proponents of the proposed rule bear the burden of proof. 5 U.S.C. § 556(d).
2. As the proponents of Proposals 1, 2, and 26, National Milk Producers Federation and International Dairy Foods Association bear the burden of producing substantial record evidence of disorderly marketing that is caused by the current legal status of producer-handlers. 5 U.S.C. § 556(d); see also Director, Office of Workers' Comp. Programs v. Greenwich Collieries, 512 U.S. 267, 276 (1994).

B. Regarding Cost of Milk and "Price Advantages"

²⁵³ Ex. 20; Carman, Tr. 97-100 (describing the inclusion of unit pooled plants and soft product plants with minimal Class I usage).

Proposed Findings

3. The cost of milk to the regulated handler is the federal order Class I price comprised of the payment of the blend price to the producer and the payment to the pool. See Sec. V, A., supra.
4. The cost of milk to the producer-handler is at a minimum the cost of production. See, e.g., Knoblauch, Tr. 3411-12 (indicating it could actually be cost of production plus some value which would include, for example, profit and return on investment).
5. Based on testimony from individual producer-handlers, economic experts, and USDA data, the cost of producing milk currently, and consistently, exceeds FMMO Class I and uniform prices. See, e.g., Sec. V, A, 2, supra; AIDA tables based on USDA ERS data; Knoblauch, Tr. 3022-23.
6. The concept of a cost advantage for producer-handlers based on the difference between the Class I price and the order blend price is a theoretical concept and does not reflect actual costs of any producer-handler. See, e.g., Tonak, Tr., 545-46; Sec. V, A, 2, supra.

Proposed Conclusions

7. The total measure of a producer-handlers' costs versus the regulated Class I price determines whether a producer-handler has a raw milk cost advantage. See, e.g., Lehigh Valley Cooperative Farmers, Inc. v. United States, 370 U.S. 76 (1962); Sani-Dairy v. Espy, 939 F. Supp. 410 (W.D. Pa. 1993) aff'd 91 F.3d 15 (3d Cir. 1996).

8. The lack of producer settlement fund payments from producer-handlers is not evidence of a price advantage or of a disorderly marketing condition. See Sec. V, A, supra.
9. The difference between the Federal Order blend price is not an appropriate proxy for producer-handlers' costs of milk or "transfer price" because in the real world, transfer prices are based on actual costs. See Sec. V, A, 1, supra.
10. The fact that the Class I price is lower than the producer-handler's cost of production proves that producer-handlers do not have a raw milk cost advantage. See Sec. V, A, 2 supra.
11. The imposition of producer settlement fund payments based upon the difference between the Class I price and the order blend price does not take into account the economic realities of the handler's operations. See Sec. V, A, 2, 3 supra.
12. Producer-handlers possess no competitive advantage over other regulated handlers by not paying into the pool. Instead, the testimony at the hearing is that producer-handlers are at a substantial cost disadvantage, because their cost of production exceeds the Class I price. Id.
13. When the producer-handler has an actual cost of production in excess of the blend price, the imposition of a compensatory payment based on the Class I-Blend Price spread results in non-uniform payments to handlers. Id.
14. Compensatory payments that result in non-uniform prices to handlers are not permitted by the AMAA. See, e.g., Lehigh Valley Cooperative Farmers, Inc. v. United States, 370 U.S. 76 (1962); Sani-Dairy v. Espy, 939 F. Supp. 410 (W.D.

Pa. 1993) aff'd 91 F.3d 15 (3d Cir. 1996).

C. Regarding Disorderly Marketing

Proposed Findings

15. There have not been unreasonable fluctuations in supplies and prices of milk to meet the public's needs. See Sec. IV, supra.

16. Every federal milk market has had and currently has adequate and regular supplies of milk for fluid consumption. See, e.g., Sec IV, supra; Dairy Market Statistics, 2008 Annual Summary, Table 30 "30--Measures of Growth in Federal Milk Order Markets, Selected Years, 1947-2008.

Proposed Conclusions

17. The existence of producer-handlers is not *per se* disruptive.

18. As the proponents of Proposals 1, 2, and 26, National Milk Producers Federation and International Dairy Foods Association bear the burden of proving and producing substantial record evidence of disorderly marketing nationwide that is the direct result of producer-handler activity. See Sec. III, supra; 5 U.S.C. §556(d) ("Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof."). Since neither the AMAA nor the applicable rules of practice provide a specific burden of proof in this proceeding, the burden of proof standard is governed by § 556(d) of the APA; Director, Office of Workers' Compensation Programs v. Greenwich Collieries, 512 U.S. 267, 276 (1994); see Kenneth Culp Davis and Richard J. Pierce, Jr., Administrative Law Treatise §10.7 (3d ed. 1994) (concluding that the combination of "burden of proof" and

“substantial record evidence” standards in formal “on the record” hearings under the APA imposes a “preponderance of the evidence” standard of proof.).

19. The factors for the Secretary to determine whether disorderly marketing conditions exist are whether the objectives of the AMAA are being met, namely (1) to protect the interests of producers and consumers (2) by ensuring an orderly flow of milk to market (3) thereby avoiding unreasonable fluctuations in supplies and prices and (4) ensuring a sufficient supply of milk to meet the public’s needs. If the objectives are being met, then marketing is orderly. 7 U.S.C. § 602(4). If the objectives are being met, then marketing is orderly. 7 U.S.C. § 602(4); see also, e.g., Smyser v. Block, 760 F.2d 514, 515-17 (3d Cir. 1985) (discussing the purposes behind the regulatory scheme) .

20. Part of protecting the interests of producers includes maintaining regulatory balance through equitable treatment and allowing producers, including producer-handlers, to choose their markets free of coercion and unreasonable barriers to entry. See Sec. IV, supra, Knutson, Tr. 3073-75 (relying on Milk Pricing Advisory Committee Report).

21. The lack of producer settlement fund payments from producer-handlers is not and does not create a disorderly marketing condition because the milk costs of producer-handlers actually exceed the minimum Class I prices. See, Sec. V, A, 2, supra.

D. Regarding Competition Between Producer-Handlers and Regulated Handlers

Proposed Findings

22. The shelf price of milk cannot provide full evidence of wholesale pricing because there is often a huge variance in the retail price of milk from store to store, and from city to city, and this has to do with the differing markups that are used by supermarkets, mass merchandisers, convenience stores and drug stores. Ex. 105; Erickson, Tr. 2276, 2278, 2286, 2289, 2297; Button, Tr. 3604, 3605, 3613, Ex. 13; Ex. 105; Hollon, Tr. 3889-90; Sharpe, Tr. 3597, Keefe, Tr. 2976; Lee, Tr. 954-55, Wernet, Tr. 2310-11, 2329-30, 2334-36; Arkema, Tr. 3668, 3672-73, 3687-89; see also Sec. V,A, 4, supra.
23. Factors such as quality, a buyer's desire for multiple suppliers, taste profile, consumer identification with a brand, transportation efficiencies, processing efficiencies, and others will influence a buying decision, as well as price. See, e.g., id.
24. Heartland Dairy milk was introduced into Hy-Vee stores where Anderson-Erickson milk was also sold during the time that Heartland Dairy was a regulated handler. Erickson, Tr. 2276, 2278, 2286, 2289, 2297; see also Sec. V, A, 4, a, supra.
25. Over-order premiums, in the case of the Kansas City market, add 30 cents or more the raw milk cost of a gallon above and beyond the Class I minimum price. Erickson, Tr. 2276, 2286; see also Sec. V, A, 4, a, supra.
26. Prairie Farms provided no evidence that it could not compete with Heartland Dairy. Price reductions due to competition are not disorderly in the absence of a raw milk price advantage. Lee, Tr. 945-55; see also Sec. V, A, 4, a, supra.
27. Country Dairy sells its milk through a distributor, and the distributor is

responsible for sales to retailers. Country Dairy is not involved in the distributor's pricing decisions. Arkema, Tr. 3668, 3672-73, 3686-89, 3694; see also Sec. V, A, 4, b, supra.

28. Country Dairy did not offer milk for sale at \$1.90 per gallon to balance its supply. Rather, a retailer approached County Dairy's distributor about a promotional price to meet competition from other retailers supplied by regulated handlers. Id.
29. The El Paso market was dominated by a single handler, Price's Creameries from 2004 through the introduction of milk from GH Dairy in 2008. Carrejo, Tr. 1468; see also Sec. V, A, 4, c, supra.
30. The raw milk cost of whole milk in El Paso was \$1.005 per gallon in March 2009. A retail sale of that gallon at \$2.28 per gallon would be profitable. Sec. V, A, 4, c, supra; Southwest Milk market Administrator's website: http://www.dallasma.com/fd?file_map=prices&downfile=2009/1and2/1%262MAR09.pdf.
31. The lack of competition in El Paso enabled the Hettingas' regulated Arizona plant to ship packaged milk from Yuma, Arizona to El Paso and make profitable sales. Hettinga, Tr. 2700; see also Sec. V, A, 4, c, supra.
32. GH Dairy was able to source milk from Nevada to supply the school milk business in El Paso and make a profit. During that period GH Dairy was a regulated handler in the Southwest Order. Hettinga, Tr. 2695-97; see also Sec. V, A, 4, c, supra.
33. The bid by GH Dairy on school milk in El Paso effectively reduced the profit "spread" on school milk by ten cents per half-pint. Hettinga, Tr. 2764; see also

Sec. V, A, 4, c, supra.

34. The testimony from various supporters of Proposals 1 and 26 demonstrated that they are not now experiencing any actual problem with producer-handlers.

Tonak, Tr. 521, 535; Asbury Tr. 578; Newell, Tr. 714; Lee, Tr. 943, Hollon, Tr. 3789; see also Sec. V, B, supra.

35. Aurora Organic Dairy has grown principally on the basis of providing an innovative product -- private-label organic milk -- and dedicating its operation to that product. Its dedication to a single market niche had permitted Aurora to provide superior quality and service to its customers that were previously underserved. Keefe, Tr. 2912-13, 19; see also Sec. V, A, 4, d, supra.

36. Aurora's growth has not been on the basis of price. Record evidence demonstrates that Aurora has lost accounts to regulated handlers that offered lower prices. Keefe, Tr. 2913; see also Sec. V, A, 4, d, supra.

Proposed Conclusions

37. Competition by producer-handlers is not a *per se* disorderly marketing condition. Knutson, Tr. 3057, 2067; See Sec. V, A, supra.

38. At federal order minimum prices for the Mideast Order, milk could be profitably sold at wholesale for less than \$1.90 per gallon in May 2009. See Sec. V, A, 4, b, supra (analyzing the competition between Country Dairy and Bareman Dairy using record evidence and FMMO price data).

39. The El Paso milk market is contestable. See Sec. V, A, 4, c, supra.

40. The producer-handlers, whose competitors suggested that producer-handlers were

competing at prices that regulated handlers could not meet, were, in fact competing at prices above regulated minimums plus processing and other costs. See Sec. V, A, 4, supra.

41. Testimony about competition from producer-handlers reveals only competition among market participants and does not reveal any price advantage that producer-handlers have over regulated handlers. Id.
42. Accounts shift from producer-handlers to regulated handlers and vice-versa on any number of bases, including price. Id.

E. Regarding the Size of Producers and Prospective Action

Proposed Findings

43. The proponents of limiting producer-handlers based on size have gauged their limits on the growing number of larger dairy herds. Cryan, Tr. 408, 1878; Tonak, Tr. 556; Asbury, Tr. 574, 592, 95; Berthiaume, Tr. 648; Damm, Tr. 696-98, 715; Daniels, Tr. 793; Buelow, Tr. 902; Lee, Tr. 944; Bothfeld, Tr. 1089, Rowe, Tr. 1245; Latta, Tr. 1404; Hollon, Tr. 3775-76; See Sec. V, B, supra.
44. The proponents of limiting producer-handlers rely extensively on prospective supposition about the future actions of large farms. Cryan, Tr. 405, 408, 415, 421; Tonak, 521, 535; Asbury, Tr. 578, Newell, Tr. 714, Lee, Tr. 943, Hollon, Tr. 3789; See Sec. V, B, supra.
45. The same proponents who testified about prospective problems from large producer-handlers testified about the same prospective problems in 2004 with

respect to the Appalachian and Southeast Orders. The record demonstrates those fears to be wholly unfounded. See Sec. V, B, supra.

Proposed Conclusions

46. Any decision to limit producer-handlers must be based on evidence of actual market disorder directly attributable to producer-handlers and not on prospective suppositions. See, e.g., 54 Fed. Reg. 27179, 27182 (June 28, 1989); Borden, Inc. v. Butz, 544 F.2d 312, 319 (7th Cir. 1976); Sec. IV, supra.
47. No actual evidence of market disorder attributable to producer-handlers exists in this record. See Sec. IV, V, supra.
48. The Secretary is prohibited from limiting producers in their capacity as producers, and must refuse to modify the producer-handler limitations based on farm sizes. 7 U.S.C. § 608c(13)(B); See Sec. V, B, supra.

F. Regarding Balancing by Producer-Handlers and Self-Sufficiency

Proposed Findings

49. The non-Class I uses of producer-handlers' milk vary dramatically, but in each instance the volumes balanced through bulk milk sales are sold at substantially less than Class I prices and generate significant losses. Hatch, Tr. 254 ; Gibson, Tr. 630; Gilbert, Tr. 2462; Flanagan, Tr. 2565; Keefe, Tr. 2910; Kreider, Tr. 2633; Button, Tr. 3602; Sec. V, C, supra.
50. In addition to bulk sales of raw milk, producer-handlers balance fluid needs with their own herd and inventory management, self-sufficient ice cream production,

fortification, cheese manufacturing, or manufacturing of butter and powder with co-packers. Keefe, Tr. 2909; Bostwick, Tr. 2851; Sec. V, C, supra.

51. Producer-handlers take on significant personal and financial risk when they elect to operate a dairy farm and processing facility at their sole risk and enterprise. In doing so, they do not receive benefits of participating in the pooling system. See, e.g., Hatch, Tr. 247-50; Taylor, Tr. 3587-88.

Proposed Conclusions

52. Existing producer-handlers, regardless of size, bear responsibility for production of fluid processing and balance their milk supplies and demands. See Sec. V, C, supra.

53. The record demonstrates that producer-handlers bear the burden of disposing of all their surplus milk whether by manufacturing other products, utilizing surplus on the farm, or selling surpluses at substantial losses. Id.

54. The past and continued existence of producer-handler status is due to the self-sufficiency of the producer-handler operation and the restriction on the producer-handler requiring their self-sufficiency. See, e.g., Id.; 54 Fed. Reg. 27179, 27182 (June 28, 1989); In re Kreider Dairy Farms, 54 Agric. Dec. 805, 1995 WL 598331 at *32 (USDA 1995).

55. Producer-handlers have no significant advantage in the market in their capacity as either handlers or producers as long as they are solely responsible for their production and processing facilities and assume essentially the entire burden of

balancing their production with their fluid milk requirements. Id.

56. Producer-handlers are practically limited in size and scale by having to source all fluid milk needs from their own farm. Sec. V, C, supra.

G. Regarding Blend Prices

Proposed Findings

57. Producer prices are affected by numerous factors including the amount of milk pooled on a given order and milk opportunistically depooled. See Sec. V, F, supra.

58. Producer prices are affected by the actions of cooperative associations of producers that result in similarly situated producers not receiving the same amount for their milk. Knoblauch, Tr. 3024, 3415-18; Rowe, Tr. 1267-68; See Sec. V, F, supra.

59. The aggregate impact of producer-handlers on producer blend prices is 1-2 cents per hundredweight. Knoblauch, Tr. 3026.

60. Opportunistic depooling by cooperatives and other handlers, permitted by regulations that USDA revised in 2005 to limit the impacts of such activities, impacts blend prices on a scale far greater than producer-handlers. Ex. 56, Ex 59; See Sec. V, F, supra.

Proposed Conclusions

61. The impact of producer-handlers on the blend price of any particular order is not meaningful in the absence of other disorderly marketing conditions caused by producer-handlers, and is counterbalanced by the risks assumed by producer-

handlers in assuming full responsibility for milk production and processing, including balancing. See Sec. V, F, supra; Cumberland Farms v. Lyng, 1989 WL 52697 (D.N.J. May 15, 1989).

62. A blend price impact is not a disorderly marketing condition *per se*. 54 Fed. Reg. 27179; See Sec. V, F, supra.

H. Regarding the Secretary's Authority to Regulate Producer-Handlers

Proposed Conclusions

63. Under the plain language of the AMAA, there is no jurisdictional predicate for the application of the pricing and pooling requirements for milk produced by an integrated producer-handler that sells only milk that is produced by its own cows. 7 U.S.C. § 608c(5); See Sec. VI, A, supra.

64. USDA's authority to impose minimum price and pooling regulations on "producers who are also handlers" contemplates regulation of those handlers who are also producers and have purchased of milk from other sources but does not extend to producer-handlers, which have no outside sources of milk. See Ideal Farms v. Benson, 288 F.2d 608 (3rd Cir. 1961); Freeman v. Vance, 319 F.2d 841 (5th Cir. 1963); Sec. VI, A, 2, supra.

65. Seven different legislative actions by Congress, commencing in 1965, consistently and specifically exempted producer-handlers from regulation. During Federal Order Reform, the Secretary declined to change producer-handler regulations due to the specific intent of Congress to exempt producer-handlers.

See Sec. VI, B, supra (setting forth all seven enactments in footnote and explaining their subsequent application by USDA).

66. The Milk Regulatory Equity Act imposed regulation on certain producer-handlers selling milk into the Arizona Milk Marketing Area and did not alter the Secretary's authority as to any other milk marketing order. 7 U.S.C. § 608c(5)(O).

I. Regarding the Positive Role Played by Producer-Handlers in the Market

Proposed Findings

67. Producer-handlers provide differentiated and innovative products and service niche markets, often before fully regulated handlers recognize new opportunities or elect to service such markets. Specific niches served by producer-handlers historically and currently include: rBST-free milk, glass bottled products, home delivery, private label organic, grass-fed milk, minimally processed (non-homogenized) milk, and stringent kosher markets. See, e.g., Sec. VII, A, supra; Knutson, Tr. 3056, 3227-29.

68. Producer-handlers can provide competition in contestable markets where one handler or a small number of handlers are extracting unwarranted profits from the market. Knutson, Tr. 3212-13.

69. Producer-handlers contribute to their local rural economies. See Sec. VII, B, 2, supra.

Proposed Conclusions

70. The ability to become a producer-handler provides a meaningful choice to producers whose farm income alone is not sufficient to sustain the farm operation, especially those whose marketing options are limited by industry consolidation and market foreclosure. See, e.g., Shatto, Tr. 1183, 89; Sec. VII, supra;
71. The abolition of producer-handler will eliminate opportunities for dairy producers to market their milk in the manner they choose. Id.
72. The abolition of producer-handler will stifle the creation of innovative fluid milk products and result in niche markets being underserved. Id.

J. Regarding the Size of Exempt Plants

Proposed Findings

73. A fluid milk plant at 450,000 pounds of Class I distribution per month is destined to be an economic failure. The only peer-reviewed study on small plants in the record found that a facility processing 644,000 pounds of milk per month would have substantial losses. Taylor, Tr. 3563-63 (citing “A Cost and Returns Evaluation of Alternative Dairy Products to Determine Capital Investment and Operational Feasibility of a Small-Scale Dairy Processing Facility,” from the Journal of Dairy Science, 2007).

Proposed Conclusions

74. The adoption of an exempt plant limit at 1,000,000 pounds independent of any changes to producer-handler regulations would afford these very small plants opportunities to compete in the marketplace and should be adopted. Id.

J. Regarding AIDA Proposals 23, 24, and 25

Proposed Findings

75. The exemption of a handler's own farm production from pricing and pooling, including down allocation, (as contemplated by the two alternative methods of Proposal 23) would permit those handlers to purchase additional milk from pool sources and thereby increase pool receipts. Knutson, Tr. 3082-83; Sec. VIII, A, supra.
76. The exemption of a handler's own farm production from pricing and pooling, including down allocation, (as contemplated by the two alternative methods of Proposal 23) would reduce the amount of surplus milk a producer-handler must maintain. Knutson, Tr. 3085; Sec. VIII, A, supra.
77. The exemption of a handler's own farm production from pricing and pooling, including down allocation, (as contemplated by the two alternative methods of Proposal 23) would avoid the imposition of a pool payment on own-farm milk already produced at a cost of production in excess of regulated minimum prices. Knutson, Tr. 3082-85; Sec. VIII, A, supra.
78. The treatment of a handler's own farm production as partially regulated milk volumes (as contemplated by the second alternative method of Proposal 23) would prohibit the sale of milk at less than the Class I price plus the costs of manufacturing, processing, handling, marketing, and delivery. The scenario described by the Dairy Institute of California witnesses could not occur under such regulations. See, e.g., Knutson, Tr. 3084; Sec. VIII, A, supra.

79. A producer-handler that controls all aspects of production, processing, and sale to the ultimate consumer operates autonomously of the regulated community.

Knutson, Tr. 3086; Sec. VIII, B, supra.

80. Individual handler pools provide an incentive for producers to sell milk to Class I handlers by channeling Class I revenues to those plant and producers serving the

Class I market. Knutson, Tr. 3092; Sec. VIII, C, supra.

81. Identifying pool producer and issues of pool qualification can be minimized or

eliminated using individual handler pools. Knutson, Tr. 3092-93; Sec. VIII, C, supra.

82. The occurrence of opportunistic depooling, and its commensurate negative impact

on pooled producer income, would be eliminated with the use of individual handler pools. Knutson, Tr. 3092-93; Sec. VIII, C, supra.

83. While producer payments under individual handler pools would be different than

under marketwide pooling, the current marketwide pooling system does not ensure equal treatment of producers, either. Through the use of its permitted powers, cooperative can and do pay producers different prices on different bases.

See, e.g., Knoblauch 3024, 3415-18; Cornell Dairy Farm Business Surveys.

Proposed Conclusions

84. AIDA's Proposal 23 is a less burdensome alternative to Proposals 1, 2, and 26, and their variants. Sec. VIII, A.

85. If the Secretary elects to limit producer-handlers by any of the offered Proposals,

those producer-handlers who control production, processing, and retailing, should remain exempt from pricing and pooling, as described in AIDA's Proposal 24.

Sec. VIII, B.

86. The current marketwide pooling system does not ensure producer equity, due to the occurrence of over order premiums, depooling, and cooperative re-blending of producer incomes. The implementation of individual handler pools provides significant benefits over marketwide pooling and should be adopted as an alternative to the elimination of producer-handlers on a nationwide basis. Sec.

VIII, C.

X. Conclusion

At the insistence of the largest trade groups in the dairy industry, the Department has held a hearing on the proposed reversal of over seventy years of Department policy regarding producer-handlers. In 2003, the industry spent three weeks in hearings looking over a mountain of exhibits, and heard from dozens of witnesses in Arizona, Washington, and Virginia. That was followed by a hearing in Atlanta which resulted in no decision, at all. Now it has been done all over again, and the only conclusion to be drawn is that the proponents have failed to present any evidence, let alone meet their burden of proof to justify a national limitation or elimination of producer-handlers. Once again, the proponents have spent more money and have parroted the same inaccurate buzzwords. The bottom line is that the Department has been provided with no proof that producer-handlers cause disorderly marketing conditions and no justification to warrant the adoption of Proposals 1 and 26 or the responsive variants.

The wholesale abolition of producer-handlers would eliminate an opportunity for dairy producers that has existed as long as the federal milk marketing order system. More importantly,

it would ensure that new market entrants, who have brought innovation, competition, and choice to the consumer would be left facing additional costs that place them at a cost disadvantage to other handlers.

Producer-handlers are the epitome of entrepreneurial risk takers that should be encouraged and not penalized. The producer-handler bears the entire risk of its operation. They invest in livestock, real estate, property, employees, equipment, plants and facilities, shipping capacity and costs and expenses of both producing and handling milk. They made their investment to become producer-handlers in reliance upon regulations and policy that has stood for over 70 years. To take revenues from these operations every month and distribute it among their competitors is anti-American. It is the antithesis of capitalism.

Simply stated, there is no evidence that producer-handlers cause disorderly marketing conditions nationwide—neither the supply nor price of milk in any marketing order is fluctuating unreasonably as a result of producer-handler activity. With or without producer-handlers, the quantity of milk previously or currently available to the consuming public is more than adequate and there are no inefficient movements of milk in the markets attributable to producer-handler activity.

For the reasons set forth in this brief, AIDA and its members request that the Secretary approve its Proposed Findings of Fact and Conclusion of Law and reject Proposals 1 and 26 and their variants. If the Secretary determines that changes to the producer-handler regulations are proper, then AIDA urges the Secretary to adopt Proposals 23, 24 and 25.

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CERTIFICATE OF SERVICE

The foregoing Brief and Proposed Findings and Conclusions was served upon the following parties on July 17, 2009, by electronic mail or hand delivery as indicated.

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/s/ Alfred W. Ricciardi

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

IN Re:	X	FEBRUARY 26, 2004
	X	9:00 a.m.
MILK IN THE APPALACHIAN AND SOUTHEAST MARKETING AREAS; NOTICE OF HEARING ON PROPOSED AMENDMENTS TO TENTATIVE MARKETING AGREEMENTS AND ORDERS	X X X X X X	DOCKET NOS. AO-388-A15, AO-366-A44 and DA-03-11 WESTIN ATLANTA HOTEL 4736 BEST ROAD ATLANTA, GA

VOLUME IV OF IV

APPEARANCES:

JUDGE PRESIDING: HON. VICTOR W. PALMER
USDA

USDA: MS. SHARLENE DESKINS

USDA/OGC

USDA/AMS/DAIRY PROGRAMS: MS. ANTOINETTE M. CARTER
MR. JACK ROWER
MR. BRAD STOKER

OTHERS PRESENT:

MR. MARVIN BESHORE
SOUTHERN MARKETING AGENCY, INC.

MR. JEFF HITCHELL
KROGER COMPANY

AL RICCIARDI
SARA FARMS AND MICHAEL SUMNERS

MR. CHARLES ENGLISH
THELAND, REED & CREEST

MR. GARY LEE
PRAIRIE FARMS

MR. EARNEST YATES
MR. WILLIAM CURLEY
DEAN FARMS

MR. PAUL CHREST
MR. CARL CONOBER
CONSULTANTS

MR. JOHN VETNE
SOUTHEAST MILK, INC.

REPORTER:

JANICE ADDINGTON

CONTRACTOR (not present):

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Attachment

1 so large that it, in fact, took over that entire marketing
2 area and could make a decision as to whether or not to
3 accept milk from a producer or not, isn't it true that in
4 that circumstance, that some producers would be denied an
5 opportunity to participate in the Class I pool?

6 A. As long as there's a Federal Order in a pool,
7 producers have the opportunity to participate if they, you
8 know, sell milk to handlers who are part of the pool.

9 Q. Okay. Your --

10 A. And if there's a -- if there's a Federal Order
11 pool in a geographic area, handlers with Class I sales are
12 required to be regulated by the pool.

13 Q. Okay. Your position, as I understand it, is that
14 size alone is sufficient to have the Secretary limit the
15 size of producer-handlers and cap it at a hard cap of three
16 million pounds per month, correct?

17 A. I don't think you characterized that correctly.

18 Q. Well, let's go through it this way.

19 A. Okay.

20 Q. Let's assume in a marketing area you've got ten
21 producer-handlers that market up to a million pounds of
22 milk a month.

23 A. Each or a total?

24 Q. Each.

25 A. Each? Okay.

1 Q. In that market then we've got producer-handlers
2 that are producing ten million pounds a month, right?
3 Correct?

4 A. Correct.

5 Q. And -- that's fine.

6 And in that situation, under any of the proposals
7 that are made regarding limitations of producer-handlers,
8 none of those producer-handlers would be limited in size.

9 A. Correct.

10 Q. Now, instead, if we take a producer-handler in
11 that same market who produces ten million pounds a month --
12 so we're taking nine participants out, and we've just taken
13 the same volume and transferred it to the producer-handler,
14 your position is that that alone would be enough to have
15 the Secretary limit the producer-handler exemption and make
16 that person a regulated handler, right?

17 A. That would be correct if the producer-handler's
18 volume of Class I sales in a marketing -- in any marketing
19 area or any market where it's greater than three million
20 pounds in a month --

21 Q. And the only distinction --

22 A. -- we would propose that they be regulated and,
23 you know, be treated for price purposes like any other
24 handler.

25 Q. And the only distinction in my hypothetical

1 between the two things is we've taken ten participants
2 producing ten million pounds and reduced it to one
3 participant that is producing ten million pounds, correct?

4 A. Well, our proposal is that three million pounds,
5 if there were a proposal -- perhaps you might make one --
6 we might give it consideration and support to move the
7 limit from three down to one. But --

8 Q. Didn't ask you that, Mr. Hollon. What I asked
9 you was the only distinction in my hypothetical was what
10 we've done is we have the same volume. We just knocked the
11 participants, producer-handlers, from ten down to one.
12 Correct?

13 A. Yes.

14 Q. All right. Thanks.

15 Now, let's take this situation. Same market.
16 Okay? Now we've got three producer-handlers. For each
17 marketing, 2,999,999 pounds of milk per month in that
18 particular market.

19 A. Yes.

20 Q. In that situation, none of those producer-
21 handlers would be required to automatically become a
22 regulated handler under any of the proposals, correct,
23 because they're less than three million?

24 A. Correct. That's correct.

25 Q. And can you tell me the difference in the market

1 in my third hypothetical versus my second? How is the
2 market impacted differently when you have three producer-
3 handlers at 2,999,999 versus one producer-handler at 10
4 million pounds?

5 A. Well, there's always --

6 Q. Other than a pound here or there?

7 A. There's always the possibility that the end
8 results may be similar, so that would be one. And so there
9 may be, indeed, an impact that may, you know, cause some
10 relook at the situation at that date.

11 So that situation would arise. We may come back
12 to the Secretary and say, you know, we're concerned about
13 this situation and we would like to do something about it.

14 Secondly, the impact, as we have seen in other
15 areas, of a single entity of sufficient size appears to be
16 greater on the market than a smaller entity, and the
17 ability to service, perhaps, a larger retail chain without
18 the requirement of paying class prices is greater.

19 Q. Is that your answer?

20 A. Yes.

21 Q. Okay. Now, let's talk about the issue of size
22 for a moment.

23 Kroger has been here, and I believe Mr. Hitchell
24 has provided some testimony. Kroger has plants throughout
25 the United States that have production on any given month