

**BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE**  
**AGRICULTURAL MARKETING SERVICE**

**In the Matter of:** ) **DOCKET NO. AO-368-A32;**  
**MILK IN THE PACIFIC NORTHWEST** ) **AO-271-A37; DA-03-04**  
**AND ARIZONA - LAS VEGAS** )  
**MARKETING AREAS** )

**JOINT EXCEPTIONS AND COMMENTS  
TO THE RECOMMENDED DECISION  
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**JOINT EXCEPTIONS AND COMMENTS  
TO THE RECOMMENDED DECISION  
BY EDALEEN DAIRY, LLC, MALLORIE’S DAIRY, INC.  
SARAH FARMS, INC., AND SMITH BROTHERS FARMS, INC.**

**I. INTRODUCTION**

The Recommended Decision would, for the first time in the seventy-year history of the AMAA (7 U.S.C. §§601 *et seq.*), apply the minimum pricing and market wide pooling provisions of milk marketing orders to producer-handlers who neither purchase raw milk from producers nor sell it to handlers. The AMAA does not provide the Secretary the legal authority, and the record provides no factual basis to change the long-standing exemption of producer-handlers. The Recommended Decision is arbitrary, capricious, and not in accordance with the law and must be terminated.

Faced with intense pressure from industry giants that compete with producer-handlers and want to take their market share, the Department ignored its practice of basing decisions on the law and the facts, and instead changed decades long Department policy despite Congressional limitations and the absence of substantial evidence. Producer-handlers in the Pacific Northwest Order, Mallorie’s Dairy, Smith Brothers Farms, and Edaleen Dairy in conjunction with one from Arizona-Las Vegas, Sarah Farms, present these exceptions and comments to the Recommended Decision.

The Secretary’s authority under the AMAA is limited to only those provisions which are enumerated in the Act. 7 U.S.C. §608c(5) and (7). The AMAA only authorizes the establishment of minimum prices and pool obligations on milk purchased from producers. Producer-handlers by definition do not purchase milk. Mykrantz, Tr.93; Christ Tr.1643-44. The Department has long maintained this position by exempting producer-handlers from such regulations, and Congress has on multiple occasions not only ratified that interpretation but legislated that the “legal status of producer-handlers” (exempt 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 Congress has not amended or repealed these permanent statutes expressly or implicitly, a fact which the Department acknowledged and accepted in order reform. The Recommended Decision exceeds the Department's authority and is therefore not in accordance with the law.

In this formal rulemaking proceeding under the Administrative Procedure Act ("APA"), the proponents bear the burden of proof. 5 U.S.C. §556(d) ("Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof."). This burden encompasses not only the production of evidence upon which a valid order can be based, but also the ultimate "burden of persuasion." *Director, Office of Workers' Comp. 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.). In other words, the proponents of the changes to Orders 124 and 131 are required to prove – on the formal record of the hearing – the essential facts of their case. See *Fairmont Foods v. Hardin*, 442 F.2d 762, 767 (D.C. Cir. 1971).

Any dramatic departure from established rules that would impose punitive and ruinous costs upon businesses that have legitimately relied on longstanding precedent must be premised on something more than the unsubstantiated and self-interested assertions of the proponents. *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 416 (3<sup>rd</sup> Cir. 1987). Claims of proprietary information and privilege does 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 action, 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 its defense.”) When a party refuses to produce relevant evidence under its control, an adverse inference arises. *See, Brewer v. Quaker State Oil Refining Corp.*, 72 F.3d 326, 335 (3d Cir. 1995); McCormick on Evidence, 184-189 (John William Strong, ed., 4th ed. 1992).

Despite their evidentiary burden, the proponents here have failed to introduce evidence within their control and, instead, relied upon anecdotes that have been assailed as presenting an incomplete picture and “estimates” that cannot be verified or cross-examined. *See, generally*, Herbein (refusing to disclose the data underlying his analysis and opinions); McBride (admitting that his testimony about competition in order 124 was not based on personal knowledge or that he knew of the relevant time frame for his statements), Smith (opining as to farm production costs without relevant background in order 124 or order 131 and without knowledge of the affected producer-handlers’ operations); Krueger (refusing to offer his own price comparisons against those obtained from Sarah Farms).

To withstand judicial review, the Recommended Decision must result from “reasoned decisionmaking”. The Secretary must adequately explain the agency’s conclusions in terms of the evidence in the hearing record and the applicable legal standards. The standards for reasoned decisionmaking are “strict and demanding.” *Motor Vehicle Mfrs Ass’n of U.S., Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 48 (1983). The Department’s action fails to meet the standard of reasoned decisionmaking because it relies on improper considerations, fails to consider important aspects of the problem, offers a rationale that is inconsistent with the evidence, or reaches a conclusion that is so implausible that it cannot be attributed to expertise or a difference of opinion. *See State Farm*, 463 U.S. at 43. In a formal

rulemaking, moreover, the Secretary must consider the record **as a whole**; he cannot simply disregard record evidence that is inconsistent with the findings and conclusions. *See* 5 U.S.C. § 706 (directing courts reviewing agency decisions to consider the record as a whole); *Allentown Mack Sales and Service, Inc. v. N.L.R.B.*, 522 U.S. 359, 366-71 (1998) (reversing NLRB decision under substantial evidence standard because the NLRB had disregarded contrary evidence in the record). The Recommended Decision does not contain sufficient findings to establish the legal bases for these changes. The Department's findings are not supported by substantial and credible evidence in the record sufficient to sustain the proponents' burden of proof. The Department also does not provide a rational and credible explanation for its findings and conclusions and departure from prior decisions. Finally, the Recommended Decision largely ignores objections and contrary evidence introduced by the opponents.

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.**

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

The Recommended Decision fails to consider whether integrated operations, common in the rest of the dairy sector and in business in general, have a right to continue to exist as they have since before the Federal Orders were even created. Instead, it is about whether producer-handlers have to either pay their competitors to participate in the market or disappear altogether.



“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.” [http://www.ams.usda.gov/dyfmoms/mib/prod\\_hand\\_dscrp.pdf](http://www.ams.usda.gov/dyfmoms/mib/prod_hand_dscrp.pdf) (June 6, 2005). This definition fails to account for the distinctive features of producer-handler operations that render their inclusion in pooling arrangements unworkable, unfair, and inconsistent with the AMAA. As an integrated operation there is no “transaction” from one entity to another to measure, value, or price. Christ Tr. 1643-44. The profit or loss, balance sheet, and return on equity are measured for the entire operation and cannot be divided.

The assumption throughout the Recommended Decision is that if producers succeed by receiving blend prices and handlers succeed by paying minimum prices, a producer-handler must be able to succeed by paying the difference between the plant blend and the FMMO blend price to the pool. Under this theory, the plant will pay minimum prices and the producer will receive a blend. This assumption, however, ignores the critical differences between arms-length sales of milk by producers to handlers and the integrated operations of producer-handlers.

When a plant and producer are not part of the same entity, each is protected from the risks associated with changes in production of the other. This is not the situation with producer-handlers. Loss of sales at the plant does not translate into a loss of production at the farm. A need for more milk at the plant cannot be readily met from the farm. A regulated handler with no production of its own purchases only the milk it needs, at the minimum prices fixed by the order. The handler, therefore, faces no risks from high raw milk production costs; if it costs more to produce milk than the class price, the plant still pays only the class price. In contrast, a producer-handler absorbs the entire costs of production and is not protected from periods where the cost of production exceeds class prices. Similarly, a handler who purchases milk can

control the volume of milk so that it pays only on the milk it actually needs. That is not the case for producer-handlers who have to dispose of all of its farm milk with or without a market.

Because a producer-handler operation cannot be readily separated into a handler and a producer, the economic consequences of this decision on the opponent producer-handlers are devastating. Compensatory pool payments required if this decision is adopted will exceed the operating profits of these family-owned businesses. Herbein Tr. 3022. These producer-handlers, and hundreds of their employees, vendors, suppliers, independent distributors, family operated stores and restaurants all face significant risk. Moreover, well in excess of thirty thousand consumers representing in excess of one hundred thousand milk drinkers oppose this Recommended Decision so strongly that they have submitted their own comments to the Department or joined in the petition to terminate this proceeding.

In sum, the Recommended Decision ignores the unique characteristics of producer-handlers' integrated operations, and forces them to pay millions of dollars into the pool without affording them any offsetting benefits.

## **II. EXCEPTIONS TO THE RECOMMENDED DECISION**

The opponent producer-handlers in accordance with 7 C.F.R. §900.12, present the following exceptions to the Recommended Decision. 70 Fed.Reg. 19636 (April 13, 2005). They request a specific ruling on each exception in accordance with 7 C.F.R. §900.13a(c).

- ▶ Opponent producer-handlers take general exception with the findings and conclusions that the Department has statutory authority to regulate producer-handlers based on size, that changes in marketing conditions and the existence of disorder have occurred to justify a change in Department policy, and that the selection of three million pounds as a cap is supported by substantial evidence

(including the elimination of the exemption and the imposition of a higher or lower cap). (Discussion, Section A, this heading).

- ▶ Opponent producer-handlers take exception with the finding and conclusion that “the legislative history indicates that there is authority to regulate [producer-handler] operations.” 70 Fed. Reg. at 19653. (Discussion, Section B, this heading)
- ▶ Opponent producer-handlers take exception with the finding and conclusion that “the major consideration in determining whether a producer-handler is a large or small business focuses on its capacity as a dairy farm.” 70 Fed. Reg. at 19654 (Discussion, Section C, this heading).
- ▶ Opponent producer-handlers take exception with the finding and conclusion that “producer-handlers with more than 3 million pounds of Class I route disposition significantly affect the blend price received by producers” and that “a blend price impact of one cent per cwt is significant.” 70 Fed. Reg. at 19654. (Discussion, Section D, this heading).
- ▶ Opponent producer-handlers take exception with the finding and conclusion that marketing conditions and the blend price impact of producer-handlers in Orders 124 and 131 have occurred “since implementation of Federal milk order reform in January 2000.” 70 Fed. Reg. at 19654. (Discussion, Section E, this heading).
- ▶ Opponent producer-handlers take exception with the finding and conclusion that “producer-handlers with more than three million pounds of route disposition per month in both the Pacific Northwest and Arizona-Las Vegas marketing areas are the primary source of disruption to the orderly marketing of milk.” 70 Fed. Reg. 19654. (Discussion, Section F, this heading).
- ▶ Opponent producer-handlers take exception with the findings and conclusions that “producer-handlers with route disposition of more 3 million pounds per month have and are placing their fully

regulated competitors at a comparative sales disadvantage” and that “the large producer-handler is able to compete for commercial customers at prices that a regulated handler is unable to match” and that “the competitive pricing advantage of producer-handlers is clearly attributable to their exemption from paying the difference between the Class I and blend price into the producer-settlement fund.” 70 Fed. Reg. at 19654. (Discussion, Section G, this heading).

- ▶ Opponent producer-handlers take exception with the finding and conclusion that “the difference between the Class I price and the blend price is a reasonable estimate of the pricing advantage producer-handlers enjoy. . .” 70 Fed. Reg. at 19654. (Discussion, Section H, this heading).
- ▶ Opponent producer-handlers take exception with the finding and conclusion that “producer-handlers with more than 3 million pounds of route dispositions per month have gained the ability to no longer bear the burden of the surplus disposal of their milk production.” 70 Fed. Reg. at 19655. (Discussion, Section I, this heading).
- ▶ Opponent producer-handlers take exception with the finding and conclusion that “orderly marketing [is] a key objective of the AMAA” without regard to consumer interests. 70 Fed. Reg. at 19654. (Discussion, Section J, this heading).
- ▶ Opponent producer-handlers take exception with the finding and conclusion that it is proper to assess producer-handler operations with more than three million pounds of monthly Class I route disposition a pool obligation equal to the Class I/blend price spread. 70 Fed. Reg. at 19654. (Discussion, Section K, this heading).

The bases for each of these exceptions are discussed below.

**A. The limitation of producer-handlers based on size, specifically the imposition of a 3 million pound cap, contradicts expressed Department policy and is not supported by substantial evidence in the record.**

The Department has repeatedly declined to impose minimum pricing and pooling obligations on producer-handlers and specifically rejected efforts to impose similar size-based limitations. In order to effect the dramatic change contemplated by the Recommended Decision, the Department “must supply adequate data and a reasoned analysis to support the change.” *Lehigh Valley*, 829 F.2d at 413. “Simply asserting that conditions have changed will not support a change in the agency's position without a showing that the assertion is supported by substantial evidence in the record.” *Id.* The Recommended Decision fails to meet this standard.

**1. The Recommended Decision violates long-standing Department policy and contradicts prior administrative decisions.**

The Recommended Decision would overturn, without substantial evidence in the record, the Department’s long-standing policy, repeatedly ratified by Congress, of exempting producer-handlers from the pricing and pooling requirements of the Federal Orders. The Department itself has recognized that it has no authority to impose a scheme of minimum pricing and pooling without purchases. This Recommended Decision purports to change that.

Since 1988, the Department has considered changes to the producer-handler exemption on at least four occasions and declined to impose minimum pricing and pooling obligations. In 1988, amendments were considered to the Texas and Southwest Plains Orders when the Pure Milk and Ice Cream Company acquired producer-handler status. Those amendments would have imposed a volume limitation on the size of exempt producer-handlers. In the Recommended Decision on the proposals, the Department stated:

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.**

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

Just one year later, the issue of producer-handler status was addressed in the consolidation of the Rio Grande Valley, Lubbock-Plainview, and Texas Panhandle orders. The Department rejected AMPI's efforts to impose more restrictive qualification requirements for producer-handlers and to limit purchases from pool plants to 5,000 pounds per month. The proposal also attempted to limit the types of customers a producer-handler could have and excluded them from chain stores and much of the retail market – just as the proposals suggest here. The Department cited virtually the same reasons expressed in the Recommended Decision in the 1988 hearing. Producer-handlers were not disruptive where they were responsible for the balancing of their own supply. Of particular significance is the fact that, like Orders 124 and 131, the Rio Grande Valley had a significant producer-handler presence. In the four years leading up to the consolidation of these marketing areas, producer-handlers accounted for between seven and eleven percent of route disposition, 55 Fed. Reg. 43345, 43353 (October 29, 1990), which is comparable to the production of producer-handlers in the two orders at issue in this hearing. Despite the same end-of-the-world rhetoric proponents employed in those earlier applications, the market continues to function in an orderly fashion in those orders, and normal, healthy competition continues to flourish.

Likewise, in 1992, the Department rejected the efforts of UDA (one of the proponents in this case) to impose additional regulations on producer-handler operations in the Central Arizona Marketing Area by requiring producer-handlers to produce a minimum amount in excess of their Class I route disposition.

The Department reasoned that the UDA proposals “lack[ed] objective standards and instead relie[d] on subjective judgments” and would otherwise “penalize producer-handlers and fully regulated handlers even when a P-H was acting in a totally unobjectionable manner.” 58 Fed.Reg. 67703, 67705 (December 22, 1993). The identical statements can be made about the arbitrary caps proposed here to address an alleged “disorderly marketing” problem that does not exist.

The Department also noted in the 1993 decision that UDA and Shamrock Foods dominated the Central Arizona Order in terms of balancing capacity and producer milk. *Id.* While there are some additional market participants in the Arizona-Las Vegas Order now, the market is still dominated by Shamrock and UDA. If the Recommended Decision is not terminated, competition in Order 131 will be stifled and their market domination would be intensified, to the detriment of consumers.

In another decision which merged several marketing orders into the former Georgia Order, the Department rejected proposals by producer cooperatives that would have prevented producer-handlers from servicing any wholesale accounts. In doing so, the Department correctly declared, “Experience in the markets involved in this proceeding indicates that effective regulation can be achieved without adopting the type of overly restrictive producer-handler provision proposed by the cooperative coalition. In particular, **there is no basis for absolutely precluding a producer-handler from having wholesale customers.**” Milk in the Georgia and Certain Other Marketing Areas, 60 Fed. Reg. 25014, 25033 (May 10, 1995).

Finally, the Department was requested during the course of Federal order reform to address the producer-handler exemption. Submissions suggesting the curtailment or elimination of producer-handler regulations were made by UDA, AMPI, and Vitamilk Dairy. Ex. 18, 21. These are the very same entities using the identical arguments here that they used in their previous petitions to the Department. Despite these requests, the proposed rule of April 2, 1999, denied their requests:

It has been a long-standing policy to exempt from full regulation many of those entities that operate as both a producer and a handler....Some modifications have been made to the producer-handler provisions in the consolidated orders for standardization. However, no changes have been made that would intentionally regulate a producer-handler that is currently exempt from regulation under their current operating procedures....**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.**

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

The Recommended Decision also contradicts the Department's long-standing policy not to regulate those plants who have not heretofore been subject to regulation. The Department's decision on order reform explicitly stated that no changes were made to purposely regulate a plant that has not been subject to regulation. 64 Fed. Reg. 16026, 16036. Prior to order reform, the Department had similarly refused to regulate handlers who did not choose to be regulated. *See Milk in the Central Marketing Area*, 53 Fed. Reg. 5777 (February 26, 1988) (declining to add certain counties in central Missouri in a marketing area because doing so would regulate Central Dairy; these counties remain unregulated today); *Milk in the New England Marketing Area*, 48 Fed. Reg. 29523 (June 27, 1983) (removing Dukes County, Massachusetts from the marketing area at the request of Seaside Dairy, a milk handler with own-farm production and over the objection of other regulated handlers).

**2. No demonstrable change in marketing conditions has occurred since order reform.**

The Department attempts to justify its Recommended Decision on the grounds that the "overall dairy industry marketing structure ha[s] changed significantly in these orders resulting in disorderly marketing." 70 Fed. Reg. at 19654. Implicit in this comment is that these "significant" changes have occurred since 2000 when the orders were implemented by an Act of Congress. It is the law, however, that in order to change regulations, the Department "must supply adequate data and a reasoned analysis to support the change." *Lehigh Valley*, 829 F.2d at 413. "Simply asserting that conditions have changed will not support



a change in the agency's position without a showing that the assertion is **supported by substantial evidence in the record.**" *Id.* (emphasis added).

A review of the Order statistics in the current hearing and the testimony admitted at the hearing shows that there is no substantial evidence that the marketing conditions in either of these two orders are different from January 2000 when the current regulations took effect. No change was made then and no evidence of the type needed to completely re-write seventy years of producer-handler regulations exists now.

Additional detailed examination of this point is set forth in Section E.

**3. The Department's selection of a three million pound cap is arbitrary and capricious.**

None of the explanations offered by proponents (in the testimony of Elvin Hollon on behalf of Dairy Farmers of America Tr.2846-47 and agreed to by William Van Dam on behalf of NDA, Tr.2921-22. provide a valid basis for the imposition of a 3 million pound cap. Studies purporting to establish that economies of scale for milk processors vanished at 3,000,000 pounds are unreliable. The exemption of milk handlers processors processing less than 3,000,000 pounds of milk per month from contributing to the milk processor promotion fund is irrelevant to the regulation of producer-handlers. The conclusion that a 3,000,000 pound per month producer-handler could serve "a number of small retail stores" does not provide a basis for regulating them. Finally, anecdotal evidence about producer-handlers and their impact on the blend price is not "evidence" of disorderly marketing.

**a. The Herbein study is unreliable and, more fundamentally, its conclusions regarding the size of producer-handlers do not provide a valid basis for regulating producer-handlers.**

Congress has never given the Secretary any authority to regulate handlers based upon their efficiencies. The argument that producer-handlers in excess of three million pounds have a different competitive status which therefore justifies removal of the exemption counters Congressional acts and this Department's long-standing policy. A perusal of the AMAA will show nothing that even comes close to authorizing the Secretary to cripple the efficiency of any industry participant. As a matter of law, the Secretary is required by law to do just the opposite and that is encourage the flow of milk to the consuming public. 7 U.S.C. §601. The protection of large handlers from competition by producer-handlers is not a valid basis for subjecting producer-handlers to the orders.

In a flawed submission that fails to meet the *Daubert* standard for expert testimony, the proponents provided a "study" by Carl Herbein with the purpose of showing that plants above 3 million pounds pose threats to larger handlers in the market. The Herbein testimony contained no facts and was based on mere speculation and conjecture. For this reason alone, the study cannot be regarded as a reliable basis for the 3 million pound limit, and its many flaws are detailed elsewhere in these exceptions and comments. Moreover, the producer-handlers were denied effective cross examination of this witness because he refused to provide the data that he claims supports the "conclusions."

**b. The Fluid Milk Promotion Act does not provide authority to limit producer-handlers.**

The use of the Fluid Milk Promotion Act (7 U.S.C. §6402(4)) exemption as a basis for setting the cap at three million pounds is arbitrary and not in accordance with the law. Prior to 1999, the Fluid Milk Promotion Act defined processors subject to that Act as any processor who processed more than 500,000 pounds of fluid milk products. In 1999, Congress increased the size of processors who were exempt from the fee from 500,000 pounds per month to 3 million pounds per month. P.L. 107-171, Sec. 1506.

The Fluid Milk Promotion Act, however, is irrelevant to the producer-handler exemption. Although both the Fluid Milk Promotion Act and the AMAA both involve milk, the two statutes serve fundamentally different purposes. The Fluid Milk Promotion Act is designed to increase consumer demand for milk through advertising and applies even to plants that are not subject to any Federal milk marketing order. The size of the plants excused from the obligation to contribute reflects the congressional judgment that smaller operations should not be required to do so. That judgment, however, is unrelated to the AMAA. The Fluid Milk Promotion Act has nothing to do with the regulation of sales by producers to handlers or marketing conditions for raw milk and does not confer any authority on the Department to regulate the internal operations of producer-handlers or to require their participation in the pooling arrangements. There is nothing in that statute that authorizes the Secretary to deny producer-handler status based upon size.

**c. The Department has explicitly denied that the servicing of wholesale or retail accounts is relevant to the producer-handler exemption.**

The number of small grocery stores that can be serviced under the cap provides no justification for the 3,000,000 pound cap and only demonstrates that the real goal of the proponents is to freeze producer-handlers out of the growing and lucrative segments of the dairy marketplace. While competing handlers might prefer to confine producer-handlers to servicing a small and dwindling segment of the market and reserve for themselves the larger and more lucrative segments, that does not provide any legal basis for restricting the size of producer-handlers. The Department rejected this rationale in creating the Southeast

Marketing Area:

Experience in the markets involved in this proceeding indicates that effective regulation can be achieved without adopting the type of overly restrictive producer-handler provision proposed by the cooperative coalition. In particular, there is no basis for absolutely precluding a producer-handler from having wholesale customers.

Milk in the Georgia and Certain Other Marketing Areas, 60 Fed. Reg. 25014, 25033 (May 10, 1995).

Mr. Hollon's testimony about the ability of a producer-handler to service small retail stores merely shows that a producer-handler under 3,000,000 pounds per month can supply milk to stores that are rapidly going out of business and becoming marginalized. Knutson Tr. 2144. As noted above, the real purpose of the study and the 3 million pound limit it purportedly supports is to freeze producer-handlers out of the larger and growing markets for fluid milk and to leave them exclusively to the "big boys" such as Dean Foods, DFA, NDA, UDA, and Shamrock. The implication is that as long as producer-handlers stay in their place that no one will have any problems. The result oriented character of this study, like the other alleged bases for justification of the 3,000,000 pound cap, is confirmed by the fact that the study was performed only after 3,000,000 pounds was selected as the cutoff.

What is striking about this argument is that witnesses from the Northwest, proposing to limit producer-handlers, complained about the lack of such small customers and their continuing demise. Vander Pol Tr. 468. It is disingenuous for the giants of the dairy industry to try to limit producer-handlers to servicing only those customers that the proponents know will not even exist in the near term.

**4. The Department also acknowledges that the 3,000,000 cap is arbitrary and capricious.**

The Department has established the 3,000,000 pound per month solely because that is what the proponents asked for and not based upon any evidence at the hearing. The Department states that:

Review of the intent of the producer-handler provision and the marketing conditions arising from this provision in these orders could warrant finding that the original producer-handler exemption is no longer valid or should be limited to 150,000 pounds per month Class I route disposition limit. However, the hearing notice for this proceeding constrains such a finding to a level of not less than 3 million pounds per month of Class I route dispositions.

70 Fed. Reg. at 19654. Implicit in this statement is that the Department is basing the limit of producer-handler exemption not on substantial evidence of the level of producer-handler activity the marketing areas, but on the view that the producer-handler exemption should no longer exist. It is further recognition that the decision as to when a producer-handler is “too big” is an arbitrary decision.

**B. Congress has denied the Department authority to regulate producer-handlers.**

The Congress has in two ways deprived the Department of the authority it now presumes to exercise. The plain language of the AMAA limits the Department to establishing minimum prices and pooling obligations only on “milk purchased from producers.” Further, the long-standing regulations exempting producer-handlers has been legislatively codified.

**1. The Secretary has no statutory authority to impose minimum prices or pool obligations on milk which a producer-handler possesses through its integrated operation.**

The Department possesses only that authority Congress provides it and no more. *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 413 (3rd Cir. 1987) (“The terms and conditions that an order may contain are limited to those provided by statute.”) Thus, the Department’s authority to impose minimum prices and pool obligations on producer-handlers depends on the authorizing statute. 7 U.S.C. § 601 *et seq.* The plain language of the AMAA, confirmed by common tools of statutory construction, denies the Department any authority to regulate a producer-handler that neither sells the raw milk it produces to any handler nor purchases raw milk from any producer. The statute is designed to regulate only the subset of dairy production and marketing that occurs in purchase transactions between producers or associations of producers, and handlers. Other market activity which is not in that subset is outside of the Department’s authority and control.

The AMAA provisions upon which these orders are based consistently refer to transactions in which handlers purchase milk from producers and the prices at which these purchases are to take place, language which cannot be stretched to encompass the integrated operations of producer-handlers. The statute authorizes the Department to fix or provide a method for fixing “minimum prices . . . which all handlers shall pay, and the time when payments shall be made, **for milk purchased from producers** or associations of producers.” 7 U.S.C. §608c(5)(A). (emphasis added). An Order can provide “**for the payment to all producers** and associations of producers delivering milk to the same handler of uniform prices for all milk delivered by them” (individual handler pool), or “for the **payment to all producers** and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered, irrespective of the uses made of such milk by the individual handler to whom it is delivered” (marketwide pool). 7 U.S.C. §608c(5)(B). (emphasis added). These payments to producers encourage seasonal adjustments in the production of milk through “equitable apportionment of the total value of the milk **purchased by any handler** [as opposed to possessed by own production],” and an 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.” (emphasis added). Subsections (D) and (E) continue this theme, referring again to milk purchased by handlers from producers, and payments made by handlers to producers.

The words “purchase” and “pay” are neither ambiguous nor unclear. The meaning of both within the statutory context is plain and unvarying. Black's Law Dictionary defines purchase as the “act or instance of buying” which necessarily involves the transmission of property from one person to another by voluntary act and agreement founded on valuable consideration. Black's Law Dictionary, 7th Ed. 1248 (1999).

Because producer-handlers neither pay themselves nor purchase milk, they fall completely outside the statutory authority of the Secretary.

An isolated reference in the AMAA to uniformity “as among handlers (including producers who are also handlers).” 7 U.S.C. § 608c(5)(C), does not support a contrary reading as has been argued by the proponents. First, because this phrase refers to “producers who are also handlers” rather than to “producer-handlers” as used elsewhere in the statute, Congress is clearly speaking about something other than producer-handlers’ integrated operations. Second, the provision in question deals with allocations among handlers for “ **the value of the milk purchased by him at the prices** fixed in accordance with paragraph (A) of this subsection,” 7 U.S.C. § 608c(5)(C) (emphasis added), and therefore contemplates that a producer who is also a handler will be involved in a purchase transaction. In context then, and especially in light of the consistent theme of the statute as a whole, the phrase “producers who are also handlers” can only mean that those producers who purchase milk from others in their capacity as handlers must make uniform payments and obtain equalized value with respect to any milk purchased or sold. Indeed, that Congress found it necessary to expressly make the statute applicable to this situation makes sense precisely because the whole Act so clearly exempts producer-handlers from regulation that in those cases where producer-handlers do purchase milk from other producers (an occurrence that does happen and is even addressed within the regulations), explicit authority to govern such transactions is necessary.

This reading of the milk marketing provisions of the Act is confirmed by comparing provisions in the same section of the Act that apply to marketing orders for other commodities. Regardless of the definition of “handlers” at 7 U.S.C. § 608c(1), the Act limits orders for milk to regulation of the purchase of raw milk from producers by handlers. In contrast, with respect to other commodities, the Department is given much

broader regulatory authority that is not limited to purchases by handlers from producers. For example, the Department is authorized under 7 U.S.C. § 608c(6) to limit the production of agricultural commodities other than milk, (§ 608c(6)(A)) and to allocate the amount of such commodities that a handler may market or transport to market (§ 608c(6)(C)). The differences in statutory language and regulatory approach between milk and other commodities are palpable, and reveal Congress's intent to limit the Department's authority to regulate milk by confining that authority to handlers' purchases of raw milk from producers.

It is a cardinal rule of statutory construction that a statute should be read as a consistent and coherent whole. The only construction of the AMAA that affords a consistent, coherent, and logical meaning to every provision of the Act is one that limits the scope of milk marketing orders to arms-length transactions between producers and handlers that are separate entities. Extending the orders to producer-handlers who neither sell nor purchase raw milk would do violence to the plain language of the Act and render parts of the Act nonsensical.

*Ideal Farms, Inc. v. Benson*, 288 F.2d 608 (3<sup>rd</sup> Cir. 1961) does not provide authority for the Recommended Decision in this case and in any event is no longer good law. The *Ideal Farms* case considered whether a producer-handler that purchased *some milk* could be subject to price and pooling regulations like a handler that purchased *all its milk* or must be exempted like producer-handlers that purchased *no milk*. Although the Court in *Ideal Farms* upheld the Department's authority to apply pooling provisions to producer-handlers who purchased some milk, the case did not hold and the Court did not address the Department's authority to apply pooling provisions to producer-handlers who have not purchased any milk. In this proceeding, the producer-handlers that would be made subject to the pooling provisions purchase *no milk* save the limited amount permitted under current regulations and, as such, are not subject to pricing according to law even under *Ideal Farms*.



Even if a broad reading of *Ideal Farms* might support the authority of the Department to extend the Orders to the producer-handlers in this case, it is unlikely that other circuits would follow it, much less extend it, because the decision rests on a flawed approach to statutory interpretation that has since been repudiated by the Supreme Court. The Court in *Ideal Farms* reasoned that it would be “illogical” to treat a cooperative that acted as an agent for its members differently from a person who processed only his own production. That is subject to dispute, but is largely irrelevant here. When the language of the statute is clear and unmistakable, as it is in this case, and there are no potentially inconsistent statutory provisions at issue, a court is not at liberty to disregard the text of the statute based on its own view of what would be a “logical” outcome. *See, e.g., United States v. Locke*, 471 U.S. 84 (1985) (refusing to depart from the plain language of a statute requiring that claims to federal land be filed “prior” to December 31, even though this set a trap for the unwary and it would be more logical to require filing on the last day of the year, rather than on the day before the last day of the year); *TVA v. Hill*, 437 U.S. 153 (1978) (refusing to depart from the plain language of Endangered Species Act even though it required the seemingly illogical termination, in order to preserve the habitat of a small and unimportant fish species, of a \$100 million hydro-electric dam project repeated funded by Congress). As Judge Hastie noted in *Ideal Farms*, “[i]f Congress has used restrictive language in the relevant operative provision of a statute, resort to the overall purpose of the legislation does not . . . justify relaxing a stated restriction in a way inconsistent with any reasonable construction of the restrictive language itself.” *Ideal Farms*, 288 F.2d at 619.

The Supreme Court's decision in *United States v. Rock Royal Co-op*, 307 U.S. 533 (1939), also relied on by the proponents, provides no support for the Department's authority to regulate producer-handlers. No producer-handlers were party to that litigation, and the Court did not address the applicability of the AMAA to producer-handlers in its decision. The Secretary had issued an Order pursuant to the

AMAA exempting cooperatives from payment of the uniform price and authorizing payments to these cooperatives and to certain handlers from the producer settlement fund. The defendants asserted there was no statutory basis for these exemptions and payments to cooperatives. The Court held that the defendants lacked standing to challenge the payments made by the Order; and that there was statutory authority to exempt cooperatives under the AMAA. *Rock Royal*, 307 U.S. at 560-62.

One defendant cooperative challenged the order on the additional ground that it was not obligated to pay because it was not a handler, but rather an agent of its member producers, and that it distributed the milk of its producers and paid to them the amount received less expenses. Under the Order then at issue, milk received from a handler's own farm was exempt, so that necessarily the only question before the Court was whether the cooperative was merely an agent for its members or acting as an independent entity. *Id.* at 551, n. 14. In dictum, because the Court had previously held that the cooperative lacked standing, the Court said that such an "agency" cooperative was subject to the AMAA; and that, as to such agency cooperative, the word "purchased" meant "acquired for marketing." Crucial to the Court's conclusion was that both "sale" and "agency" cooperatives were separate entities from their producers and properly characterized as handlers under the Act. *Id.* at 581 (observing that the cooperative does not have its own farm but is itself a handler under the Act.) Thus, even the agency cooperative engaged in transactions in which it acquired milk from producers who were separate entities and the cooperative ultimately paid a price for the milk it sold (the amount it returned to members after the sale). The Court also noted that the cooperative bought and sold milk from non-members, further solidifying its status as a separate entity properly characterized as a handler.

**2. Congress has repeatedly preserved the exempt status of producer-handlers when amending the AMAA, thus adopting the exclusion of producer-handlers by re-enactment.**

Since the 1960s, each time Congress amended 7 U.S.C. 608c, Congress concurrently stated that the Secretary may not alter the legal status of producer-handlers. These repeated congressional mandates make clear that Congress was aware of the producer-handler exemption and wanted it to continue. As such, even if the exemption were not required by the text of the AMAA itself, the exemption has been incorporated into the statute through these re-enactments. Put simply, Congress did not ratify the Secretary's policy but instead legislated the legal status of exemption – an exemption that was not subject to any limitation on size based on numbers or market share. The Department may not disregard these repeated legislative actions and unilaterally eliminate or curtail the exemption for producer-handlers.

In this regard, *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000), is closely on point. The Supreme Court in *Brown & Williamson* rejected the FDA's effort to regulate tobacco products notwithstanding statutory language that was far more supportive of administrative authority than the statutory provisions of the AMAA are in this case. The Court relied heavily on the fact that Congress had adopted a number of statutes addressing tobacco against the backdrop of FDA statements that tobacco was beyond the scope of its regulatory authority. These subsequent statutes effectively engrafted the exclusion of tobacco from the FDA's authority into the statute itself and prevented the agency from later attempting to assert that authority against tobacco companies. Under the reasoning of *Brown & Williamson*, Congress's repeated amendments to the milk marketing provisions, which expressly preserved the exempt status of producer-handlers, prevent the Department from asserting authority to regulate producer-handlers that neither purchase nor sell milk.

For example, in 1968 Congress amended subsections 608c(5) and (18) and then stated,

The legalstatus of producer-handlers of milk under the 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 [amending subsecs. (5) and (18) of this section] as it was prior thereto.

Pub.L. 89-321, Sec. 103. In doing so, Congress ratified the exemption of Smith Brothers Farms and Mallorie's Dairy who were in existence at that time.

Congress again ratified and codified the exemption of Mallorie's Dairy and Smith Brothers Farms when it found:

The legalstatus of producer-handlers of milk under the 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 Act [amending subsec. (5)(B) of this section] as it was prior thereto.

Agriculture and Consumer Protection Act of 1973, Pub.L. 91-524. In nearly identical language, Congress again ratified the exemption of the very producer-handler opponents in Order 124 in the Food and Agriculture Act of 1977, Pub. L. 95-113, Title II, at Sec. 201, and also in the Agriculture and Food Act of 1981, P.L. 97-98. In adopting this language the Senate noted, "This provision insures about 300 producer-handlers that their status shall remain unaffected by the bill." S. REP. 97-126, 258. Among those 300 produce-handlers were Mallorie's Dairy, Smith Brothers Farms and Edaleen Dairy.

Congress had numerous other occasions to amend section 608c(5) and each time, it confirmed the legal status of producer-handlers including the opponents herein. *See* Food Security Act of 1985, Pub. L. 99-198 Section 201; Food, Agriculture, Conservation and Trade Act of 1990, P.L. 101-164.

Finally, in the order reform decision, the Department denied changes to the producer-handler exemption:

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. Since producer-handlers are intended to be exempt from most regulation, some means must be provided to determine and to verify producer-handler status. Accordingly, the market administrator is provided with the authority to require reports and other information deemed appropriate to determine that an entity satisfies the requirements of producer-handler status. Such authority is currently provided in the orders and should continue.

63 Fed. Reg. 4802, 4939-40 (January 30, 1998). Congress then ordered the Secretary to implement the order reform decision. Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 Pub. L. 106-78, 113 Stat. 1135 (October 22, 1999).

**C. The Department's conclusion that a producer-handler with three million pounds of Class I route disposition is a large business is arbitrary and capricious.**

The record establishes that all four opponent producer-handlers are small businesses because they employ fewer than five hundred employees. There is nothing in the record to dispute this fact. Nevertheless, for the first time, the Department has determined that producer-handler operations greater than three million pounds of Class I route disposition are not small businesses subject to the Regulatory Flexibility Act, 5 U.S.C. § 601, *et seq.* 70 Fed.Reg. at 19636. In its order reform decision, the Department found that **all** producer-handler organizations in the federal order system were small businesses. Even then, each of the four producer-handlers submitting these comments exceeded three-million pounds of Class I route disposition and were considered small businesses.

There are 111 producer-handlers of which all were considered small businesses for purposes of this final RFA, submitting reports under the Federal milk marketing order program.

64 Fed. Reg. 16026, 16035 (April 2, 1999).

USDA has a special responsibility to consider the impact of proposed rules on small businesses. Had the Department classified the four affected producer-handlers as small businesses, as it had prior to this hearing, it would have been required to perform an analysis under the Regulatory Flexibility Act. The impact on these producer-handlers is undisputably severe. To avoid this analysis, the Department classified each of the four producer-handlers as large businesses.

The Department's reasoning that, producer-handlers "must be dairy farmers as a pre-condition to operating processing plants as producer-handlers," and that, therefore, their status as small or large businesses should be measured according to the dairy farmer standards, 70 Fed. Reg. at 19636, makes no sense and is tantamount to regulating dairy producers. It is equally true that producer-handlers must be handlers as a precondition to operating dairy farms as producer-handlers which means that by the same logic, producer handlers should be evaluated as handlers, in which case they would be considered a small business if they have less than 500 employees. As the Department is permitted only to regulate handlers, every other handler plant in Orders 124, 131, or any other order for that matter, is considered a small business if it has less than 500 employees. Under the Recommended Decision, the Department will assess producer-handlers pool obligations as handlers, but has measured their size as producers.

Furthermore, this analysis completely ignores the fact that a producer-handler could produce well over three millions of farm production each month and not be a regulated plant. If the producer-handler distributes less than three million pounds of Class I products each month, it will remain unregulated under the Recommended Decision. A producer-handler's actions as a handler trigger its pooling obligations, not its actions as a producer.

Once the Department returns to its prior, and correct, determination of producer-handlers as small businesses, the analysis flips. Now, as a small business, the producer-handlers compete against huge national and international businesses. It is a violation of the Regulatory Flexibility Act to regulate and impose ruinous obligations on small businesses for the benefit of much larger oligopolies.

The Department has also failed to consider the impact that these proposed regulations will have on other small businesses. For instance, each of the producer-handlers filing these exceptions and comments sell dairy products to independent milk distributors. These businesses, largely sole proprietorships or businesses employing a handful of employees will be adversely affected if the Recommended Decision is permitted to take effect. Some of the independent distributors have submitted comments to the Department opposing this decision. The Department must consider the negative effect that the revocation of the long-standing producer-handler exemption will have on all of these small businesses.

**D. A reduction in the blend price of approximately a few cents per hundredweight cannot provide the basis for a finding of disorderly marketing.**

The degree of blend price disparity discussed in the Recommended Decision and at the hearing on these proposals is *de minimis*. In fact, the Department has held that:

The estimated changes in all the class prices at test under the tentative final decision were so small that no single order blend price could have been increased or reduced by more than about **2 cents per hundredweight, or less than .2 percent. A change of this magnitude has to be considered “approximately zero” in an analysis of milk markets.**

Milk in the New England and other Marketing Areas, 66 Fed. Reg. 54064, 54066 (October 25, 2001) (emphasis added). Thus, the suggestion in the Recommended Decision that a one cent per hundredweight impact on the blend price is significant conflicts with other decisions of the Department. Likewise, the Recommended Decision’s conclusion that the blend price impact of the producer-handler exemption is a

few cents in each of Orders 124 and 131, if accurate, would not provide a sufficient basis for finding that disorderly marketing conditions exist.

**1. The Department's acceptance of such small price changes as the basis for a finding of disorderly market conditions conflicts with prior milk marketing decisions.**

In other decisions, with blend price impacts of comparable size, the Department has consistently concluded that such small differentials are insignificant and do not justify changes in marketing orders. In recent decisions, including one rendered after the Recommended Decision in this proceeding, the Department confirms that the blend price impacts discussed in this decision are insignificant and cannot justify a dramatic departure from long-standing administrative policy.

Blend price impacts of one cent per cwt are not significant. The Recommended Decision contradicts the Department's expressed stance on what is a significant blend price disparity. One month after the Recommended Decision in this case was announced, the Department explicitly denied that a blend price disparity estimated at seven cents for the current year and averaging twenty cents justified the merger of marketing orders:

The differences in the weighted average blend prices for the two orders was \$0.36 per cwt in 2000, \$0.24 per cwt in 2001, \$0.21 per cwt in 2002, \$0.09 per cwt in 2003, and \$0.08 per cwt in 2004. Over the 2000 to 2004 period, the Appalachian order blend price exceeded the Southeast order blend price by an average of \$0.20 per cwt. . . . Based on this analysis, the absence of disorderly marketing conditions, together with the minimal and unchanged overlap between the Appalachian and Southeast orders in Class I sales and milk procurement area, the two orders should not be merged.

Milk in the Appalachian and Southeast Marketing Areas, 70 Fed. Reg. 29410, 29420 (May 20, 2005).

This finding, although consistent with the Department's decisions throughout the administration of the federal orders, cannot be reconciled with the Recommended Decision in the instant proceeding.



Last year, the Department reclassified milk used in the production of evaporated milk from Class III to Class IV. The Department supported its decision by relying on the fact that the resulting decline in blended producer revenues, while greater than one cent, would be of “minimal impact”:

The amendments adopted in the tentative final decision and this final decision should not have a significant economic impact on dairy producers or handlers associated with Federal milk orders. . . . The classification change should have only a minimal impact on the price dairy producers receive for their milk due to the small quantity of milk pooled under Federal milk orders that is used to produce evaporated milk or sweetened condensed milk in consumer-type packages. For example, using the Department’s production data provided in the hearing record for milk, skim milk, and cream used to produce evaporated milk and sweetened condensed milk in consumer-type packages by handlers regulated under Federal milk orders for the three years of 2000 through 2002, the reclassification of the milk used to produce these products from Class III to Class IV would have affected the statistical uniform price for all Federal milk orders combined by only \$ 0.0117 per hundredweight.

Milk in the New England and other Marketing Areas, 69 Fed. Reg. 57233, 57236 (September 24, 2004).

In 2001, the Department’s discussion of price variations resulting from modifications to the Order’s Class III butterfat pricing scheme also establishes that the Recommended Decision’s characterization of a one cent threshold is inconsistent with prior decisions:

The estimated changes in all the class prices at test under the tentative final decision were so small that no single order blend price could have been increased or reduced by more than about **2 cents per hundredweight, or less than .2 percent. A change of this magnitude has to be considered “approximately zero” in an analysis of milk markets.**

Milk in the New England and other Marketing Areas, 66 Fed. Reg. 54064, 54066 (October 25, 2001)

(emphasis added). Similar statements were made regarding Class IV prices:

The calculated Class IV skim milk price would increase by an average of \$ 0.127 per hundredweight. The calculated 3.5 percent Class IV milk price would increase by an average of \$ 0.118 per hundredweight, reflecting the net difference between the increase in the skim milk price and the very small decline [i.e. 0.9 cents] in the Class IV butterfat price.

*Id.* at 54086.

It is **wholly arbitrary** that a blend price impact of two cents is “approximately zero” in 2001; that a variation of 1.17 cents in September 2004 is prefaced with the modifier “only”; and that in May 2005, seven cents difference warrants no change, but an impact of one cent in this proceeding is “significant.” If, in fact, a blend price impact of one cent per hundredweight is significant, then the Department would have been in error to reclassify evaporated and sweetened condensed milk and would have been obligated to merge the Appalachian and Southeast Orders. The butterfat price changes adopted in 2002 would likewise have been erroneous.

Indeed, the blend price impact of retaining the producer-handler exemption in each of the Department’s prior hearings was more than one cent. As discussed herein, the market share of Class I milk has not changed since order reform, when the Department reject proposals to eliminate the exemption. Similarly, a blend price impact of greater than one cent was insufficient to prompt the Department to revoke the producer-handler exemption in 1988, 1991, 1993, 1995, and 1999; it is still insufficient today.

Conversely, when the Department has amended the federal orders due to negative impacts on blend prices, the amounts have been dramatically higher than one cent per hundredweight (or even six cents per hundredweight). *See e.g.* Milk in the Upper Midwest Marketing Area, 70 Fed. Reg. 19709, 19712, 16. (April 14, 2005) (describing a blend price reduction of 25 cents per hundredweight); Milk in the Pacific Northwest Marketing Area, 69 Fed. Reg. 18834, 18837 (April 9, 2004) and Schild Tr.149 (describing an impact of \$755 per month on a 200 cow farm, which equates to 18 cents per hundredweight); Milk in the Central Marketing Area, 68 Fed. Reg. 51640, 51644 (August 27, 2003) (referring to blend price differences ranging from 32 cents to 91 cents per hundredweight); Milk in the Mideast Marketing Area, 67 Fed. Reg. 39871, 39881-82 (June 11, 2002) (flawed diversion limitations result in blend price reductions of 55 cents per hundredweight).

In short, this Recommended Decision, and this Recommended Decision alone, treats minimal differences in blend price as significant justification for changing milk marketing orders. The Recommended Decision, moreover, offers no explanation for this aberrational result. Such an unexplained departure from the Department's uniform precedent violates fundamental principles of consistency in administrative decisionmaking.

The law that governs an agency's significant departure from its own prior precedent is clear. In this regard, the agency cannot do so without explicitly recognizing that it is doing so and explaining why. . . . The agency has a duty to explain its departure from prior norms.

*NLRB v. Intl. Union of Operating Engineers, Local 925*, 460 F.2d 589, 604 (5th Cir. 1972); *accord WLOS T.V., Inc. v. FCC*, 932 F.2d 993, 998 (D.C. Cir. 1991).

**2. Price variations of similar magnitude are inherent in milk markets and thus cannot be evidence of disorderly market conditions and cannot be eliminated by regulation of producer-handlers.**

Variations in the blend price of two to four cents in Order 124 and four to six cents in Order 131 are not evidence of disorderly marketing. From a pure magnitude standpoint, such small differences amount to a fraction of a percent of the blend price. In the Pacific Northwest Order, the blend price has averaged \$12.77 over the five plus years since January 2000. Accordingly, two cents represents a mere 0.16% of the blend price. Four cents computes to 0.31%. In the Arizona-Las Vegas Order, the blend price has averaged \$13.18 since order reform. Four cents of the blend price equates to 0.30% of the average blend. Six cents is 0.46 percent. At most, the increase in producer revenue that could result from the full regulation of producer-handlers in these two orders is less than one-half of one percent. (Calculations

based on data made available by the Market Administrator: <http://www.fmmaseattle.com/stats.htm>). In comparison to these historical fluctuations, the conclusion that even a six cent per hundred weight price impact is evidence of disorderly market conditions simply cannot stand.

The insignificance of the market impact cited in the Recommended Decision is confirmed by the evidence in the record. For instance, a witness for Northwest Dairy Association testified that his cooperative was re-blending NDA producers as much as twenty cents per hundredweight to account for cooperative management expenses and for what NDA views as flaws in the Federal Orders that overprice producer milk. McBride Tr.1534-35. (describing cooperative fees, CWT adjustments, a work stoppage accrual fund, and make allowance adjustment that reduced pay prices for NDA producers by 9.5 cents, 5 cents, 10 cents and 5 cents, respectively). Similarly, a one cent change in the price for commodity cheddar cheese results in a fluctuation in the Class III price of approximately ten cents. The range of blend prices for Order 124 since order reform has been wide, with a low of \$10.13 in March 2003 and a high of \$17.45 in May 2004. The average month-to-month change in the blend price has had a magnitude of 45.7 cents. For Order 131, the range and average fluctuations are similar. (Source: Market Administrator Data: <http://www.fmmaseattle.com/stats.htm>.)

In the absence of disorderly marketing conditions, the proposed change cannot be upheld on the basis of increasing producer revenue. Orders 124 and 131 have a more than ample supply of fluid milk to meet the needs of the consumer market and to maintain a generous reserve. Under such circumstances, the Department has been loathe to increase producer revenue for the sake of generating farmer returns. For example, Darigold–Northwest Dairy Association (here, a proponent of changes to the Pacific Northwest Order) requested changes in 1993 to reduce the location adjustment for Yakima County, Washington. The

proposed change was justified on the basis that it would increase returns to producers. The Department denied the request, stating that:

Current conditions indicate harmonious relationships within the marketplace. The location adjustment change proposed is not needed to prevent disorderly marketing conditions in Yakima County or anywhere within the marketplace. Fluid milk needs are being more than adequately met, and there appears to be no need to encourage production of milk in the Pacific Northwest market by increasing the level of returns to producers.

Milk in the Pacific Northwest and Southwestern Idaho-Eastern Oregon Marketing Areas, 59 Fed. Reg. 8546, 8555 (February 23, 1994). Similarly, there is no need to increase producer revenue here. Doing so will only stimulate milk production at the expense of producers' future well-being.

**E. The Recommended Decision's reasoning and findings regarding marketing conditions and the retail environment in Orders 124 and 131 are fundamentally flawed and unsupported by the evidence in the record.**

The Recommended Decision's effort to justify the imposition of a limit on the size of producer-handlers points to various changes in the market that have allegedly arisen since order reform, but these justifications cannot withstand scrutiny. The Department must specifically find, based upon substantial evidence in the record, that market conditions have substantially changed in the short period between January 2000 and the hearing in August 2003 to justify a change in the regulations. The Department recognized that January 1, 2000 (the date that consolidated marketing orders created by order reform took effect) is the appropriate "look back" period for examining changes in market conditions in an Order. *See*, 70 Fed. Reg. 29410, 29418-20 (May 20, 2005) (the Department considered proposals to redefine the boundaries of the Order in the Southeast area of the country). Similar considerations can be found in the Department's decisions regarding the former Western Order and regarding the classification of evaporated milk and sweetened condensed milk. 68 Fed. Reg. 49375, 49383 (August 18, 2003) (describing the features of

the Western order adopted during order reform and their operation); 69 Fed. Reg. 9764, 9768 (March 2, 2004) (examining Class pricing relationships for the period of January 2000 through the date of the hearing).

Therefore, the Department must show by substantial evidence that the market conditions in 2000 differed significantly from those at the time of the hearing. There is no evidence in the record to demonstrate a change in the market since 2000. Because the market conditions were the same, the Department effectively renders two interpretations based on the same facts and based upon the identical policy. *See, Lehigh Valley*, 829 F. 2d at 415 (affirming injunction of an order amendment because the “Secretary offers no explanation as to why these factors are more important in 1985 than they were in 1975.”)

**1. The Department affirmed the producer-handler exemption during order reform.**

The Department addressed this identical issue during order reform, when it flatly rejected proponents efforts to limit the producer-handler exemption, thus necessarily concluding that producer-handlers did not cause disorderly marketing conditions. 64 Fed. Reg. 16135 (April 2, 1999) (“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.**”) (emphasis added). At that time, Mallorie’s Dairy, Edaleen Dairy and Smith Brothers Farms operated as producer-handlers in Order 124 essentially as they do today, and Sarah Farms operated as a producer-handler in Order 131 essentially as it does today. Nothing in the operations of these producer-handlers justifies the radical change adopted by the Recommended Decision.

In 2000, the four producer-handlers existed in both of the orders and that their aggregate market share was consistent with that they had in 2003 at the time of the hearing. Further, these producer-handlers had the same customer base and presence in 2000 as they did in 2003. The nature of contracts with

wholesale buyers was the same in 2000 and 2003 because there is no evidence to suggest otherwise. The approximate theoretical impact on the blend prices of the orders were the same. There was no evidence for Order 131 so the Secretary cannot by law make a finding of a change. For Order 124, the percent of Class I milk handled by producer-handlers in 2003 was less than it was in 2000. *See tables, infra.*

Although there was anecdotal testimony of regulated plants losing sales to producer-handlers there were similar stories of producer-handlers losing sales to regulated plants. As Dr. Knutson noted, this was the sign of a healthy competitive market. Knutson Tr.2151. (“New competition and account switching is normal market behavior and not -- and certainly not evidence of chaos.”)

A proponent witness with extensive experience in milk marketing testified that the complained of “inequities” have existed for at least forty years:

Q. Okay. Now, you would agree with me that the regulatory terms based upon your testimony have not been equal concerning producer/handlers and regulated handlers for the last 40 years?

A. That's correct.

Christ Tr.at 1632-33.

The proponents also allege that the Department may act preemptively to prevent disorderly marketing conditions from occurring. This argument, however, contradicts the Department’s stated position in the Recommended Decision that the **actual** size of producer-handler operations must be so large as to disrupt the market. 70 Fed. Reg. 19636, 19653 (April 13, 2005).

There is no evidence as to any such potential disruption here. The record shows that in this supposedly attractive environment for disruptive practices, that since 1994 there has not been a single new producer-handler established in the Arizona-Las Vegas or the Pacific Northwest marketing areas. There

was no evidence at the hearing of even the real possibility of a producer-handler starting up in either of the two orders. In the two years between the notice of hearing and these exceptions and comments, there have been none. Simply asserting that the potential exists without a factual showing that there has been a growth of producer-handlers in the affected marketing areas does not constitute any evidence, let alone substantial evidence. The proponents' expressed fear of large producers becoming producer-handlers is unfounded. At the hearing, Elvin Hollon argued that there were producers in attendance to "get schooled" on becoming a producer-handler. Hollon Tr.1023. Alan Ritchey, a witness and producer-handler "student," ceased to operate a dairy farm before the hearing ended. D. Brandsma. Tr. 2542. Since Mr. Ritchey never "graduated" and the "school" is now "closed", it is clear that the proponents' prediction is nothing other than the same "sky is falling" rhetoric that has been espoused for decades. *See, Borden, Inc. v. Butz*, 544 F.2d 312, 319 (7<sup>th</sup> Cir. 1976).

In response to one of the industry's prior failed attempts to eliminate the producer-handler exemption, the Department opined that the potential for market disruption, while present, is not enough. Importantly, the Department refused to accede to the industry without proof of **actual** disruption. Milk in the Texas and Southwest Plains Marketing Areas, 54 Fed. Reg. 27179, 27182 (June 28, 1989). The expressed policy of the Department is that until disruption exists, full regulation of producer-handlers is not appropriate. The Recommended Decision deviates from this long-standing policy without data and evidence supporting the change.

As previously noted, the Department has also reversed course on its policy defining producer-handlers as small businesses for purposes of the Regulatory Flexibility Act analysis. The Department has heretofore treated producer handlers as "small businesses" based upon the number of employees. In 1999, the



Department did just that in order reform. Milk in the Northeast and other Areas, 64 Fed. Reg. At 16037.

There is likewise no substantial evidence to support this additional reversal in policy.

**2. The substantial evidence showed that any blend price impact attributed to the producer-handler exemption existed prior to the implementation of order reform.**

Class I route disposition from producer-handlers is, by definition, disposition not priced by the order. If the Class I disposition of producer-handlers increases, then the blend price impact will increase accordingly. The evidence from the market administrator conclusively establishes that the blend price impact of the producer-handler exemption before order reform is substantially equal to that impact since January 2000 as Class I dispositions are actually decreasing in Order 124:

Class I route disposition of Producer-Handlers in Order 124					
	2000	2001	2002	2003	2004
Class I Sales by P-H (million lbs./mo.)	18.94085	19.033134	18.264592	17.589262	16.092792
Change from prior year	n/a	0.49%	-4.04%	-2.71%	-8.51%
Average Annual Change 2000-2004			-3.76%		
Source: Exhibit 5, Table 11 and Market Administrator Statistics (Monthly Bulletins); Calculations performed					

Looking at the statistics for the years immediately prior to order reform conclusively establish that this pattern of decline:

Class I route disposition of Producer-Handlers in Prior Order 124			
	1997	1998	1999
Class I Sales by P-H (million lbs./mo.)	17.442	16.615	17.216

Change from prior year	n/a	-4.74%	3.62%
Average Annual Change 1997-1999			-1.30%
Average Annual Change 1997-2004			-1.11%
Source: Market Administrator Statistics (Monthly Bulletins); Calculations performed			

It is wrong to characterize this impact as a change since the implementation of order reform.

The implication that blend price reductions have occurred since order reform is simply wrong. 70 Fed. Reg at 19654. The level of producer-handler activity in the Pacific Northwest has remained stagnant since 2000. Similarly, the record is devoid of evidence to show that any impact on the blend price from producer-handler operations in Order 131 have arisen since order reform. This lack of evidence must be held against the proponents who have the burden of proof.

**3. “Growing concern” of marketplace changes is not evidence of actual disorderly marketing and is not substantial evidence to support a change in policy.**

The industry’s “growing concern” that producer-handlers will sell all of their supply to large retail customers and shift the balancing to the regulated market is not evidence of actual disorderly marketing and is not substantial evidence to support a change in policy. Similarly, the “potential” for producer-handlers to have certain types of sales is not an adequate basis for regulatory change. Proponents argued and the Department has adopted a position that if something could happen in the future, the Department should regulate it. But “could haves” are not enough. If cow manure was gold, producers could give their milk away. Speculation by the Department is equally fanciful. *See Borden, Inc. v. Butz*, 544 F.2d 312, 319 (7<sup>th</sup> Cir. 1976) (No substantial evidence to support Secretary’s decision when the testimony “consisted of hortatory, conclusory and speculative opinions and opinions.”).

Missing in the record is the evidence of any new producer-handler in the marketing areas, let alone a large one, since 2000. There have been no new producer-handlers in the Pacific Northwest in thirty years. The same market “potential” of which there is “growing concern” existed in 1995 and thereafter when the Department took comments on order reform including proposals to remove the producer-handler exemption. It did not happen then. It has not happened since. As the courts have said, prospective potential must be based on past experience. *Fairmont Foods Co. v. Hardin*, 442 F.2d 762, 772 (D.C. Cir. 1971).

Further, evidence must be limited to the affected marketing areas. *See* 7 U.S.C. § 608c(11)(a),(c). Evidence, for example of activity in the East is not evidence of the same in the Northwest or even in the Northwest for the Arizona-Las Vegas marketing area. As one proponent witness stated,

Q. Okay. And what evidence in – should the secretary be considering with respect to these proceedings?

A. I believe by rule, he’s required to consider evidence relating to marketing conditions in these two orders and none other.

Christ Tr.at 1587.

**F. The record is devoid of substantial evidence that producer-handlers are the primary source of disruption to the orderly marketing of milk or even that disruption is occurring.**

The proponents had the burden of proving two essential facts to support the Recommended Decision: (1) there exist disorderly marketing conditions resulting from the presence of producer-handlers in Order 124 and Order 131; and (2) the imposition of a 3 million pound cap represents the point at which a producer-handler created disorderly marketing within each of the orders. Proponents failed to prove either one of these.

Disorderly marketing is not occurring in either Order 124 or Order 131. There has been no interruption in the amount or quality of milk supplied to consumers in the Pacific Northwest and in Arizona-Las Vegas. There has been no suspension of any order terms, no emergency hearings, no disruption of supplies to the fluid milk, no shortages of milk in grocery stores, no substantial milk moving in or out of the order as a result of the existence of producer-handlers. There has been no rush of producers withdrawing from the pool in either Order 124 or Order 131. Rather, the number of producer-handlers has decreased and the volume of milk produced and sold by the producer-handlers has decreased. Moreover, there has been no evidence showing any inability of the pool to continue to operate as it has operated for the last seventy years.

The proponents alleged, and the Recommended Decision adopted as fact, that Vitamilk, a pool handler, was put out of business by a producer-handler in Order 124 because of an unnecessarily low sales price. 70 Fed. Reg. at 19640. Contrary to the Recommended Decision's conclusion, the record reveals that Vitamilk went out of business because Kroger and Safeway (pool handlers vertically integrated into their retail operations) merged with Vitamilk customers who accounted for approximately fifty percent (50%) of Vitamilk's business and Vitamilk was not able to obtain a sufficient number of new distributors. Vander Pol Tr. 468, Ex 52a p.3. Mr. Vander Pol of Vitamilk testified that Vitamilk lost a **customer** to Edaleen Dairy, a producer-handler, but there was no testimony from that customer as to the reason(s) why the business was lost, and the uncontradicted testimony was that such business represented no more than a truckload (50,000 pounds) of milk a week, amounting to a negligible impact on Vitamilk's 14.2 million pounds a month of business. D. Brandsma Tr.2543-44. There was also testimony that Vitamilk took away customers from producer-handlers; that it was unwilling to be flexible in its marketing policies to school systems; and that its employees were unionized, leading to higher than average costs. Vander Pol Tr.475,

477. In short, it may have been unfortunate that Vitamilk failed, but the factual record is that the failure was not caused by producer-handlers.

In an effort to substantiate their position without presenting actual data from actual transactions, the proponents hired a number of “experts” who speculated about costs and market conditions. Each of these experts provided only generalized statements and theories without reliance on actual costs and actual transactions. The conclusions reached by each of these “experts” were contradicted by the evidence at the hearing and by the actual experts in the field retained by the producer-handlers. Nonetheless, the Recommended Decision unquestioningly accepts their opinions as valid without acknowledging the powerful contrary evidence in the record or addressing the serious flaws in their methodologies.

For example, the opponents experts, Dr. Knutson and Mr. Morrison, testified that the studies prepared by the proponents’ experts were scientifically valueless and factually erroneous. The Herbein study, upon which all of the proponents’ experts relied, used unverified “industry data” to conclude that producer-handlers “just had” to be selling below Class I pricing. Because this “study” could not be properly cross examined let alone scientifically verified, it must be totally rejected as well as the testimony that relied upon it. Indeed, it is evident that this study represents a post-hoc rationalization for the \$3 million dollar monthly limit on producer-handlers, which (as conceded by the proponents’ own witnesses) was selected long before the study was commissioned. Herbein Tr.at 3045. The opponents also presented evidence, elicited in some cases from proponents’ own witnesses, that regulated handlers could match the prices of producer-handlers. *See e.g.* Krueger Tr.3090-91.

The opponents further demonstrated that Herbein’s analysis was fatally flawed, was biased, was based on data that were not comparable, and was without consideration of the actual data in Order 131. It was further shown that Cryan, Hollon, and others relied on Herbein’s study for their own analysis. Since

they did rely upon the Herbein data, the conclusions of the other experts of proponents were worth little. Instead of a hardy critical review, however, the Recommended Decision accepts the proponents' "experts" conclusions without consideration of their glaring deficiencies; and as if handed down in graven stone.

Dr. Knutson's testimony summarizes some of the methodological faults in the Herbein "study":

Only two of the plants were P-Hs, both being substantially smaller than the P-Hs impacted by this proposal. Yet, Mr. Herbein generalized as if all of the plants were P-Hs. Mr. Herbein's sample plants were located outside of the Arizona-Las Vegas and almost entirely outside of Pacific Northwest Orders with substantially no demonstrated comparability of product mix, processing, or distribution conditions. Even at that, there was no indication that they were randomly selected. In fact, there was adverse selection in that these plants were not only not representative of the P-H niche; they were also small firms that have for years had problems surviving. In other words, Mr. Herbein's data represents an unrepresentative worse case scenario that is completely useless in this hearing. Then an error was made in making regional cost adjusted by using the CPI rather than the PPI (Producer Price Index).

Knutson, 2140-41; Exhibit 44, page 9.

The conclusion reached by Dr. Knutson as to the Herbein testimony is that, "Mr. Herbein's testimony is of no value in either drawing the conclusions he reached or as a basis for decision regarding the proposal to fully regulate P-Hs." When a theory flies in the face of the hearing evidence, the rational decision is to reject the conjecture and to adopt the facts. The Recommended Decision does the opposite.

The actual evidence of pricing of milk within the marketing areas destroyed the central thesis of Herbein's study (producer-handlers sell milk at a cost less than a regulated handler could sell). During the cross examination of Hein Hettinga, co-owner of Sarah Farms, proponents placed into evidence market administrator prepared documents showing the minimum Class I prices for various sizes of consumer products. They also submitted price announcements by Sarah Farms for the same period. The spread between the announced price by Sarah Farms and the minimum price was consistent with Kroger's

testimony that the raw milk component of processed milk represented 70% of the cost. Hitchell Tr.216. Further, Mike Krueger of Shamrock Foods, testified that it could profitably sell milk at the prices announced by Sarah Farms. Krueger Tr.3090-91.

A distributor for Smith Brothers Farms testified as to the prices which he purchased milk at wholesale. Ellis Tr. 2109 (describing a markup of 30-40 percent on his price from Smith Brothers). Those prices, too, were in excess of the theoretical price proposed by Herbein in his “study” and consistent with that of Hitchell’s testimony.

Had there been, as a matter of fact, true price undercutting by producer-handlers in this market, it would have been a simple matter for the proponents to provide specific evidence of their cost of milk and prices at which they were forced by competition to sell in those markets. The record is totally devoid of any such information. The only conclusion which a fact finder can draw from this lack of evidence by the proponents is that the evidence would not support their contention. As a result of the absence of any evidence that would support their position, the proponents were forced to hire Herbein to make up numbers that would assist them in their cause.

Merely having someone claim to be an expert is not enough. Instead, actual evidence is required,

Moreover, the testimony of the proponents of expansion consisted of extremely general and speculative opinions. The experts were not able to provide specific examples of the problems they alleged were occurring as a result of the failure to regulate the twenty-county area under federal orders.

*Lehigh Valley*, 829 F. 2d at 416. Indeed, *Daubert v. Merrell Pharmaceuticals, Inc.*, 509 U.S. 579 (1993) and its progeny, which establish a new regime for the treatment of expert testimony in civil cases, reflect the recognition that some purported expert testimony is so lacking in any scientific/analytical basis that its admission to the factfinder under the guise of expert analysis would be misleading to the point of

being a denial of due process. The Herbein “study” falls into that category; the Department should not even have considered it, much less relied upon it as the cornerstone of the Recommended Decision. Once the Herbein study is removed from the proponents’ testimony, moreover, their already weak case collapses.

**G. The hearing evidence establishes that pool handlers can, and successfully do, compete with producer-handlers.**

It is an undeniable fact, on which both proponents and opponents have agreed, that there is competition within the dairy industry, and that customers move somewhat frequently from one handler to another; and for reasons which may or may not relate to price. *See, e.g.* Knutson Tr. 2151 (account switching is normal market behavior.) Krueger Tr. 588 (discussing quality as a factor). Thus, the circumstance that a customer moved from a pool handler to a producer-handler, or vice versa, proves nothing. There is no substantial evidence in the record to support the conclusion that fully regulated handlers cannot compete with producer-handler’s due to an intrinsic price advantage. In many cases, pool handlers were indeed able to take away customers from the producers-handlers. Ex. 22, Fn5, 9. The Recommended Decision’s conclusion that such shifts were made for reasons other than price is contradicted by the record and is speculative, if not an outright falsity.

In fact, Department representatives offered, and the Secretary accepted as fact, testimony that regulated handlers regularly and successfully compete against other handlers exempt from regulation:

Mr. Wise explained that Arizona handlers, including three Maricopa County, Arizona handlers, Safeway, Kroger, and Shamrock, which are in the same marketing area as Clark County, Nevada, and are also regulated under the Arizona-Las Vegas Milk Marketing Order, ship milk into Clark County, Nevada [and compete against unregulated dairies in Clark County.]



*In re Unified Western Grocers, Inc.*, AMA Docket No. M-1131-1, 2004 WL 2189171 at 8 (September 20, 2004).

Evidence from the hearing and events that have occurred since the close of the hearing demonstrate that the regulated handlers' claims of inability to compete are simply wrong.

The record demonstrates that Sarah Farms lost about the same amount of business to pool handlers in Order 131 as it gained. Sarah Farms gained business with Costco and Sam's Club that amounted to roughly 550,000 gallons monthly in 2003, while Shamrock took away Wal-Mart, Food for Less, several Target stores, Basha's stores, and other accounts from Sarah Farms, amounting to approximately 450,000 gallons monthly. *See* Exhibit 22. While the proponents' self-serving statements have been that they did not gain business on price, but gained it only on other issues, there is no independent evidence on why the accounts moved, in either direction.

Regulated handlers did not stop eroding Sarah Farms' customers after this hearing ended. Shamrock, one of the proponents in Order 131, has underpriced Sarah Farms and taken away seven Basha's stores in Tucson, Arizona. Declaration of Hein Hettinga dated June 9, 2005 ("Hettinga Declaration") ¶ 5. This supplemental evidence is important for a number of reasons; not the least of which is that Shamrock identified the seven Tucson Bashas' as a critical example as to why it needed the Department's help in order to "compete" with Sarah Farms. Swanson Tr.3068, Krueger Tr. 3084. The real evidence proves the opposite – as the smallest handler in Order 131, Sarah Farms cannot compete in Order 131 with such a large and powerful handler. Importantly, too, is that assertions of pool handler failure caused by producer-handler inroads were (and are) shown to be pure fiction.

Likewise, the record shows that Sarah Farms did not grow on the basis of taking business away from the pool handlers. Rather, the testimony was that Sarah Farms' business grew in part because of the

growth of its existing customers, with which Sarah Farms concurrently grew; and in part as a result of a withdrawal of Carnation from the dairy business in Arizona; a withdrawal that was caused not by the competition from a producer-handler, but by the competition with pool handlers. Carnation's withdrawal resulted in a business vacuum into which Sarah Farms was able to step, and to develop its business, even though Shamrock actually took the lion's share of that business. Sarah Farms was also aided by the growth of existing customers such as Food City, which after the bankruptcy of Southwest Supermarkets, took over several Southwest Supermarket stores, and which expanded the volume of the existing customer base of Sarah Farms. This growth has enabled Sarah Farms to increase its volume in the marketplace, a volume that is still minuscule compared to Shamrock and UDA which, together with the proprietary retail/handler units such as Safeway and Kroger, control the vast majority of milk sales within Order 131. *See* Hettinga Testimony, Exhibit 53.

It is one of the least understandable conclusions in the Recommended Decision that the Department opines that Sarah Farms is an alleged threat to the AMAA because it has purportedly gained perhaps 15% of the fluid milk market in Order 131. In contrast, Shamrock and the other large handlers, with approximately 85% of the market, and who continue to take significant business away from Sarah Farms, are allegedly not a threat. *See* Hettinga Declaration ¶ 5, 7. There is no directive to the Department in the AMAA to promote monopoly or oligopoly in the milk markets. The effect of the Recommended Decision, however, does just that.

In Order 124, the hearing evidence equally pointed to healthy and vigorous competition among regulated handlers and producer-handlers alike. In the intervening months, regulated handlers have continued to price their products competitively with producer-handlers. Specifically, Smith Brothers Farms lost school milk bids to Wilcox Dairy for the Puyallup and Sumner school districts. As school milk

contracts, these customers are determined wholly based on price. Wilcox's bids are lower than those of Smith Brothers. Declaration of Alexis Koester dated June 10, 2005 ("Koester Declaration") ¶ 5-11. These are supposedly the same accounts that regulated handlers simply could not compete for. VanderPol Tr. 472; Hollon Tr. 1098. Independent jobbers who purchase milk from Edaleen Dairy have lost accounts to other distributors selling milk from regulated handlers. Riverside Distributing, an Edaleen distributor, lost fifteen Rite-Aid stores to a supplier of Safeway milk. Declaration of Jerry Handlos dated June 10, 2005 ("Handlos Declaration") ¶ 4-7. The prices for Safeway milk are as much as five cents per gallon lower than milk from Edaleen. Handlos Declaration ¶ 11. According to Mr. Handlos, the prices from Safeway are consistently lower than those offered by Edaleen Dairy. Handlos Declaration ¶ 13. This corroborates the statements of Eric Flintoff of Medosweet Farms who has lost sales of Edaleen Dairy products on the basis of price to regulated handlers including Safeway and Wilcox. Declaration of Eric Flintoff Dated June 9, 2005 ("Flintoff Declaration") ¶ 5-7. Mr. Flintoff remains an Edaleen Dairy distributor primarily on the basis of quality. Flintoff Declaration ¶ 8.

**H. The record does not support the conclusion that the producer-handlers possess a price advantage equal to the difference between the Class I price and the blend price.**

The Department has eschewed defining the source of pricing differences among milk handlers due to the inherent speculation as to their origin. The record here provides no verifiable evidence, only speculation, as to the source of alleged but unproven systemic pricing advantages of producer-handlers. Because there is no adequate data to support the conclusion in the Recommended Decision concerning the alleged "pricing advantage", this finding cannot stand.

- 1. The price paid for a gallon of milk is a function of innumerable factors, only one of which is the cost of purchasing or producing the raw product.**

Retail price is not a function of raw milk cost alone, but of all costs of production, processing, packaging, transport and overhead. As the Department concluded in a recent 15(a) hearing:

The Secretary of Agriculture cannot ensure a ‘level playing field’ among competing handlers. There are too many constantly competing variables, many of which are beyond the Secretary of Agriculture’s control.

*In re Unified Western Grocers, Inc.*, AMA Docket No. M-1131-1, 2004 WL 2189171 at 9 (September 20, 2004). In *Unified Western Grocers*, the Department found that unregulated plants in Clark County, Nevada, do not impose a trade barrier on other partially regulated plants in California selling into Order 131. In dismissing the petitioners’ complaint that competing against an unregulated plant was not feasible, the Department found that minimum prices set by state interests in California and Nevada, over-order premiums, freight costs and fuel and energy expenses are but some of the “myriad” of factors that all affect the costs of purveying milk to retail markets. *Id.*

Here, handlers in favor of limiting the size of producer-handlers have made virtually identical arguments. That is, they claim that they cannot match the prices offered by producer-handlers exempt from minimum pricing and pooling. Just as the Secretary could not determine in *Unified Western Grocers* that lack of regulation translated into the inability to compete in regards to Clark County plants, the same finding is demanded under these facts. If the Clark County exemption does not, *ipso facto*, constitute a pricing advantage, then the long-standing exemption from minimum pricing and pool obligations applicable to producer-handlers cannot constitute one either.

- 2. The Department cannot conclude from the record that producer-handlers hold a “pricing advantage” attributable solely to the producer-handler exemption or that an accurate measure of any such “advantage” is the difference between the Class I price and the blend price.**

There is no evidence in the record that producer-handlers as a group have any price advantage; much less one equivalent to the difference between the Class I price and the Blend Price. What the evidence does show is that pool handlers have always been competitive, that they have consistently taken business away from producer-handlers, and that they have been able to do so on the basis of price. Flanagan Tr. 2353-54; Koester Tr. 1781. Producer-handlers, in fact, have been declining in number and participation in the market for many years, and continue to do so. Ex. 7; Table 4; Ex. 10; Koester Tr. 1779. This is evidence of a price disadvantage. In an effort to avoid the ineluctable conclusion that no significant price advantage exists for producer-handlers, the proponents have grounded their allegations of unfairness and disorder on the theoretical assertion that the Class I - blend difference is an absolute advantage to producer-handlers. If this is true today, it has been equally true for over 70 years. Similarly, for over 70 years, the Department has denied the validity of the claimed price advantage.

Moreover, there is no evidence in the record of any specific instance in which a regulated handler has lost business to a producer-handler on the basis of price and the price advantage can be attributed to the exemption rather than the other myriad of factors that affect retail prices. To the extent that any producer-handler has an alleged “price advantage” it does not arise from the Class I/cost of production differential, even where such a differential exists. Instead, a so-called “advantage” can result from a producer-handler’s production efficiencies or marketing decisions. *See, e.g., Unified Western Grocers*, 2004 WL 2189171, at 9, 13.

There is no evidence in the record establishing what a producer-handler’s costs of production are, which is a necessary predicate to determining whether there is a pricing advantage. The Department’s conclusion that the difference between the Class I price and the blend price is a reasonable estimate of any such “pricing advantage” is arbitrary and capricious. *See* 70 Fed. Reg. at 19654.

Without knowing the actual costs of production, the Department cannot say whether a producer-handler has a lower cost of raw milk to the plant than a regulated handler, and the record contains no evidence that the producer-handler's actual costs of production were equal to, or lower than the blend price. To the contrary, the opponent producer-handlers' unchallenged testimony was that such production costs have been higher than the blend in some recent years. Koester Tr. 1784; Heerspink Tr. 1990. This is hardly the evidentiary foundation necessary for the Department to change 70 years of producer-handler policy.

**I. Producer-handlers continue to bear the burden of the surplus disposal of their milk production.**

The Department fails to point to adequate data and record evidence or to explain its conclusion that producer-handlers are, “not assuming the entire burden of balancing their production.” As such, this finding is arbitrary and capricious. Without actual evidence, the Recommended Decision speaks of producer-handlers shifting their balancing obligations only in terms of speculation and conjecture:

[P]roducer-handlers with more than 3 million pounds of route dispositions per month have **gained the ability** to no longer bear the burden of the surplus disposal of their milk production. This represents a **significant development** that warrants the need for regulatory action because producer-handler exemption from the pricing and pooling provisions of the orders has been rationalized on the basis that producer-handlers bear the entire burden of balancing their own production. . . . A changing retail environment gives rise to **the potential** of producer-handlers entering into sales agreements with retailers to furnish the retailer with as much milk as the producer-handler can deliver.

The “ability” to avoid the burden of balancing does not establish that this has in fact occurred. Likewise, the “potential” for contracts in which a retailer takes as much milk as a producer-handler can deliver does not establish that any producer-handler operates in such a context. The Recommended Decision then compounds this speculation with further speculation that:

[i]n such a marketing environment, the regulated market's pooled producers essentially become the residual suppliers of Class I milk to the market when a producer-handler's production is not able to satisfy the fluid milk demands of their customer. The retailer need only purchase milk from fully regulated handlers to offset what a producer-handler is not able to supply. This is of **growing concern** to both producer and regulated handler interests in the Pacific Northwest and the Arizona-Las Vegas Marketing Areas because consumers are buying an increasing share of their grocery needs from discount outlets.

70 Fed. Reg. at 19655.

This "significant development" has existed in the Arizona marketing order at least ten years before the hearing in this proceeding and for 8 years prior to order reform. In 1992, the Department held a hearing to consider amendments to the Central Arizona Milk Marketing Area (predecessor to the Arizona-Las Vegas Marketing Area which is the focus of this proceeding) in response to a producer-handler who provided all of its milk to a store and the store then balanced off of regulated handlers. 58 Fed.Reg. 67703, 67705 (December 22, 1993).

Similarly, the Department had actual knowledge of the same practice in the Pacific Northwest prior to order reform. In the adversary case of *In re Andersen Dairy, Inc.*, AMA Docket No. — 124-3 (February 12, 1990) Andersen Dairy, a regulated handler under prior Order 124 had a common ownership with several retail stores. The stores purchased milk from Mallorie's Dairy, a producer handler under the order. The market administrator pierced the corporate veil between the stores and the processor and treated the deliveries by Mallorie's to the stores as a delivery to the regulated handler, Andersen. As a consequence, it assessed Andersen the obligations to the pool. *Id.* at 3-8.

Thus, for the Department to say that producer-handlers "have gained the ability" and this "represents a significant development" misstates the facts. There is nothing new or novel about producer-handlers selling milk to retail stores that also purchase milk from regulated handlers. How much the producer-

handler supplies or on what terms has always been a subject of private negotiation. For the Department to now claim such is “new” is not supported in the record or by common sense.

Mere speculation is not sufficient to support the Department’s “findings.” *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 414 (3<sup>rd</sup> Cir. 1987). In actuality, not only is there no evidence that this has occurred, there is no rational basis to conclude that it is likely to occur.

The only evidence in the record relating to balancing costs comes from producer-handlers who testified that such costs are real and significant. Witnesses for the proponents agreed. Hitchell Tr.222-233; Vander Pol Tr.507. A fair reading of the Recommended Decision shows that the Department is basing purported factual findings on unfounded fears and “growing concerns” of the largest players in the dairy industry. In reality, these large interests have been trumpeting these fears of producer-handlers for decades. Their “Chicken Little” scenarios have yet to come to fruition and the number of producer-handlers continues to dwindle. To hinge this substantial change in Department policy on such a slender evidentiary reed would be to render the substantial evidence requirement illusory.

Moreover, the sales of bulk milk by producer-handlers into states not part of the Federal order system does not establish that these producer-handlers no longer bear the costs of balancing their surplus. These are legitimate outlets for producer-handlers and regulated handlers alike. The Department trots out the red herring by concluding that:

producer-handlers in both the Pacific Northwest and the Arizona-Las Vegas marketing areas with route disposition of 3 million pounds per month enjoy sales of fluid milk products into unregulated areas such as Alaska and California. These examples contribute in demonstrating a shifting of the burden of balancing milk supplies onto the order’s [sic] pooled producers. This outcome has the [sic] compounded disadvantage for regulated handlers and their producer-suppliers because fully regulated handlers must account to the marketwide pool for Class I sales outside of the marketing area at the Class I price. This yields a two-fold advantage to producer-handlers: the ability to eliminate balancing their milk production through Class I sales at the



expense of the regulated market and the ability to compete on a consistent basis at prices that fully regulated handlers are unable to meet.

70 Fed. Reg. at 19655.

This finding likewise rests on two unsubstantiated conclusions: (1) that the producer-handlers are not balancing their production because they sell into unregulated areas and (2) that the burden of balancing has been shifted to the pool participants by such sales. These conclusions are factually unsupportable and logically indefensible. It is a truism that every sale made by a producer-handler is a sale not made by another handler (whether exempt, fully regulated, or otherwise.) This is true for sales direct to consumers, to traditional grocery stores, to coffee shops, to big box stores, and to outlets in unregulated areas. In fact, the entire issue of sales into unregulated areas assumes that such sales by producer-handlers are somehow different from producer-handlers into a federal marketing area. In both cases, the sale is exempt from minimum prices and pooling obligations. In both cases, the fully regulated handler must account to the federal order. The Department has wholly failed to explain how the producer-handler sales to out-of-market customers have an effect that is different from the effect of sales to in-area customers.

The over-arching question is what any of this has to do with a producer-handler's balancing requirements and costs, both of which were testified to by producer-handlers and uncontroverted by the proponents. The record is devoid of any evidence to suggest that the possibility of such sales somehow relieves producer-handlers from the burden of balancing their excess production. Sales into unregulated regions are not guaranteed and require producer handlers to absorb additional marketing and transactions costs. Milk that cannot be disposed of as fluid milk must still be disposed of at much lower prices by producer-handlers. Whatever advantages might come to producer-handlers from such sales have been present throughout the history of the system. The possibility of sales into exempt regions existed prior to

and during order reform when the Department reaffirmed the producer-handler exemption without limitation. The Department has failed to identify record evidence substantiating any change in market conditions.

Also, missing in this analysis is the ever present risk of potential balancing costs resulting from dramatic changes in either production or sales. For example, a customer can cancel a sale at any time and the producer-handler is then faced with excess capacity and excess milk production that cannot be readily changed. This is an ongoing and significant risk. As David Beene testified about regarding a producer-handler he operated, when a single customer canceled its order, the producer-handler was faced with a significant loss its sales and, as a consequence, had to sell the plant because it could not balance those sales. Beene Tr.1680, 1686, 1748. Such cancellations usually come quickly and without warning. Brandsma Tr. 2536.

The Recommended Order also fails to address fundamental issues that must be resolved before any conclusion on the avoidance of the need to balance surplus can be reached. What is the amount of “surplus” milk that must be balanced? What milk is truly “surplus”? Certainly, for example, the milk needed by cheese plants such as Tillamook is not “surplus.” What is the fair share of surplus that a handler must bear? Before the Department can conclude that the surplus is not being handled, these questions must be answered. The absence of evidence in the hearing record to answer these questions precludes the Department from changing 70 years of consistent producer-handler policy.

**J. The Recommended Decision offends the goal of the AMAA to provide an adequate supply of milk to consumers at a reasonable price.**

The Recommended Decision also concludes that the policy of the AMAA is to preserve “orderly marketing.” “Orderly marketing” is not the objective of the AMAA and is a nebulous concept at best.

Congress has defined the policy of the AMAA as follows:

Through the exercise of the powers conferred upon the Secretary of Agriculture under this chapter, to establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in section 608c(2) of this title as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.

7 U.S.C. § 602. The policy goal is to ensure that there is enough milk being supplied to the consumer market at a reasonable price to meet consumer demand.

The conclusion that orderly marketing through the establishment of minimum prices and pooling of revenues is the intent of the AMAA rather than the means by which the ends of the AMAA are achieved turns Congressional intent on its head. The real purpose of the AMAA and the milk orders is to supply milk to the public at a reasonable price. 7 U.S.C. §602; Albright Tr. 2489. The record is devoid of evidence that any consumer has been deprived of reasonably priced, wholesome milk in sufficient quantities. Indeed, the higher prices that will inevitably result from the Recommended Decision, are contrary to the interests of consumers and the intent of the Act.

The Department must consider the consumer impact of any change to the regulations. Over thirty thousand customers and concerned citizens, representing well over 100,000 milk drinkers, have objected to the Recommended Decision because it will increase prices, limit choices, and harm family businesses. The Department must honor their input.

**K. The decision to assess producer-handlers the difference between the Class I price and the blend price is arbitrary and capricious.**

The magnitude of any blend price impact is, in part, a function of the cooperatives who have the ability to manipulate the blend price and Class I utilization within the Order by choosing the amount of producer milk in other classes to be pooled. To the extent that producer milk is depooled or pooled in markets to the East, the Class I utilization on Orders 124 and 131 will increase.

In Order 124, the range in blend to Class I differences for milk in 2004 was a low of 20 cents in April to a high of \$5.58 cents in June, with an average of \$2.16. For Order 131, the range was -\$1.30 to \$5.51, with an average of \$1.77. The difference in the low differential between Order 124 and 131 is attributable to the practice of UDA not to depool its milk, a practice that will likely come to an end if the Recommended Decision is promulgated. Besides having such a wide range, and therefore, being unpredictable, a producer-handler will be at an added disadvantage in that fully regulated handlers without production know what their pool obligations are by the 23rd of the month prior. 7 C.F.R. § 1000.50(q). On the other hand, producer-handlers would not know their obligation until after the blend price is announced on the 14th of the following month in Order 124 and 11th of the following month in order 131.. 7 C.F.R. § 1124.62, 7 C.F.R. § 1131.62. The Department has long held that advance pricing for Class I milk is essential for the orderly marketing of milk, but as Class I handlers, these producer-handlers with more than three million pounds of route disposition per month would be denied the benefits of advance pricing without any rational basis for the distinction.

**III. The Recommended Decision establishes a dangerous precedent that any blend price discrepancy among producers is evidence of disorderly marketing.**

Categorizing a one-cent blend price impact as significant has far-reaching ramifications. In the future, the Department can expect to receive proposals for order modifications demanding absolute equality among producers. Until now, the Department has wisely shied away from this unworkable position. The most

immediate example is that presented by the recently denied proposal to merge or divide the marketing areas in the Southeast. Despite finding that producers in the Appalachian Order received an average of twenty cents less than their counterparts in the Southeast and that these producers competed for sales to similar plants, the Department declined to intervene to reduce this gap. 70 Fed. Reg. 29421. The wisdom or folly of this decision will be debated among those with a greater interest in these marketing areas, but those in favor of merging the marketing areas can be expected to point to the Department's statement in this proceeding as a glaring inconsistency in policy.

This precedent would set the threshold for market disruption so low that the frequency of mandatory order revisions would overwhelm the Department. The requirement to achieve absolute parity would exponentially increase the time required to develop record evidence and to analyze possible decisions. The burdens on the Department and the attendant costs on order participants will subsume the program. The timely resolution of real problems will be hindered, if not prohibited.

**IV. The effect of this order is to regulate producer-handlers in their capacity as producers, which is expressly prohibited by 7 U.S.C. § 608c(13)(B).**

As part of the limitations on the Secretary's authority under the AMAA, Congress has expressly declared that, "[n]o order issued under this chapter shall be applicable to any producer in his capacity as a producer." 7 U.S.C. § 608c(13)(B). This is an absolute requirement, not an issue left to the Secretary's discretion. The Recommended Decision violates this express statutory prohibition because it regulates producer-handlers in their capacity as producers.

It is a right of producers to be producer-handlers, Congress has repeatedly legislated that right. Making a decision on whether a producer can exercise that right is a regulation of the producer as a producer based upon his **production**. Thus producers are regulated by the federal order in terms of how

much milk they may produce to have the right to remain exempt from pricing and pooling. This is because producer-handlers must manage their production in light of the regulations.

The ruinous penalty associated with exceeding three millions pounds of route disposition per month means that producers must take substantial steps to avoid reaching that level, including keeping their sales substantially below three million pounds, in order to avoid even an accidental occurrence. The target would be about ten percent less. This is because the scheduling of delivery of orders and actual receipt at months end would be the most likely cause of a producer-handler being trapped. One day is approximately three percent of monthly production and three days represents a weekend with a holiday. Quite simply, these regulations would be tantamount to regulating the farm production of producer-handlers.

The Department has also explicitly relied on the size of producer-handlers as producers to define them as larger businesses so that they can be regulated in their capacity as a handler:

These entities are dairy farmers as a pre-condition to operating a processing plant as producer-handlers....Consequently, **the size of the dairy farm determines the production level of the operation and is the controlling factor in the capacity of the processing plant and possible sales volume.**

70 Fed. Reg. at 19653 (emphasis added). The Recommended Decision thus contains contradictory treatment of producer-handlers. On the one hand, it treats producer-handlers as handlers and on the other hand it wishes to characterize producer-handlers based upon their capacity of their farm operations. The Department cannot measure a producer-handler as a producer for purposes of the RFA and then claim that regulation of that entity is done as a handler.

#### **V. The Recommended Decision disproportionately affects women and Hispanics.**

The Department has failed to perform a Civil Rights Impact Analysis (USDA Policy 4300-4) to determine the civil rights impact of the Recommended Decision on both women and minorities. The record

shows that the only handlers in Orders 124 and 131 with significant female ownership interests or women in high-level management are the producer-handlers. Koester Tr. 1771, 1773; Heerspink Tr. 2548-9; Flanagan Tr. 2345; Hettinga Tr. 2618. There is no evidence of significant woman ownership or management by other handlers. The effect of the Recommended Decision disproportionately and detrimentally impacts women and woman-owned enterprises to the advantage male dominated handlers.

Further, there has not been a civil rights analysis completed by the Department regarding the impact of the Recommended Decision on the substantial number of Hispanic employees of the four adversely affected producer-handlers.

**VI. The Recommended Decision poses serious procedural and constitutional problems that require reconsideration by the Department.**

By publishing a Recommended Decision that is result-driven rather than founded in fact and law, the Department has exposed itself to challenges based on the innate unfairness of this proceeding. By changing course without reason, without evidence, and without transparency, the Recommended Decision tramples the due process rights of the opponent producer-handlers. The grab for money for the benefit of private-party proponents is accomplished only through the official act of the Department of Agriculture. This official act constitutes a government taking of private property from these family businesses without any compensation. Some of the Constitutional infirmities of the Recommended Decision are discussed below.

**A. *Ex parte* communications have deprived affected producer-handlers of procedural due process.**

This rulemaking proceeding has been infected by at least three instances of *ex parte* communications to the Department. The first incident, a letter from National Milk Producers Federation and International

DairyFoods Association sent directly to Secretary Johanns was made part of the hearing record only after the opponent producer-handlers complained to the Department about its propriety to the Department. Second, opponents have been made aware of letters from Congress which urged the Secretary to issue a decision, that have not but should also be made a part of the record. The third known incident involved Gary Hanman, the CEO of proponent Dairy Farmers of America, who made a direct and blatant appeal and threat to Dairy Programs Director Dana Coale outside of the hearing process. In addition, in hearings in the Appalachian and Southeast Marketing areas, proponents have reargued the merits of this case. Instead of presenting evidence and testimony about marketing conditions in Order 5 or Order 7, they simply admitted, over the objections of the Department and Sarah Farms, the transcript of testimony presented in this proceeding.

There is also reason to believe that prior to the issuance of the hearing notice in the Southeast proceeding and a similar noticed hearing in the Mideast marketing area, that proponents had discussions with Department staff, ostensibly to talk about other marketing areas, but in fact the proponents discussed these marketing areas and used the exemption from *ex parte* restrictions in Orders 5, 7, and 33 to reargue their position as to Orders 124 and 131. Although such communications did not violate the *ex parte* rules for those marketing areas where a hearing notice was not yet issued, they certainly violated the *ex parte* restrictions applicable to this hearing and must be made part of this hearing record.

It is the *ex parte* contact by Gary Hanman that is most egregious. The Dairy Programs Director is in direct supervision of the decision in this ongoing proceeding. Yet in a speech entitled “DFA: Yesterday, Today, and Tomorrow,” Hanman plainly violated both 5 U.S.C. § 557 and 7 C.F.R. § 900.16(a). Hanman’s statements, which are reproduced in their entirety in a Motion filed with the Department by Sarah Farms, described what DFA views as “deficiencies in the program [that] are not [Dana Coale’s]



fault, but they are something she and us have to solve.” Hanman then articulated DFA’s argument in favor of eliminating the producer-handler exemption and opined that if changes were not made, “ the classified system of pricing that we've known will go away.” This can only be interpreted as a thinly veiled threat by DFA that it would seek to have marketing orders terminated if the Department did not accede to DFA’s demands, as occurred in the Western Order.

Hanman’s actions constitute an outside the record appeal to the very person in charge of formulating this decision. No party opposing DFA’s proposals was notified of this *ex parte* contact either in advance or in hindsight. No party to the hearing had an opportunity to cross examine Hanman, to challenge his statements, or to provide arguments regarding the same. Notwithstanding Sarah Farms’s motion, to which the Department has not adequately responded, the record has not been reopened. These comments were intended to influence and may have actually influenced the hearing process in this docketed proceeding and, accordingly, have infringed on the due process rights of the opponent producer-handlers. *See Maine Care Svc., Inc. v. USDA*, 2001 WL 1399516 (D. Me. Nov. 9, 2001). At a very minimum, the Department should be obligated to follow its own regulations and the applicable statute and place on the record any documents provided at this hearing, and a description of the influence Mr. Hanman’s comments had on the proceeding.

Several days before these exceptions and comments were prepared, Ms. Coale filed a memorandum with the USDA hearing clerk explaining that she was, in fact, present for Mr. Hanman’s comments regarding this proceeding. This memorandum fails, however, to provide any description of what was discussed, what documents Mr. Hanman presented to the group, or what effect his comments had on the proceeding. The law mandates and due process considerations dictate that these disclosures be made.

As a frequent proponent of amendments to Federal milk marketing orders, DFA knows the strict prohibition of *ex parte* communications by and between Department officials and interested parties. While Dana Coale was a captive audience at the Dairylea convention, DFA violated the statutes, regulations, and fundamental notions of fairness and also took advantage of Ms. Coale and the opponents.

There is a remedy for such unfair and opportunistic conduct. The APA provides the Department with the opportunity to require an infringing party to, “show cause why his claim of interest should not be dismissed, denied, disregarded, or otherwise affected on account of [a] violation.” 5 U.S.C. §557(d)(1)(c).

DFA intentionally interfered with the hearing process and has called into question both the fairness of the Recommended Decision and the accuracy of the actual hearing record. The Department should dismiss or deny the proposed changes in the marketing orders by DFA and should also strike any “evidence” presented by DFA and any of its witnesses.

**B. The imposition of a 3 million pound monthly cap on some but not all producer-handlers in Orders 124 and 131 violates the opponents’ right to due process and equal protection of the laws under the United States Constitution.**

The proposed limitation of three million pounds means that if a producer-handler has three million and one pounds of production he becomes fully priced under the order. At three million or less pounds per month, the producer-handler has no obligation to the pool. Once a producer-handler reaches one pound more, however it is obligated to pay the difference between the blend price and Class I price. If, for example, that difference is \$1.20, the obligation is \$36,000.01. This pound of milk represents a price of \$3,600,001.00 per hundredweight! All of this assessment will be borne by milk owned and produced by the producer-handler.

In addition to the inherently punitive and arbitrary nature of this the proposed “economic” regulation, there is also an arbitrary geographic impact which violates the rights of the producer-handlers within the marketing order affected by the Recommended Decision. If the Recommended Decision were to become final, each of the opponent producer-handlers will be subjected to punitive assessments that their neighboring producer-handlers in other marketing areas will not be required to pay simply on the basis of a regulatory line drawn in the sand and a similarly arbitrary line on a map. As a result of the Western Order being voted out by DFA, certain portions of Oregon, specifically, Baker, Grant, Hardney, Malheur and Union Counties are completely unregulated. Moreover, even though Clark County, Nevada, is located in the Arizona-Las Vegas Marketing Area in Order 131, a plant located in Clark County, Nevada, is unregulated because it is exempt from the pricing and pooling provisions of Order 131. Therefore, a producer-handler that has sales only in the above mentioned Eastern Counties in Oregon, is not subject to the proposed 3 million pound monthly limitation. Similarly, a producer-handler located in Clark County, would also not be subject to the proposed 3 million pound penalty provisions. For these reasons, the proposed change in the marketing orders for Orders 124 and 131 as it relates to producer-handlers are arbitrary, capricious, without any rational relationship to a legitimate government purpose and therefore in violation of both the due process and equal protection clauses of the United States Constitution.

The Department cannot deny these four families the right to operate their producer-handler operations in a manner that is not subject to the pricing and pooling provisions of the respective orders based only on their size or their geographic location in the respective order areas while granting that same benefit to other producer-handlers due solely to the happenstance to that either their route disposition of milk that month is 2,999,999.9 and not 3,000,000 pounds and/or that their sales are located either in the unregulated area of Oregon or in Clark County, Nevada. This is especially true because it is undisputed that each of the

four producer-handler operations meet all of the current requirements to be a producer-handler in the effected orders and have operated as producer-handlers in those orders for a number of years.

**VII. Conclusion: Opponent Producer-handlers are entitled to a ruling on each of their exceptions and a denial of the proposed orders.**

Based upon the exceptions stated herein and the arguments presented, the Opponent Producer-handlers request that the Secretary issue a separate response to each of the exceptions tendered herein as required by 7 C.F.R. §900.13a(c) ("After due consideration of the record, the Secretary shall render a decision. Such decision ...shall include ...(c) a ruling upon each exception filed by interest persons").

In consideration of the record in this proceeding and the exceptions and comments filed the Secretary must deny the issuance of a marketing order. 7 C.F.R. §900.13a(d)(1). In the event the Secretary finds the exceptions well taken but finds authority or reasoning that he believes supports the issuance of such orders, then opponents are entitled to a subsequent Recommended Decision in order to provide them notice and an opportunity to respond to those new announced and articulated reasons for regulation.

The Secretary should not adopt the Recommended Decision. Instead, he should terminate the proceeding because the proponents have failed to carry their burden of proof, the Secretary does not have statutory authority to establish minimum prices or pooling on milk not purchased, and the decision is arbitrary, capricious, and otherwise not in accordance with the law.

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## CERTIFICATE OF SERVICE

The foregoing Comments and Exceptions to the Recommended Decision was Statement was served upon the following parties on June 13, 2005, by electronic mail, FedEx Overnight Service, and /or first-class United States Mail service as indicated.

### **VIA U.S. MAIL, E-MAIL, AND FEDEX**

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Ryan K. Miltner

**BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE**

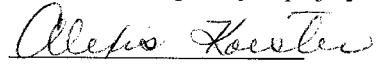
<b>In the Matter of:</b>	)	<b>DOCKET NO. AO-368-A32;</b>
<b>MILK IN THE PACIFIC NORTHWEST</b>	)	<b>AO-271-A37; DA-03-04</b>
<b>AND ARIZONA - LAS VEGAS</b>	)	
<b>MARKETING AREAS</b>	)	

**DECLARATION OF ALEXIS KOESTER**

1. I, Alexis Koester, am the President of Smith Brothers Farms, Inc. of Kent, Washington.
2. Smith Brothers is a producer-handler located in Federal Order 124.
3. A significant portion of Smith Brothers' business involves sales to schools located in the Seattle area.
4. For the 2004-2005 school year, Smith Brothers submitted bids to Puyallup School District.
5. As Smith Brothers and Wilcox Dairy, a regulated handler, supplied firm bids to the school district, as the district preferred.
6. Smith Brothers did not receive the contract for supplying the school.
7. Wilcox Dairy offered the school district a lower per unit price on half pints of 1% milk, half pints of chocolate milk, cottage cheese, ice milk bars, ice cream sandwiches, yogurts in four once containers. The price on whole milk was equal.
8. Smith Brothers also submitted a bid to supply the Sumner school district for 2004-2005.
9. Smith Brothers submitted a firm bid. Wilcox Dairy submitted an escalating bid.
10. Smith Brothers did not receive the contract for supplying the school district.
11. Smith Brothers was underpriced by Wilcox Dairy on all items.
12. I have attached copies of summary bid sheets provided to Smith Brothers Farms by the

districts reflecting the prices offered by Wilcox and Smith Brothers to support this  
declaration.

Executed under penalty of perjury this 10 day of June 2005.

  
ALEXIS KOESTER



*Dupall*

2004-2005

DAIRY/ICE CREAM PRODUCTS BID NO. B01720

ITEM NO./DESCRIPTION	QTY	Wilcox		Dairy Fresh		Smith Bros	
		UNIT	PRICE Firm	UNIT	PRICE Escalating	UNIT	PRICE Firm
1A. 1/2 Pint Milk, 1%, daily	Daily						.175
1B. 1/2 Pint Milk, 1%, twice weekly	alt del		.169		.212		.177
2. 1/2 Pint Milk, Whole	daily		.188		.255		.188
3.A. 1/2 Pint Choc Milk, daily	daily						.182
3.B. 1/2 Pint Choc Milk, twice weekly	alt del		.174		.218		.18
4. Cottage Cheese	per lb.		.95		1.19		1.12
5. Ice Milk Bars	dz		2.14		2.64		2.45
6. Ice Cr. Sandwiches	dz		6.25 24 pk		7.20 27 pk		6.75 24 pk
7. Popsicles	dz		NA		2.70 18 pk		1.45
8. Yogurt 8 oz.	ea		.4125		.50		.57
9. Yogurt, 4 oz. Yonni	ea		.275		.29		.30
10. Other Ice Cr Novelties	dz		NA		Fudge 2.88 dz Cream 2.76 dz		Dixie 2.75 dz 11.50 2 dz Fudge 2.85 dz Tuffee 2.40 dz Cream 2.05 dz Super 2.00
11.A. Orange Juice, 4 oz.	ea						
11.B. Orange Juice, alternate	ea		7.64 48 pk		.19 each		.133 each



**Sumner School District**  
*...a great place to learn!*

**Business Services**

1202 Wood Ave.  
 Sumner, WA 98390  
 (253) 891-6010  
 Fax (253) 891-6098

July 29, 2004

Smith Brothers Farms  
 27441 68<sup>th</sup> Ave S  
 Kent, WA 98032

RE: Dairy Bid

Dear Sir:

On July 28, 2004 the Board of Directors awarded the Dairy Bid to the low bidder as follows:

Wilcox Farms, Inc

Attached you will find a copy of the bid recap.

Thank you for your participation in our dairy bid.

Sincerely,

Katie Burt  
 Purchaser

Attachments

**Sumner High School - National Blue Ribbon School**  
**Serving the Communities of Sumner, Bonney Lake, Edgewood and Unincorporated Pierce County**

Y	stat	VENDOR
0.00	108.00	Smith Bros Dairy/Fresh
0.00	142.00	Wilcox Dairy/Fresh
0.00	188.00	Smith Bros Dairy/Fresh
0.00	180.00	Wilcox Dairy/Fresh
0.00	104.80	Smith Bros Dairy/Fresh
0.00	90.40	Wilcox Dairy/Fresh
0.00	135.00	Smith Bros Dairy/Fresh
0.00	102.00	Wilcox Dairy/Fresh
0.00	21.00	Smith Bros Dairy/Fresh
0.00	94.84	Wilcox Dairy/Fresh
0.00	57.12	Smith Bros Dairy/Fresh
0.00	98.82	Wilcox Dairy/Fresh
0.00	62.27	Smith Bros Dairy/Fresh
0.00	25.76	Wilcox Dairy/Fresh
0.00	51.00	Smith Bros Dairy/Fresh
0.00	0.00	Wilcox Dairy/Fresh


**BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE**

<b>In the Matter of:</b>	)	<b>DOCKET NO. AO-368-A32;</b>
<b>MILK IN THE PACIFIC NORTHWEST</b>	)	<b>AO-271-A37; DA-03-04</b>
<b>AND ARIZONA - LAS VEGAS</b>	)	
<b>MARKETING AREAS</b>	)	

**DECLARATION OF ERIC FLINTOFF**

1. I, Eric Flintoff, am the president of Medosweet Farms ("Medosweet").
2. Medosweet is an independent distributor of milk in the Pacific Northwest.
3. Medosweet distributes milk products purchased from Edaleen Dairy in Lynden, Washington.
4. Medosweet also distributes milk products purchased from other handlers, including handlers regulated by Federal Order 124.
5. In the period from February 2004 through the present, Medosweet has lost sales of its dairy products to independent distributors who exclusively market products from regulated handlers.
6. Such sales were lost on the basis of price.
7. Medosweet has lost sales to Liberty Distributing (distributors of Safeway milk), Wilcox Dairy, and others on the basis of price alone.
8. Despite the fact that the prices offered to us by Edaleen Dairy are somewhat higher than other regulated handlers we continue to supply our customers with product from Edaleen Dairy because the quality is uniformly and consistently better than that offered by other regulated handlers.

Executed under penalty of perjury this 9<sup>th</sup> day of June 2005.

  
ERIC FLINTOFF

BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of: ) DOCKET NO. AO-368-A32;  
 MILK IN THE PACIFIC NORTHWEST ) AO-271-A37; DA-03-04  
 AND ARIZONA - LAS VEGAS )  
 MARKETING AREAS )

DECLARATION OF JERRY HANDLOS

1. I, Jerry Handlos, am the president of Riverside Distributing Company, an independent distributor of milk products operating out of Burlington, Washington.
2. I have been a distributor of milk since 1961.
3. Riverside Distributing Company employs thirteen individuals.
4. Riverside Distributing Company purchases milk from Edaleen Dairy in Lynden, Washington.
5. Until earlier this year, Riverside Distributing supplied milk to fifteen Rite-Aid stores in Washington state.
6. Earlier in 2005, Sunshine Dairy another independent distributor of milk began supplying the fifteen Rite Aid stores formerly supplied by Riverside Distributing Company.
7. The milk supplied by Sunshine Dairy is purchased from Safeway, a regulated handler.
8. In addition, Riverside Distributing Company formerly supplied milk to three 7-11 convenience stores in Washington state.
9. Earlier this year, Southland Corporation, the parent company of 7-11 Stores, established a major distribution center with Wilcox farms, a regulated handler.
10. As a result of this arrangement, Riverside Distributing company no longer supplies milk to

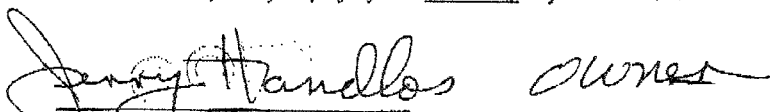
7-11 convenient stores.

11. For May 2005, the following were the prices for gallons of milk offered to independent distributors such as Riverside Distributing by milk handlers in the Pacific Northwest:

	Whole Milk	2% Reduced Fat	1% Low Fat	Skim
Safeway	1.8971	1.781	1.576	1.4398
Edaleen Dairy	1.82	1.60	1.59	1.54
Darigold	2.249	2.060	1.934	1.816
Wilcox	2.293	2.122	1.998	1.889

12. The prices in the table above are representative of the prices offered to independent milk distributors in the Pacific Northwest. While the exact prices fluctuate, the relationship remains relatively unchanged.
13. Safeway, a regulated handler consistently prices its products competitively at or below the prices offered by Edaleen Dairy, a producer-handler.
14. While the listed prices from Darigold and Wilcox Dairy appear higher than those for Safeway and Edaleen, the listed prices do not reflect rebates and volume discounts that, in the industry, are known to be offered and which make their prices more competitive to Safeway and Edaleen.
15. In my personal experience, the prices from all handlers in the Pacific Northwest, whether regulated or unregulated, have been historically competitive and continue to be competitive today.

Executed under penalty of perjury this 10 day of June 2005.

  
JERRY HANDLOS *owner*