USDA
OALJ/OHC

2016 MAR 31 PM 1:51

RECEIVED

Charles M. English, Jr. (D.C. Bar No. 386572)
chipenglish@dwt.com
DAVIS WRIGHT TREMAINE LLP
1919 Pennsylvania Avenue, NW, Suite 800
Washington, DC 20006
Telephone: (202) 973-4200
Facsimile: (202) 973-4499

Ashley L. Vulin (Oregon Bar No. 145454)
ashleyvulin@dwt.com
DAVIS WRIGHT TREMAINE LLP
1300 SW Fifth Avenue, Suite 2400
Portland, OR 97201
Telephone: (503) 241-2300
Facsimile: (503) 276 5793

Of Attorneys for Dairy Institute of California

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In re: Milk in California	[AO] Docket No. 15-0071

BRIEF AND PROPOSED CONCLUSIONS OF LAW

SUBMITTED BY

DAIRY INSTITUTE OF CALIFORNIA

Charles M. English
Ashley L. Vulin
1919 Pennsylvania Avenue, NW
Suite 800
Washington, DC 20006

Attorneys for Dairy Institute of California

March 31, 2016

TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Rules

Regulations

Constitutional Provisions

Other Authorities

I. INTRODUCTION

This Brief and Conclusions of Law is submitted on behalf of the Dairy Institute of California ("the Dairy Institute"), a trade association representing proprietary fluid milk processors and ice cream, yogurt, and cheese. This matter comes before the United States Secretary of Agriculture upon the request of three dairy farmer-owned Cooperatives: Dairy Farmers of America ("DFA"), Land O'Lakes, Inc. ("LOL"), and California Dairies Inc. ("CDI") (collectively, "the Cooperatives").

II. EXECUTIVE SUMMARY

In this United States Department of Agriculture ("USDA") order promulgation proceeding, California dairy farmer interests ask the Agricultural Marketing Service ("AMS") to intervene in California's state regulated milk market and to adopt a Federal Milk Marketing Order ("FMMO") for California. While USDA is writing on a blank slate as to California, it is not doing so with respect to either the authorizing statute, the Agricultural Marketing Agreement Act ("AMAA"), or the decades of agency and court interpretation regarding the AMAA and federal milk regulation. USDA's 80 years of assiduously hewed guiding principles governs USDA's challenge to incorporate, if at all, California's large milk supply into the FMMO system. USDA has both authority, when appropriate, to act and also a duty to serve the public interest generally, and the dairy industry in particular, by judiciously using its well-honed skills and regulatory power to facilitate efficient movements of milk, to assure a fluid milk supply for consumers and to stabilize milk markets for dairy farmers. USDA fulfills these public interest duties within the strict purposes of the AMAA and by relying on the guiding principles and precedent set by it in prior decisions.

The proponent cooperatives (the "Cooperatives") pretend to seek a FMMO for California. In fact, the Cooperatives, relying solely on a recent Congressional enactment, want USDA to adopt a unique FMMO relying almost exclusively on the existing California State Order's ("CSO") novel provisions while replacing CSO price formulas with existing, out-of-date, and overvalued FMMO price formulas ("Cooperative Order"). The recent law does not justify the unique features demanded in the Cooperative Order.

The Cooperatives rely on a single sentence from the 1996 Farm Bill, as amended in the 2014 Farm Bill, (collectively the "Quota Provision") to justify their far-reaching and unprecedented result: "The order covering California shall have the right to reblend and distribute order receipts to recognize quota value." 7 U.S.C. § 7253(a)(2). The Cooperatives repeatedly rewrite the Quota Provision to say both more and less than it does by adding words and phrases not found in the statute (e.g., "protect," "preserve," "maintain," and "without diminishing"), and by ignoring one of the statute's controlling phrases ("have the right to"). This wordsmithing causes the Cooperatives to misinterpret the Quota Provision as creating a broad requirement ("shall . . . [protect] quota"), rather than granting a limited permission ("shall *have the right to* . . . recognize quota").

Moreover, Congress did not repeal or expressly amend the AMAA with the Quota Provision. The AMAA requires uniform payments (that handlers pay uniform prices and producers receive uniform prices) and explicitly prohibits the creation of trade barriers. The Quota Provision, found in a different statute, must be read in conjunction and consistent with these provisions. As a means of reconciling the mandatory AMAA and permissive Quota Provision, the Dairy Institute's proposal mirrors USDA's previously-used approach for Oregon in addressing quota. The Quota Provision does not permit USDA to abandon 80 years of precedent and existing statutory language under the AMAA in order to accommodate unique California regulatory provisions like quota.

As discussed below, the record evidence fails to demonstrate that there are actual disorderly marketing conditions justifying federal intervention in California milk pricing. The Cooperatives' principal and precipitating focus on minimum regulated price differences between California and FMMOs is not linked to any actual marketing conditions or competitive harm that is disorderly. Their belatedly expressed concern over diminishing sales of out-of-state milk to Class I handlers that is clearly priced at the California plant blend prices does not justify implementation of a FMMO. The Dairy Institute maintains that USDA should, if it proposes any FMMO for California, propose an Order that actually has the look, feel, and operational similarities of existing FMMOs, subject to updated pricing models.

The Cooperative Order is also fatally flawed because it does not promote orderly marketing and would result in less efficient movements of milk. First, unlike any other FMMO ever adopted, there are no "performance-based pooling standards" that would assist in drawing milk to fluid milk processors (defined as "Class I" handlers by FMMOs). USDA has for decades repeatedly found that the only proper method for determining who gets to share in the milk order's higher prices paid by Class I handlers is to establish and enforce valid performance-based pooling standards for all milk seeking to participate in the pool. These pooling standards are the *quid quo pro* for requiring that all Class I milk be pooled and subject to the higher minimum pricing and pooling provisions of an order. The Cooperatives admit that Class I processors, in addition to paying the Class I differential added to the higher of Class III (cheese) and IV (nonfat dry milk and butter) prices, will have to negotiate private contract prices for milk over and above the regulated minimum price. Thus, the Class I differential will fail to deliver one drop of milk to any fluid milk plant and the effectiveness of the FMMO will be subject to the movements and whims of private parties.

Second, the Cooperative Order places mandatory regulatory burdens on all California plant operators that no other plants operating under any other FMMO face and that are inconsistent with the AMAA. The problems caused by this mandatory pooling of manufactured milk are exacerbated when combined with the outdated FMMO pricing formulas from 1996. This dangerous combination of errant regulation over-values milk for manufacturing uses, which illogically will encourage milk production while discouraging California plant capacity to handle that increased volume of milk. Such an outcome spells economic disaster for the California dairy industry.

The Cooperatives' proposed price formulas are critically flawed for three reasons. The out-of-date price formulas ("make allowances") in FMMOs are unjustified in the face of evidence from California state surveys that those allowances are insufficient. The Cooperatives submitted no evidence that current economic conditions justify continuing the use of existing FMMO make allowances. Moreover, the uncontradicted record evidence is that the value of whey in the FMMO formula for Class III is overstated. Finally, the Cooperatives' failure to recognize location values for Class III and IV milk in California results in significant overvaluation of that milk. Location value is the economic concept underpinning the Class I price surface, so in proposing Class I price surfaces, the Cooperatives adopt this concept. The Cooperatives' reliance on location value for Class I milk, but not for Class III and IV, is inconsistent, arbitrary, and capricious.

USDA cannot lawfully adopt minimum prices that are patently out of date. The Dairy Institute Proposal incorporates up-to-date minimum prices that reflect the current milk environment and correct the Cooperative Order shortcomings in relying on pricing data primarily from the 1990s, which has only been partially updated. Adoption of the Cooperative Order would also overturn USDA's long-standing policy of crafting minimum price formulas for manufactured products that are market clearing. Dr. Stephenson, the only non-government neutral economic expert to testify, expressly cautioned against the risks that would occur if such prices are set too high, including setting of California Class III prices at current FMMO levels. The Cooperatives also fail to justify the economic need for or level of Class I differentials.

Third, the Cooperative Order creates trade barriers as to out-of-state milk and permanently negates uniform prices paid to dairy farmers by enshrining second class citizenship for all dairy farmers who do not own California-issued quota. Out-of-state dairy farmers, who cannot under California law own or hold quota, will be particularly mistreated under the Cooperative Order. The zero-sum game of pool distributions means that the prioritization of this $1.70 premium to certain farmers that is paid off the top of the pool must come at the cost of reducing payments to all other farmers.

Finally, the Cooperative Order unaccountably extends the California marketing area into Nevada by providing for automatic pooling of a Nevada plant when the California Class I market does not need production serving that plant.

USDA should address the recognition of quota, but the ultimate result must still comply with the AMAA. The answer cannot be the "all or nothing" approach that the Cooperatives have steadfastly sought, especially because important aspects of the Cooperative Order would be subject to California, not federal law. Their complaints to the Administrative Law Judge when quota options were offered, requested, and considered – going so far as to say that any FMMO which did not incorporate their quota program exactly as proposed was a "non-starter"[1] – indicate how insincere the Cooperatives are about truly obtaining a genuine FMMO, rather than just an enhanced CSO. Quota value is $1.70 per cwt and can be recognized without omitting performance standards, imposing mandatory pooling (thus increasing the size of the pool), increasing minimum classified pricing, or applying quota to out-of-state milk. The Cooperative Order quite obviously is designed not merely to recognize quota value, but instead to enhance the California overbase price. Recognizing the inherent and irreconcilable tension between USDA's uniform pricing obligation and the permanent underclass that would be created by adopting quota wholesale, it is reasonable for USDA to find a way to establish uniform pricing over time while protecting the economic interests of those without quota. The Dairy Institute's position, strongly supported by evidence and law, is that an FMMO cannot adopt quota without also retaining performance-based pooling standards and voluntary pooling of milk used to produce manufactured products. Both quota and pooling standards/voluntary pooling can coexist; if there are resulting changes to quota made by rational, self-interested actors, then that is the result of their decision to adopt an FMMO. The limited language of the Farm Bill supports this result. If USDA determines not to adopt the Dairy Institute's approach, at the least it should phase out quota using a system of buyouts or other options raised at the hearing. No legal or policy

[1] Tr. 7012: 4 – 19 (Objection by Mr. Beshore).

justification exists for USDA to allow a state program, however strongly it is valued by its participants, to become a mechanism of disruption and discrimination within the FMMO system.

The producer-distributors' proposal exacerbates both the quota problem (discussed above) and the accompanying multiple layers of non-uniform prices. That proposal is yet another unjustified deviation from FMMO policy and is contrary to the purpose of FMMOs of sharing Class I sales value among dairy farmers. An FMMO adopting exempt quota would create a favored group of California fluid milk processors who would forever be provided a permanent regulatory pricing advantage over all other Class I handlers by not having to contribute to the pool. The Quota Provision does not justify or require yet more deviations from any other FMMO that would provide this extra benefit. Moreover, none of these existing entities operate in a fashion even remotely consistent with FMMO producer-handler regulations, regardless of size. Similarly, the Ponderosa proposal should not be adopted as it, too, is contrary to the purpose of FMMOs that Class I sales be shared among dairy farmers.

Any proposed California FMMO presupposes that it is legally justified under the AMAA and 7 C.F.R. Part 900. As a predicate, USDA must first find that disorderly marketing exists (7 C.F.R. §900.3(a)) and that the proposed order will create more orderly marketing conditions (7 C.F.R. §900.3(b)). The Dairy Institute challenges both the assertion that there is any real disorderly marketing and that the Cooperative Order would result in more orderly marketing conditions.[2]

From the time this proceeding was requested until the end of the hearing, the Cooperatives claimed that their theory of disorderly marketing rested on the difference between FMMO Class III and California Class 4b prices. But no witness actually selling cheese products under FMMOs made such a claim – indeed Wisconsin cheesemakers disavowed any problem. USDA has traditionally held that the existence of a regulatory advantage is not by itself

[2] The Dairy Institute does not believe that any California FMMO is legally justified, but has chosen to propose its own FMMO should USDA disagree. The readability of this Brief is enhanced by not repeating this qualification needlessly. USDA must consider all statements regarding support for the Dairy Institute alternative proposal as so qualified.

sufficient to establish the required disorderly marketing finding. Rather, FMMOs correct regulatory advantages that are abused by someone and result in real world, not theoretical, problems. The Cooperatives assert instead that California dairy farmers are being treated unfairly because the CSO price levels are below FMMO class price levels. But this is not a disorderly marketing condition.

As this hearing evolved, the Cooperatives turned their attention to an allegation that out-of-state milk is unpriced, and that fact alone justifies a California FMMO. However, the out-of-state milk volume is decreasing and priced by California plants at the plant blend. And no Class I handler testified that they encountered competitive problems with out-of-state milk being received by their regulated handler counterparts. Under the AMAA and USDA's regulations, USDA must also conclude that the proposed remedy will resolve those disorderly marketing conditions. Adoption of the Cooperative Order would actually result in disorderly marketing by omitting performance-based pooling standards, requiring pooling of milk used to produce manufactured products, overvaluing Class III and IV milk, and creating a permanent second economic class for out-of-state producers that can never achieve traditional uniform milk prices in light of quota. If out-of-state milk is the disorderly marketing condition that justifies an Order, USDA cannot cure that so-called problem by violating its statutory requirements. Given the overarching problems with the Cooperative Order, it is hard to see how these alleged disorderly marketing conditions can be resolved when the creation of the Cooperative Order would result in significant dislocations and abandonment of so many core principles underlying FMMOs.

This brief and Proposed Findings of Law analyzes in detail the FMMO issues discussed above, including the need for USDA to adopt an FMMO with the following elements: performance-based pooling standards, voluntary pooling of manufactured milk, revised and updated FMMO pricing that recognizes 2015 economics and weaknesses in the pricing of whey, economically justified, if any, Class differentials, a realistic application of shrinkage rules to ESL facilities, and a sunset or revision to quota that holds out-of-state milk harmless. To the extent the Dairy Institute Proposal results in differences in provisions from traditional FMMOs, these differences largely result from the fact that this is a promulgation order hearing in which USDA must consider current marketing conditions in California. The existing FMMOs have been largely left unchanged since USDA adopted an overhaul in 1999 based upon 1996 and earlier data. Unlike the Cooperative's departures from other orders, which are in contradiction to the AMAA, the Dairy Institute's departures are in fact required by the AMAA. The philosophical underpinnings of the Dairy Institute Proposal that would result in differences from the existing FMMOs are thus fundamentally different from those relied upon by the Cooperatives. For all of the above reasons, should the evidence lead USDA to propose an FMMO for California as discussed below, then it should adopt the proposal submitted by the Dairy Institute.

III. BURDEN OF PROOF

A. The United States Supreme Court in 1994 Clarified that Proponents Must Carry Both Burden of Production and the Burden of Persuasion.

This proceeding "is governed by the provisions of Sections 556 and 557 of Title 5 of the United States Code." 80 Fed. Reg. 47210 (Aug. 6, 2015). Under Section 556(d), proponents have the burden of proof for establishing a California Federal Milk Marketing Order.[3] Accordingly, Cooperative Proponents have the burden of: 1) presenting persuasive facts to the USDA in support of each part of their proposal ("Burden of Production"); and 2) presenting facts supporting the need for any proposal ("Burden of Persuasion"). Proponent Cooperatives fail on both accounts.

1. The Cooperatives have not met their "Burden of Production."

The phrase "Burden of Production" refers to the requirement that the proponent of a Rule or Order must come forward with evidence to support its claim. Proponents seeking price regulation must present "their best economic case to the price-setting agency."[4] *Tenoco Oil Co.*

[3] "Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof." 5 U.S.C. § 556(d). The relevant statute, the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. §601, *et seq.*) does not provide otherwise.

[4] A corollary of the burden of production, requiring price control proponents to present their "best economic case" for a particular price or price formula, is that failure to produce relevant evidence in proponents' control allows the decision-maker to infer that the evidence, if presented, would be adverse to proponents' case. *See* analysis of law in Ex. 78, Memorandum on Negative Inference of Failure to Introduce Relevant Evidence.

v. Dept. of Consumer Affairs, 876 F. 2d 1013, 1027-28 (1st Cir. 1989) (gasoline wholesale price regulation). Thus, in this proceeding involving whether or not to *promulgate* an entirely new FMMO for California, the Cooperatives must present evidence supporting every aspect of their proposal. A palpable dearth of evidence exists, however, on a number of key aspects of the Cooperatives' proposal: no justification for Class I differentials, no impact analysis of mandatory pooling on handlers, no support for how their proposal will ensure sufficient milk for Class I uses without performance-based pooling standards; no evaluation of current marketable whey values; and no analysis of current marketing conditions in California for purposes of determining need for or determination of classified prices. While the Cooperatives managed to introduce many pages of tables, charts, and testimony, when one strips these exhibits of their self-serving conclusions and down to the data that supports these arguments, there is little meat on the bone. Cooperatives did not fulfill their Burden of Production for a California FMMO.

2. Proponents have not met their "Burden of Persuasion."

As discussed at length in *Greenwich Collieries,* the Administrative Procedure Act's Burden of Proof requirement under 5 U.S.C. § 556(d) requires that Proponents not only produce evidence in support of their claim, but also they must carry the day with the Burden of Persuasion. *Director, Office of Workers' Comp. Programs, DOL v. Greenwich Collieries*, 512 U.S. 267, 276 (1994) (holding that proponents of Rule or Order must both produce evidence and carry the burden of persuasion). The term Burden of Persuasion means that the person advocating a rule must prove the *need* for the rule. The *Opponents need not prove anything.* If the Agency is in doubt, then the Proponents did not carry their burden and the Rule must be rejected. *Id.* at 281.

This discussion is especially important because the United States Supreme Court clarified in 1994 that agencies cannot decide in favor of rules unless the Proponent does carry its burden of proof. *Id.* Moreover, in this case, the Cooperatives assert that a difference in the California minimum 4b price and the Federal minimum Class III price constitutes disorderly marketing warranting an order. However, as discussed below in Section V, USDA has never found this type of circumstance to be disorderly marketing. Furthermore, the history and application of the AMAA demonstrate disorderly marketing conditions must be related to disruption of Class I sales. Cooperative Proponents have made no such argument here. Whatever the Agency thinks of the alternatives, the Agency must first determine solely whether the Proponents have carried their burden to warrant any FMMO. Opponents submit that they have not.

B. The Record Evidence Does Not Support the Proposal.

Beyond the limited evidence available for this Record and the fact that the Secretary is being asked to abandon nearly all of the core principles of the FMMO system, the Record in fact contradicts many of the provisions and policies for which the Cooperative Proponents are advocating. As discussed below, the Cooperatives failed on nearly every level to provide reliable, persuasive evidence in support of their proposal provisions.

C. Objections

The Dairy Institute preserves all of its objections raised at the hearing. 7 C.F.R. 900.8(d)(2). Additionally, the Dairy Institute incorporates its legal arguments at the hearing: that USDA should find that the Cooperatives' refusal to disclose the relevant study by Chuck Nicholson and Mark Stephenson means the study would have been adverse to the Cooperatives' affirmative claims. *See* Ex. 40 (Stipulation Regarding Stephenson and Nicholson Study) and Ex. 78 (Memorandum on Negative Inference of Failure to Introduce Relevant Evidence).

IV. USDA LACKS THE LEGAL AUTHORITY TO ADOPT THE COOPERATIVE ORDER

A. Introduction

The Cooperative Order is like an inverted pyramid balanced precariously on the Cooperatives' strained and unjustified interpretation of the Farm Bill. The Cooperatives erroneously assert that the language "[t]he order covering California shall have the right to reblend and distribute order receipts to recognize quota value" (7 U.S.C. §7253(a)(2) (2015), hereinafter the "Quota Provision") means that the AMAA has been amended by striking or altering the meaning of the AMAA uniform payments requirement (7 U.S.C. §608c(5)(B)) and the trade barrier prohibition (7 U.S.C. §608c(5)(G)). The Cooperative Order wholly depends on this unwarranted conclusion – without stretching the language of the Quota Provision, the AMAA clearly prohibits the wholesale adoption of the quota system into an FMMO.

Unlike the factual arguments before the USDA in this hearing, the meaning of the language of the Farm Bill is a purely legal question determined by the rules of statutory construction. The Cooperatives' interpretation of the Quota Provision is flatly contradicted by no fewer than ten rules of statutory construction that both the courts and Congress recognize and follow. The Quota Provision cannot be stretched into a broad requirement to preserve, protect, and maintain quota without diminution. Instead, the much narrower grant of discretion to USDA must be read as consistently as possible with the unamended AMAA, which expressly and specifically requires uniform payments to producers and prohibits trade barriers.

The Cooperative Order fails to achieve either mandate by ignoring or misinterpreting the following rules of statutory construction: (1) Congress knows how to explicitly amend the AMAA; (2) implied repeals and amendments of statutes are disfavored; (3) Congress knows established judicial and agency interpretation and makes a departure from that with specificity; (4) two separate statutes will be harmonized so that both can be given effect; (5) specific statutory terms prevail over general terms; (6) words are given their ordinary meaning, which is frequently the dictionary definitions; (7) statutory language is bound by the words Congress chooses to use and cannot be enlarged by adding words not used by Congress; (8) statutory language is not to be construed as "mere surplusage;" (9) courts can rely upon legislative history that is consistent with plain meaning or clarifies any ambiguity; and the Doctrine of Constitutional Doubt requires that USDA interpret the Quota Provision so as to avoid serious Constitutional doubt.

The proper application of any one (and certainly all) of these rules of statutory construction upends the Cooperatives' flimsy pyramid. The Quota Provision does not amend the AMAA and it must be interpreted consistently with the AMAA. Congress did not rewrite the

AMAA, so neither may the Cooperatives. The Dairy Institute Proposal, by precise design, gives consistent meaning to the Quota Provision in light of the AMAA and therefore should be the proposal adopted by the USDA.

B. Congress Did not Amend the AMAA in the 1996 or 2014 Farm Bills.

1. Congress did not express or imply any intent to amend the AMAA.

Since its inception, Congress has expressly amended the AMAA multiple times. Congress passed the original AMAA in 1937 (which reenacted the Agricultural Adjustment of 1933 ("AAA")). The lengthy AMAA grants authority to USDA with specificity and detail. In fact, the AMAA'S "very purpose was to avoid the infirmity of overbroad delegation ..." *Zuber v. Allen*, 396 U.S. 168, 185 (1969). The AMAA has been subject to extensive agency interpretation and court review defining the scope, range and extent of USDA authority. The AMAA and in particular 7 U.S.C. §608c (the specific section that expressly authorizes, *inter alia*, milk marketing orders) has been expressly amended multiple times over the decades by Congress.[5] In doing so Congress has always shown that it knows precisely how to amend, and what sections or paragraphs to amend, of the AMAA and 7 U.S.C. §608c, providing USDA specific instructions or authority to act. The Quota Provision does not meet this standard and thus cannot be an amendment of the AMAA.

Congress enacted the Quota Provision as part of a statute separate from the AMAA. The Quota Provision was originally enacted as §143 of Title I of the 1996 Farm Bill. Congress specified that Title I "may be cited as 'the Agricultural Market Transition Act.'" ("AMTA"). 7 U.S.C. §7201(a). Congress did not say that Title I or any part of it shall be cited as the AMAA or that it amended the AMAA. Instead the AMTA is a separate and distinct Act of Congress. To be blunt, the AMTA is not the same thing as the AMAA. The language relied upon by the Cooperatives is instead found only within the AMTA and codified at 7 U.S.C. §7253(a)(2). If

[5] For instance (and this list is not intended to be exhaustive), Congress has in multiple enactments amended or added (sometimes on a temporary basis) 7 U.S.C. §§608c(5)(A), (B) (twice), (H), (I), (J), (K), (L), (M), (N) and (O) and 608c(12), (17), (18) and (19). Attachment 1.

Congress had intended to amend the AMAA, then it would have said so with respect to §7253(a)(2). It did not.[6]

Congress routinely amends existing Acts of Congress in other enactments, which makes meaningful its decision not to do so in this case. When Congress amends an act, in the first sentence of such an amendment it routinely expressly states the name of the act it is amending and what sections or paragraph or even subparagraphs are being amended. With respect to the AMAA, that language is always substantially as follows: "The Agricultural Adjustment Act, as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended, is further amended by adding [striking] . . . ." There always immediately follows an enumerated new, modified, or stricken specifically referenced section, paragraph, subparagraph or clause. Attachments 1 are copies of six recent amendments to 7 U.S.C. §608c affecting dairy policy under the AMAA. The Farm Bill provisions lack this critical express language that would amend 7 U.S.C. §608c. Congress' failure to employ this basic term of art and language (always referencing the Act and section amended when amending an Act of Congress) is clear evidence that 7 U.S.C. §608c has not been amended by the Quota Provision. *Whitfield v. United States*, 543 U.S. 209, 216 (2005) ("Congress has included an express overt-act requirement in at least 22 other current conspiracy statutes, clearly demonstrating that it knows how to impose such a requirement when it wishes to do so").

2. Implied repeals and amendments of statutes are disfavored.

A corollary principle is that courts disfavor implied repeals (whether a section or a statute *in toto*) and amendments. "[It] can be strongly presumed that Congress will specifically address language on the statute books that it wishes to change." *United States v. Fausto*, 484 U.S. 439, 453 (1988); *American Cas. Co. of Reading, PA v. Nordic Leasing, Inc.*, 42 F.3d 725, 735 (holding that when sections of a statute have been amended but certain sections have been left untouched, courts must assume that the legislature meant to leave the untouched provisions alone

[6] This separately named Act is by itself a definitive repost to the Cooperatives' counsel' incredulous question to Dr. Schiek. Tr. 6728: 2 – 4 (Cross-Examination of Dr. Schiek by Mr. Beshore).

and their original meaning intact). As a key aspect of the separation of powers, courts are rightfully cautious in expanding their role from interpretation into lawmaking. *See* U.S. Const., Art. I, § 1; *and see* Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533, 540–42 (1983).

Congress failed to "specifically address" 7 U.S.C. §608c in the Quota Provision and it made no effort to amend any sections of it. To the contrary, Congress in the sentence prior to the Quota Provision references the method of approving a California order under "§608c of this *title*" (meaning the AMTA). 7 U.S.C. §§7253(a)(2). In unrelated paragraphs Congress referenced the number of orders issued and the Class I pricing table adopted in the 1985 Farm Bill under 7 U.S.C. §608c. Congress did not in any of those references say it was amending any portions of 7 U.S.C. §608c. *See, e.g.,* 7 U.S.C. §§7253(a)(1) and (a)(3). The fact that Congress explicitly mentions §608c, but does not expressly amend it, shows that Congress was aware of the provision and its requirements but took no steps to amend or change them.

Moreover, consistent with the clear conclusion that Congress did not repeal, amend or override 7 U.S.C. §608c, Congress did not include "notwithstanding any provision of law" language in the Quota Provision that could support an alternative conclusion. Such language, while not dispositive and sometimes read narrowly (as implied amendments are disfavored), is often used by Congress in an attempt to broadly insure that a provision will have legal effect regardless of other laws. *United States v. Hyde,* 497 F.3d 103 (1st Cir. 2007) (Mandatory Victims Restitution Act supersedes bankruptcy law); *United States v. Novak*, 476 F.3d 1041 (9th Cir. 2007) (same supersedes ERISA). Indeed, in the 1996 Farm Bill Congress used similar language ("[n]othing in this Act or any other provision of law shall be construed") to exempt California's separate fluid milk standards from preemption in the very next section. 7 U.S.C. §7254. The fact that Congress used that phrase expressly designed to impact other laws and even other provisions in the AMTA (7 U.S.C. §7254), but not in the Quota Provision (adopted simultaneously as part of the AMTA) is yet another reason why the Quota Provision cannot be viewed as impliedly amending or repealing anything, much less any portion of 7 U.S.C. §608c.

Moreover, the U.S. Supreme Court construed the impact of §7254 narrowly, not broadly.[7] *See Whitfield, supra.*

3. Congress is aware of judicial review of the AMAA.

Congress enacted the Quota Provision with full knowledge of the nearly 80 years of numerous court decisions interpreting and applying the AMAA with respect to marketing orders. In a number of cases, courts struck down USDA action as unlawful, inconsistent or unauthorized. In making amendments to any Congressional Act, Congress is deemed to act with the knowledge of court action and statutory interpretation; Congressional action must be considered in that light. As with the principle that Congress does not amend statutes by implication, Congress must speak clearly if it intends to overturn or alter judicial interpretations of law. *Midatlantic Nat'l Bank v. New Jersey Dep't of Envt'l Protection*, 474 U.S. 494, 501 (1986) ("[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific"); *quoting Edmonds v. Compagnie Generale Transatlantique,* 443 U.S. 256, 266-67 (1979). Indeed Judge Wald from the D.C. Circuit Court of Appeals concluded that in order to overcome a presumption of this type, Congress must "signal[] its intention in ***neon lights.***" Patricia M. Wald, *Some Observations on the Use of Legislative History in the 1981 Supreme Court Term,* 68 Iowa L. Rev. 195, 208 (1983).

As it happens, the U.S. Supreme Court has left no doubt that judicial interpretation of both the uniform payment requirements and the trade barrier prohibition must be enforced in the absence of express Congressional amendment, language not found in or applicable to the Quota Provision. *Zuber v. Allen, supra* (striking down the Massachusetts-Rhode Island Order's nearby differentials as not being authorized economic justified adjustments to uniform price requirement

[7] In any event, the scope of a "notwithstanding any other provision of law" or in the alternative "nothing in this Act or any other provision of law" phrase must be directly linked to any specific language that follows. The U.S. Supreme Court concluded that 7 U.S.C. §7254 did not apply to provisions of the CSO or its authorizing statute because the fluid milk standards are found in a different section of the California Code and do not apply to the pooling and pricing of milk. *Hillside Dairy, Inc. v. Lyons*, 537 U.S. 1039 (2003) (holding that 7 U.S.C. §7254 did not express an intent to insulate the CSO's pooling and pricing provisions from a dormant Commerce Clause challenge).

required by 7 U.S.C. §608c(5)(B)); *Lehigh Val. Co-op. Farmers, Inc. v. United States*, 370 U.S. 76 (1962) (striking down compensatory payments to producer settlement fund from partially regulated Class I handlers as being an unlawful trade barrier prohibited by 7 U.S.C. §608c(5)(G)). Congress' historical response to these two cases negates any conclusion that the Quota Provision was meant to counter these judicial interpretations from our highest court. Congress failed to signal any such intention, let alone with "neon lights."

a. *Zuber* requires specific economic based exceptions to uniform payment provisions.

In *Zuber*, USDA merged four sub-markets and readopted for the Massachusetts-Rhode Island Order "nearby differentials," which were adjustments to the uniform price paid to dairy farmers in favor of dairy farmers who were located closer to the cities and the Class I handlers. As with CSO quota, there were historical, non-FMMO bases and justifications offered to support this adjustment. Prior to any federal regulation, the local dairy farmers acting through cooperatives banded together to collectively bargain for their milk in order to establish market stability.

> During the 1920's era of relative market stability the nearby farmers enjoyed premium prices for their product. These favorable prices were apparently attributable to reduced transportation costs and also the nearby farmer's historic position as a fluid milk supplier.

Zuber, supra at 173-74.

In order to make the collective arrangement work and create a disincentive for nearby farmers to provide an alternative source of supply to the city Class I handlers, the cooperatives decided to divide the profits by paying more to the nearby farmers who historically served the fluid market.

> Frequently employed was a base-rating plan whereby each producer would be assigned a percentage of his milk for which he could claim payment at the Class I fluid price. For the remaining production he would be paid at the Class II rate. Apparently bases were assigned according to the anticipated participation of the producer in the fluid market. As a result, nearby producers received more favorable bases in view of their historical role as fluid suppliers in an equilibrium market.

Id. at 174. The Court summarized the effect of the program: "The deduction for differential payments withheld for the benefit of nearby producers reduces the uniform 'blended' price to those producers ineligible to collect this particular adjustment." *Zuber, supra at* 178 *citing* 7 C.F.R. §1001.72 (1969). In adopting the original Boston and other sub-market orders and in merging these Orders, USDA continued the cooperative practice claiming that it was an authorized adjustment to the uniform price authorized by 7 U.S.C. §608c(5)(B).

> Farmers who would have been entitled to the differential under any one of the previous four marketing regulations continue to receive these payments under the present order. These nearby farmers are eligible for the differential on any shipments within the New England marketing area, even though their milk may actually be used outside the radius of their particular nearby zone.

Id. at 179. USDA and the nearby farmers justified the nearby differential as an authorized adjustment to the uniform prices under 7 U.S.C. §608c(5)(B) of the AMAA which provided at the time as then amended by Congress in substantive and relevant part as follows:

> Providing . . 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. . . subject . . . only to adjustments for (a) volume, market and production differentials customarily applied by the handlers subject to such order, (b) the grade or quality of the milk delivered, (c) the locations at which such delivery of such milk is made, and (d) a further adjustment, equitably to apportion the total value of the milk purchased by any handler, or by all handlers, among producers and associations of producers, on the basis of their marketings of milk. . .

7 U.S.C. §608c(5)(B).[8] The U.S. Supreme Court found otherwise and struck down the Order provisions for the nearby differentials.

The *Zuber* Court first examined the basis and significance for the general requirement of uniformity of price and observed that only *specifically* enumerated adjustments are permitted.

> The foundation of the statutory scheme is to provide uniform prices to all producers in the marketing area, subject only to specifically enumerated

[8] As discussed below, Congress in 1965 temporarily amended 7 U.S.C. §608c(5)(B) by expressly replacing the original (same as today) language of clause (d) of 7 U.S.C. §608c(5)(B) to provide more specific authority for what became known as base-excess plans. Clause (d) was not before the court.

> adjustments. The question before the Court, stated most simply, is whether payment of farm location differentials, set forth above, is a permissible adjustment under § 8c(5)(B) to the general requirement of uniformity of price.

Id. The Court then conducted a searching analysis of the statute and its legislative history especially in light of the AMAA's reenactment and amendments to the AAA[9] designed "'[t]o eliminate questions of improper delegation of legislative authority raised by the decisions in *Schechter et al. v. United States. . .*'" *Id.* at 183 n. 16 *quoting* H.R. Rep. No. 1241, 74th Cong. 1st Sess., 8 (1935).[10] The Court concluded that Congress intended and did "confine the boundaries of the Secretary's delegated authority." *Id.* at 183 and n. 16.

> The statute before us does not contain a mandate phrased in broad and permissive terms. Congress has spoken with particularity and provided specifically enumerated differentials, which negatives the conclusion that it was thinking only in terms of historical considerations.

Importantly the Court went on to observe that each of the specifically enumerated adjustments to uniform prices of the kind relied upon by USDA to justify the nearby differentials - "volume," "grade or quality," "location" and "production" - all compensated or rewarded "the producer for providing an economic service or benefit to the handler." *Id.* at 183-84. The Court concluded that the specific and "permissible adjustments are limited to compensation for rendering economic service." *Id.* at 188.[11] The Court found that the nearby differentials, like California quota, "do not fall in this category" especially as the Secretary and the nearby farmers failed to advance "any economic justification for these differential payments." *Id.*

The importance placed by the U.S. Supreme Court on its conclusion and judicial interpretation that the permissible adjustments to uniform prices are directly tied to economic

---

[9] Unlike the Quota Provision, this is a clear example of Congress amending legislation responding to judicial interpretation and limitation and establishing that Congress was looking to overcome those judicial rulings. Congress in 1996 and 2014 in enacting the Farm Bill did nothing of the kind.

[10] While not an attorney, Dr. Schiek was referring to this part of *Zuber* in his testimony at Tr. 4033:9 – 4035:22 (Cross-Examination of Dr. Schiek by Mr. Beshore). The second-guessing query from Cooperatives' counsel was just as incorrect as was his incredulous query with respect to the issue of amendments to the AMAA. *See* note Tr. 6728: 2 – 4 (Cross-Examination of Dr. Schiek by Mr. Beshore), *supra.*

[11] The Court also recognized and found that statutorily authorized adjustments under 7 U.S.C. §608c(5)(B) are only "permissible," meaning discretionary and not mandatory.

justifications cannot be overstated as the Court repeatedly and specifically made precisely that point. "There is no suggestion in the findings, nor have the parties explained, how the present [nearby] differential contributes to the broad, general purpose of eliminating crippling competition." *Id.* at 193. "This Court has been slow to attribute to Congress an intent to compensate for inefficient allocation of economic resources. *Cf. West Ohio Gas Co., v. Comm'n,* 294 U.S. 63, 72 (1935)." *Id.* at 190. "[N]or is there any evidence demonstrating the present necessity for nearby producers." *Id.* And finally, the issue "is whether the provisions are authorized by the statute. The Secretary's order is devoid of any economic justification and relies solely on the historical factor of the nearby producer's favorable share of the fluid use market." *Id.* at 190.

The judicial imprimatur established for interpreting and amending 7 U.S.C. §608c(5)(B) is most clearly stated by the Court in discussing both the legislative history of the AMAA and the need for a specific departure from the "legislative purpose to treat all farmers equally." *Id.* at 185.

> Legislative silence is a poor beacon to follow in discerning the proper statutory route. For here the light illumes two different roads. If nearby payments had the notoriety and significance in the milk distribution industry attributed to them by the dissent, Congress could have given its blessing *by carving out another specific exception to the uniform price requirement*. In an Act whose very purpose was to avoid the infirmity of overbroad delegation and to set forth with particularity the details for a comprehensive regulatory scheme, *it would have been a simple matter to include in a list of enumerated differentials, 'nearby payments,'* or at least to allude to them in the report of the draftsmen. It is clear that Congress was not conferring untrammeled discretion on the Secretary and authorizing him to proceed in a vacuum. This was the very evil condemned by the courts that the 1935 amendments sought to eradicate. It would be perverse to assume that congressional drafters, in eliminating ambiguity from the old Act, were careless in listing their exceptions and selecting the illustrations from the committee report from which their words would ultimately derive content.

Id. (emphasis supplied; footnotes omitted). Applying the *Zuber* Court's strict reading of the specific and limited adjustments that Congress authorized to uniform payments, the statutory construction principle that Congress must make its intention clear in order to change judicial interpretation precludes USDA from concluding that the Quota Provision is a specific exception (or even any exception at all) to the pre-existing payment uniformity requirement. Quota, like the nearby differentials, is a California historical artifact, based at its inception on then existing service of the fluid market, and with no economic justification for departing from the AMAA's core principle of requiring uniform payments paid to dairy farmers.

b. *Lehigh* precludes the trade barriers imposed by the Cooperative Order.

In *Lehigh*, the U.S. Supreme Court exhaustively reviewed 7 U.S.C. §608c(5)(G) determining that that provision prohibits trade barriers from being erected by the Secretary in his regulation of the marketing of milk:

> No marketing agreement or order applicable to milk or its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of a milk or milk product thereof produced in any production area in the United States.

7 U.S.C. §608c(5)(G) (1965).

In *Lehigh*, the Secretary had included in the New York-New Jersey FMMO a provision for compensatory payments on non-pool milk sold in the marketing area by outside handlers.[12] A handler who brought outside fluid milk into the area would have to pay the pool producers through the producer-settlement fund an amount equal to the difference between the minimum prices for the highest and lowest use classification prevailing in the area. This provision had the consequence of requiring non-pool milk to subsidize pool milk which was thus insulated from competition. The *Lehigh* Court concluded that "as regards milk the word 'prohibit' refers not merely to absolute or physical quota restrictions, but also *encompasses economic trade barriers of the kind effected by the subsidies called for by this 'compensatory payment' provision.*" *Lehigh, supra,* at 97 (emphasis supplied). Therefore, the Order set up an economic trade barrier specifically prohibited by 7 U.S.C. §608c(5)(G). The Quota Provision fails to reference either

[12] At the time, 23 FMMOs included a provision as found unlawful in *Lehigh*. *Lehigh, supra,* at 83 and n.9.

Lehigh or §608c(5)(G); thus, USDA must conclude that "compensatory payments" and any other trade barriers remain prohibited.

As described in greater detail in Section VIII, under the Cooperative Order, the quota premium is paid out first from all California FMMO proceeds, including the value of out-of-state milk. Only California dairy farmers can own quota, so by definition no out-of-state dairy farmer can receive this premium payment. Moreover, since the Cooperative Order only applies to California, by definition all out-of-state dairy farmers are, as with *Lehigh,* outside the Order even if they are pool producers. While the Cooperatives claim that the out-of-state dairy farmers still receive the "uniform price" as they define it, the fact remains that mathematically those out-of-state farmers will have their milk payments reduced by their pro-rata amount of milk after deduction of the $1.70 premium. This is nothing more than another compensatory payment made to some in-state dairy farmers that not coincidentally results in the out-of-state dairy farmers receiving a non-uniform price.[13] *Lehigh* condemns this result: "[i]n effect, therefore the nonpool [out-of-state] milk is forced to subsidize the pool [California quota] milk and insulate the pool [California quota] milk from the competitive impact caused by the entry of the entry of the outside milk." *Id.* at 89-90.

c. *Hillside Dairy* further affirms the conclusion that the AMAA prohibits trade barriers.

Not only has Congress failed to override or re-interpret *Lehigh*, but it also in the Quota Provision (especially the 2014 reenactment that removed the expired time provision) did not write on a blank slate with respect to milk regulation for California. In 1997, California dairy farmer interests successfully sought from California Department of Food and Agriculture ("CDFA") an amendment to the CSO that effectively required California processors to account to the CSO pool for its purchases of out-of-state milk. This in turn increased the California quota and overbase prices at the expense of the out-of-state milk:

[13] The fact that some in-state interests also subsidize the quota is of no moment for this purpose. *Dean Milk Co. v. City of Madison,* 340 U.S. 349, 354 n.4 (1951).

> The quota and overbase pool prices [which are paid to California raw milk producers] are generated from that pool of revenue, whereas prior to the Amendments, the quota and overbase prices were calculated after the out-of-state milk had, in effect, been subtracted out of the pool. The effect of this change is that quota and overbase prices have increased. . . Plaintiffs contend this payment, which is made because of interstate raw milk sales and only disbursed to certain California dairy businesses for their benefit, is an unconstitutional tariff.

Hillside Dairy, Inc. v. Kawamura, 317 F. Supp.2d 1194, 1197 (E.D. Cal. 2004) (internal record citation omitted).

The out-of-state milk farmers successfully sought a court injunction against this action in *Hillside*. Citing *West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 196 and 203 (1994), the court in *Hillside* found the CSO amendments to be discriminatory and unlawful:

> Since the 1997 amendment to § 900 requires out-of-state raw milk producers to pay for benefits received exclusively by California dairy businesses, it is similar to the milk pricing order invalidated in *West Lynn.* Like the charge in *West Lynn,* this charge attendant to interstate milk sales, which is evident on the face of the Pooling Plan and just benefits certain California dairy businesses, renders § 900 discriminatory "because it, like a tariff, neutralizes advantages belonging to the place of origin." *West Lynn,* 512 U.S. at 196 (citation and quotation marks omitted).

Hillside, supra at 1198. There is no real, practical, or effective difference between the CSO Pooling Plan amendments found unlawful by the court in *Hillside* and the Cooperative Order's treatment of out-of-state milk which would deprive out-of-state milk (whether received in California or at a plant located outside California but regulated on the Cooperative Order) of a traditional uniform blend price under the Order. The Cooperative Order would permanently treat those dairy farmers as second-class citizens deprived of the statutorily required uniform price to be paid to all dairy farmers.

Congress must indicate when it intends to change the law, especially after judicial interpretation. Congress adopted the Quota Provision after the *Lehigh* and *Hillside* decisions enforcing the restriction on trade barriers, but made no mention of that case, amending §608c, or exempting quota from such trade barrier restrictions. Accordingly, the Quota Provision must be interpreted to comply with both the trade barrier language and the U.S. Supreme Court's interpretation of it as prohibiting any economic trade barrier or subsidy paid by out of area farmers for the benefit of California farmers.[14] The Cooperative Order, especially in light of the *Hillside* decision directly on point for California, would establish precisely the kind of compensatory payment stuck down as unlawful in these cases, especially as applied to out-of-state milk (whether packaged or raw milk, as discussed in Section VIII).

d. Congressional response to *Zuber* and *Lehigh* precludes any reading of the Quota Provision as amending the AMAA.

Congress's response to *Zuber* and *Lehigh* supports the conclusion that the Quota Provision did not amend the AMAA. Congress knows precisely how and in what specific manner to amend 7 U.S.C. §608c(5)(B), and has done so before in a clear and cogent amendment that in no way resembles the sparse language of the Quota Provision. Both in 1965 (Attachment 1.A) and in 1970 (Attachment 1.B) Congress expressly amended clause (d) of 7 U.S.C. §608c(5)(B) to provide additional detailed and specific circumstances in which USDA could permit deviations from the uniform pricing requirements of the section.[15] Both the 1965 and 1970 Farm Bill amendments to the AMAA also provided special voting procedures permitting individual dairy farmers to vote on Base-Excess plans, in lieu of bloc voting, and provided that voting "no" on these types of order amendments only would not result in the termination of the order otherwise required in 7 U.S.C. §§608c(12) and 608c(19). The 1965 Farm Bill Amendments to clause (d) expressly expired at the end of 1969. The 1970 Farm Bill Amendment again rewrote clause (d), and added *several pages* of additional authority for seasonal pricing deviations in clauses (e) and (f). These provisions were also temporary and were extended by subsequent Farm Bills until they expired December 31, 1996 when the 1996 Farm Bill failed to further extend its application. *See* 61 Fed. Reg. 69016-68019 (December 31, 1996).

[14] As discussed below, Congress actually reaffirmed 7 U.S.C. §608c(5)(G) as judicially interpreted by *Lehigh* in the 1970 Farm Bill.

[15] Congress in the 1965 Farm Bill amendment also temporarily adopted subsection H to 7 U.S.C. §608c(5) which authorized manufacturing milk only orders. That paragraph has since lapsed, but is yet another example of Congress' knowledge and ability to expressly amend the AMAA unlike its actions in the 1996 and 2014 Farm Bills.

Some Cooperative Order proponents compared the California quota system to the now expired base-excess plans that Congress expressly authorized in the 1970 Farm Bill. Ex. 58, at 7 (Testimony of Mr. Christ); Tr. 2530: 1 – 21 (Testimony of Mr. Christ). We do not entirely accept the comparison especially because Congress in the base-excess plans authorizing language expressly provided for new producers under an order to build a base, something the CSO quota system does not permit. But the comparison is otherwise apt in that today the Congressional pronouncement needed to justify CSO quota and all of the attendant bells and whistles cannot be found anywhere in 7 U.S.C. §608c(5)(B). Just like authority for base-excess plans, it does not exist in the AMAA.

The point is that unlike Congress' amendments in 1965 and 1970 Farm Bills, Congress in the Quota Provision made no reference to the AMAA or 7 U.S.C. §608c(5)(B), and it certainly failed to amend or add to the authorized adjustments that the *Zuber* Court found tied to economic costs. In light of the Supreme Court's decision in *Zuber* holding that only expressly named adjustments to uniform pricing are permitted as well as the fact that Congress post-*Zuber* (just one year later) amended the very section at issue today, Congress clearly knew how and why to make specific amendments to the AMAA. It did neither in 1996 or 2014. Instead, Congress enacted a separate statute (the AMTA), not an amendment to existing law. As to *Lehigh*, Congress did speak, but in such a manner as to affirm, not disavow, *Lehigh*. As part of the 1970 Farm Bill, and more than 8 years after the U.S. Supreme Court issued its decision in *Lehigh*, Congress affirmed the law as judicially interpreted:

> (d) It is not intended that existing law be in any way altered, rescinded, or amended with respect to section 8c(5) (G) of the Agricultural Adjustment Act, as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended, and such section 8c(5) (G) is fully reaffirmed.

Pub. L. 91-524, §201(d).[16]

[16] The fact that this paragraph also expired on December 31, 1996 is of no moment because its expiration doesn't change the language of 7 U.S.C. §608c(5)(G) or undo *Lehigh*. The point was that Congress applied *Lehigh* to the temporarily authorized Base-Excess plans, carefully preventing those plans from creating trade barriers on the basis of the extensive language in then amended §608c(5)(B).

Thus, with *Zuber* and *Lehigh* in mind, Congress' action with the Quota Provision is not a change in policy or an amendment of the AMAA affecting in any way the uniform payment requirements or the trade barrier restrictions of 7 U.S.C. §§608c(5)(B) and (G).

C. The AMAA and the Quota Provision must be Harmonized to Give Both Effect.

1. Different statutes will be harmonized to give both effect.

As equal Congressional pronouncements, the Farm Bill and AMAA must be interpreted to give both effect. The Dairy Institute does not suggest in any way that the Quota Provision is hollow or lacks meaning. Of course, 7 U.S.C. §7253(a)(2) is just as much a law as is the AMAA. But it is quite obviously a separate enactment rather than an amendment to the AMAA. As such it will not be read as replacing or substituting the AMAA or any part of it. Under rules of statutory construction, any conflicts between the two statutes which are otherwise silent as to their relationship must be resolved by the court reading the "statutes to give effect to each if [it] can do so while preserving their sense and purpose." *Ruckelshaus v. Monsanto, Co.* 467 U.S. 986, 1017-18 (1984) (reconciling FIFRA (Federal Insecticide, Fungicide and Rodenticide Act) and Tucker Act taking remedies by implying a requirement that FIFRA remedies must be exhausted before resorting to Tucker Act remedies); *Lewis v. Lewis Marine, Inc.,* 531 U.S. 438 (2001) (reconciling differences between Limitation of Liability Act and the saving to suitors clause); *Watt v. Alaska*, 451 U.S. 259, 267 (1981) (reconciling the Wildlife Refuge Revenue Sharing Act with the Mineral Leasing Act regarding the meaning of "minerals"). Courts will only apply a rule that the later of two statutes prevails if the provisions of the two statutes are "irreconcilably conflicting," (*id.* at 266) taking into consideration all principles of statutory construction. As discussed below, the two statutes can and must be reconciled so as to not undermine and strike the AMAA's provisions regarding both uniform payment requirements and trade barrier prohibitions.[17]

[17] For instance, USDA can conclude that the Quota Provision provides the necessary authority to adopt the Dairy Institute's proposal to recognize quota similar to the 1967 treatment for Oregon, discussed below. It is unclear whether USDA had the authority in 1967 to adopt Oregon quota into the FMMO.

The Cooperatives asserted at the hearing that of course the AMAA and the Quota Provision are irreconcilable. Tr. 7012:20 – 7013:13 (Objection by Mr. Beshore). Their unsupported conclusion simply misses the mark. The foregoing discussion regarding the importance of Congress speaking clearly, expressly and forthrightly as to amendments to existing law becomes nonsense if general, non-specific single sentences that make no reference to the AMAA can be read to alter long-standing, specific, detailed and judicially interpreted laws. Far from presuming that Congress will not impliedly amend a law, the Cooperatives rely on an interpretation that would make such amendments by implication routine and easy. As discussed below (and is consistent with multiple principles of statutory construction), USDA can and must reconcile the two provisions.

2. Specific statutory terms govern over general terms.

The principle of statutory construction that specific terms govern over the general supports the Dairy Institute's conclusion that the AMAA and the Quota Provision can be reconciled. "However inclusive may be the general language of a statute, it will not be held to apply to a matter specifically dealt with in another part of the *same* enactment." *Fourco Glass Co. V. Transmirra Products Corp.,* 353 U.S. 222, 228 (1957) (citations omitted) (emphasis supplied).[18] The Quota Provision is general and certainly not as specific when comparing and reconciling to the AMAA and 7 U.S.C. §§608c(5)(B) and (G). Congress presumably knew how to say and could have at least said that the California Order is authorized to "adjust uniform prices under the AMAA for" a specific purpose, especially in light of *Zuber* and *Lehigh*. After the Court's decisions in those two cases in the 1960s, Congress certainly knew (as it did with the 1970 Farm Bill amendments) that clarity and specificity were demanded if it chose to amend the uniform payment requirements or trade barrier prohibition.

[18] While this principle generally applies to provisions within the same statute, it also applies to resolve conflicts between two statutes. *Morton v. Mancari,* 417 U.S. 535, 550-51 (1974) (a general statute will not be held to repeal by implication a more specific on unless there is a "*clear indication otherwise*") (emphasis supplied).

The Quota Provision is entirely silent with respect to trade barriers. Instead, Congress' enactment that the California "order shall have the right to reblend and distribute quota value" does not reference the AMAA, the AMAA's uniform payment requirements, the AMAA's specific limitation that uniform prices apply "subject . . *only to adjustments*" listed, or trade barriers. Congress' failure to employ terms of art (e.g., referencing the AMAA or uniform payments or including "notwithstanding any other provision of law" language) or other language it normally uses to amend the AMAA or any other statute is dispositive also when deciding to reconcile the AMAA with the Quota Provision. *FCC v. NextWave Personal Communications, Inc.,* 537 U.S. 293, 302 (2003) (when Congress intends to create exceptions to the bankruptcy law requirements, "it has done so clearly and expressly."); *Dole Food Co. v. Patrickson,* 538 U.S. 468, 476 (2005) (Congress knows how to refer to "ownership in other than the formal sense," and did not do so in the Foreign Sovereign Immunities Act when defining "instrumentality."). Having not done so in the Quota Provision, Congress cannot be said to have created any irreconcilable exception to the AMAA uniform payment requirements or trade barrier prohibition.

D. The Quota Provision Can and Should Be Reconciled Consistent with the Dairy Institute's Proposal.

Reconciliation of the AMAA and the separate Quota Provision also requires USDA to determine the meaning of the Quota Provision. In other words, what is the specific meaning of this phrase: "[t]he order covering California shall have the right to reblend and distribute order receipts to recognize quota value." When it does so, USDA must abide by the rules of statutory construction discussed above (that it cannot read the Quota Provision as amending the AMAA and that it must reconcile, to the extent possible, the Quota Provision with the AMAA). However, an additional set of statutory construction rules will guide USDA's specific analysis of the words in the Quota Provision – words shall be given their plain meaning, being neither dismissed now expanded, and consistent legislative history may be considered when interpreting a provision. Complying with these requirements then makes reconciling the AMAA and the Quota Provision relatively straight forward.

While all of these canons of construction will be discussed below, one in particular (legislative history) provides a particularly clear beacon to the USDA in its interpretation. In its Conference report dated January 27, 2014, Congress stated that, through the Quota Provision, it was providing USDA "discretion" to recognize quota in an "appropriate" manner. H.R. Rep. No. 113-333, at 385 (2014), found at http://www.gpo.gov/fdsys/pkg/CRPT113hrpt333/pdf/ CRPT-113hrpt333.pdf. Therefore, USDA must conclude that the Quota Provision provides it the discretion to recognize quota in an appropriate manner that maintains uniform prices paid to dairy farmers and avoids creating trade barriers.

The Cooperatives urge the opposite result by enlarging the statute and demanding that USDA give them a quota system exactly as they request. Their alternative reading is difficult to reconcile with the AMAA, making that interpretation less likely to have been Congress' intent. Indeed their interpretation would amount to a disfavored implied amendment of the AMAA. Additionally such an interpretation has no basis in the text of the provision. While a good lawyer can wordsmith any phrase to suit his needs, USDA is beholden to a higher calling to comply with Congressional intent and enforce the laws as written.

1. The ordinary meaning and plain language of the Quota Provision supports the Dairy Institute's interpretation.

The preferred starting point under the rules of statutory construction is to give words their ordinary meaning, most frequently derived from the dictionary. *FDIC v. Meyer*, 510 U.S. 471, 476 (1994) ("we construe a statutory term in accordance with its ordinary or natural meaning.")

> The dictionary defines "recognize" as follows:
> **rec□og□nize** (rek□ə nīz□) ***vt.*** **-nized□, -niz□ing** [altered (after prec.) □ extended stem of OFr. *reconoistre:* see prec.] **1.** to be aware of as something or someone known before, or as the same as that known **2.** to know by some detail, as of appearance; identify *[*to *recognize* a butterfly by its coloring*]* **3.** to be aware of the significance of *[*to *recognize* symptoms*]* **4.** to acknowledge the existence, validity, authority, or genuineness of *[*to *recognize* a claim*]* **5.** to accept as a fact; admit, accept

> [to *recognize* defeat] **6.** to acknowledge as worthy of appreciation or approval [to *recognize* devotion] **7.** to acknowledge the legal standing of (a government, state, etc.) by some formal action, as by entering into diplomatic relations **8.** to show acquaintance with (a person) by greeting **9.** to acknowledge as having the right to speak, as in a meeting -- **rec□og□nize□er** ***n.***

Recognize. (1984) *Webster's NewWorld Dictionary* (p. 1186, 2d college ed.).

This definition simply fails to support the broad goals of the Cooperative Order. And so the Cooperatives and their allies rarely used the word "recognize." Indeed, USDA can "be aware of the significance of" quota and "acknowledge" quota value without negating uniform prices or creating trade barriers. USDA can find that "recognize quota" can be reconciled with the AMAA by implementing the Dairy Institute's quota proposal, discussed in detail below, that would exempt out-of-state milk from the quota system and permit California dairy farmers to elect whether or not they wish to remain in the quota system.

2. The Cooperatives improperly seek to enlarge the Quota Provision.

A corollary to the plain meaning rule is that statutes are not to be "enlarged," and as a result, courts cannot add language that Congress has not included. *Lamie v. United States Trustee,* 540 U.S. 526, 536 (2004) (an "absent word" cannot be added to a statute; "there is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted"); *Iselin v. United States*, 270 U.S. 245, 251 (1926) (holding that the Revenue Act of 1918 did not expressly authorize taxing license fees collected by an arts patron for the use of her Metropolitan Opera box):

> What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function. Compare *United States v. Weitzel,* 38 S. Ct. 381, 246 U. S. 533, 543, 62 L. Ed. 872*; Peoria & Pekin Union Ry. Co. v. United States,* 44 S. Ct. 194, 263 U. S. 528, 534, 535, 68 L. Ed. 427.

Iselin, 270 U.S. at 251.

The operative language "reblend and distribute order receipts to recognize quota value" cannot be enlarged, as the Cooperatives and their allies propose: they insist on making the pool of money larger both by including out-of-state milk in the pre-quota pool calculation, but also by requiring the participation of manufactured product manufacturers in the minimum price and pooling provisions. They demand not so much that quota value be recognized as that quota and overbase prices be increased to a level higher than they are under the CSO. In realizing that "recognize" is a term that does not support the Cooperative Order, they rewrite the Farm Bill and twist the word "recognize" beyond all recognition.

The Cooperatives improperly seek to change the meaning of the Quota Provision by substituting multiple words and phrases that Congress did not use. The following is just a sample of their extraordinary effort to rewrite the legislation (emphasis supplied in all):

- "In 2014 Congress provided a necessary prerequisite for correcting this condition when it re-authorized the language in the 1996 Farm Bill allowing the USDA to promulgate a California FMMO while **retaining** the California state quota program." Ex. 19, at 5 (Written of Mr. Hollon).

- "That Congressional authorization makes clear that a California FMMO will have all the benefits and characteristics of the other ten FMMO's, while **maintaining** the unique California system of sharing milk sales revenues through the state quota program." Ex. 19, at 5 (Testimony of Mr. Hollon).

- "In fact, paramount to any consideration of a California federal milk marketing order (FMMO) was the assurance that the quota program would **not in any way be diminished or affected**. Congress recognized this and in the 2014 Farm Bill language dealing with the promulgation of an FMMO in California directed that the marketing order provisions **allow for the continuation of the quota program** in California." Ex. 42, at 2 (Testimony of Dr. Erba).

- "The language from Congress makes it clear that the quota program **should have the right to exist** within the framework of a FMMO." Ex. 42, at 24 (Testimony of Dr. Erba).

- "In fact, paramount to any consideration of a California federal milk marketing order (FMMO) was the assurance that the quota program would **not in any way be diminished or affected**. Congress recognized this and in the 2014 Farm Bill language dealing with the promulgation of a FMMO in California directed that the marketing order provisions **allow for the continuation** of the quota program in California." Ex. 54, at 6–7, (Testimony of Lon Hatamiya).

- "In order to best 'recognize quota value,' **the full economic value must be determined and maintained**." Ex. 54, at 7 (Testimony of Lon Hatamiya).

- "So Congress knew what the system was and it authorized this hearing, and it authorized a Federal order that **incorporates** quota…" Tr. 767:14–16 (Statement by Mr. Beshore).

This extraordinary effort to broadly expand the Quota Provision is evidence that the Cooperatives and their allies realize that the Cooperative Order is not supported by Congress' "recognize quota value" language. Importantly, the California code contains more robust language that the U.S. Congress did *not* include in the Quota Provision: "All pool quota initially determined pursuant to Section 62707 shall be recognized *and shall not in any way be diminished.*" Cal. Food & Agric. Code § 62712(e) (emphasis supplied). Ignoring the principles of statutory interpretation, the Cooperatives make words mean what Congress did not say:

> 'When *I* use a word,' Humpty Dumpty said, in a rather scornful tone, 'it means just what I choose it to mean – neither more nor less.'
>
> 'The question is,' said Alice, 'whether you *can* make words mean so many different things.'

Lewis Carroll, *Through the Looking Glass, the Walrus and the Carpenter*, 6 (1872).

"Quota value" is also itself a limited term of art. It is different from the "quota price," the "overbase price," or even the "quota system." As discussed in Section VIII, quota value is the $1.70 per cwt premium that is deducted first from the pool proceeds in the CSO. The quota price is the overbase price plus the quota price (after accounting for other adjustments). It is obvious from the statements above and the thrust of the Cooperative Order that the real goal is to reach well past quota value and enhance California dairy farmer quota and overbase prices at the expense of all other industry participants. As discussed below, the Cooperative Order would increase the minimum regulated prices of all classes of milk. Also as discussed below and in the brief filed by Dean Foods, Class I handlers would not receive the traditional benefit of performance-based pooling standards leaving their dairy farmer suppliers free to charge additional prices for milk just to obtain a milk supply. Manufactured products manufacturers will be uniquely required to pay regulated minimum prices that must be pooled, and out-of-state dairy farmers will have their minimum regulated prices reduced in order to subsidize California dairy farmers with quota. Each of these results is justified on the attempted broad rewriting of the actual Quota Provision.[19]

3. The Quota Provision is permissive, not mandatory.

a. Statutory language is not mere surplusage.

The focus then turns to Congress' phrase "shall have the right to." While the word "shall" is often considered mandatory, the U.S. Supreme Court has found that sometimes "shall" means "may" especially when viewed in context with the remainder of the statute. *Guitierrez de Martinez v. Lamagno*, 515 U.S. 417, 430-34 (1995) (holding that the Westfall Act's scope of employment certifications made by the U.S. Attorney General are subject to judicial review because conclusion that an employee acted within scope of employment was not conclusive, notwithstanding the multiple uses by Congress of the word "shall:" the United States "shall" make a scope of employment determination; upon such certification an action "shall" be determined to be a cause of action against the United States; and as a result, the United States "shall" be substituted as the real party defendant). The majority described Congress' use of "shall" and "may" concluding that sometimes "shall" means "may" and sometimes *vice versa*:

> Though "shall" generally means "must," legal writers sometimes use, or misuse, "shall" to mean "should," "will," or even "may." See D. Mellinkoff, Mellinkoff's Dictionary of American Legal Usage 402-403 (1992) ("shall" and "may" are "frequently treated as synonyms" and their meaning depends on context); B. Garner, Dictionary of Modern Legal Usage 939 (2d ed. 1995) ("[C]ourts in virtually every English-speaking jurisdiction have held—by necessity—that *shall* means *may* in some contexts, and vice versa."). For example, certain of the Federal Rules use the word "shall" to authorize, but not to require, judicial action. See, *e.g.,* Fed.Rule Civ. Proc. 16(e) ("The order following a final pretrial conference *shall* be modified only to prevent manifest injustice.") (emphasis added); Fed.Rule Crim.Proc. 11(b) (A *nolo contendere* plea "*shall* be accepted by the court only after due consideration of the views of the parties and the interest of the public in the effective administration of justice.") (emphasis added).

[19] The Cooperatives claim that there is a uniform price for all dairy farmers, it just happens to be the same thing as the overbase price. It is fallacious to claim that this is the same thing as the uniform price required by the AMAA especially after *Zuber*.

Id. at 432, n.9. USDA must conclude in this instance that what may, at first blush, appear to be mandatory, is in fact discretionary.

If Congress had intended USDA to recognize quota using "shall" in its mandatory form, it would not have included the words "have the right to" immediately following "shall." Another basic principle of statutory construction is that "[a] statute should be construed so as to avoid rendering superfluous so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant. . ." *Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (quoted in *Corley v. United States*, 556 U.S. 303, 304 (2009); *Astoria Federal Savings & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991); *Sprietsma v. Mercury Marine*, 537 U.S. 51, 63 (2003) (interpreting word "law" broadly could render word "regulation" superfluous in preemption clause applicable to a state "law or regulation"). The phrase "shall have the right to" is authorization language, but it is permissive rather than mandatory authorization language. This is an example consistent with *Lamagno* where "shall" means something other than the mandatory usage.

b. Consistent legislative history supports the Dairy Institute's conclusions about the meaning of the Quota Provision.

In official legislative history Congress agreed with this conclusion that the Quota Provision is permissive rather than mandatory. The authority with respect to FMMO Reform and a California Order found in the 1996 Farm Bill expired in 1999. In the 2014 Farm Bill, Congress expressly amended the 1996 Farm Bill, by exempting 7 U.S.C. §7252(a)(2) (dealing with the California FMMO issue only) from the expiration date:

> SEC. 1410. ADMINISTRATION AND ENFORCEMENT.
>
> (d) INCLUSION OF ADDITIONAL ORDER.—Section 143(a)(2) of the Federal Agriculture Improvement and Reform Act of 1996 (7 U.S.C. 7253(a)(2)) is amended by adding at the end the following new sentence: 'Subsection (b) does not apply to the authority of the Secretary under this subsection.'.

Note that in its 2014 Conference Report, Congress showed yet again that it knows precisely how to amend a prior enactment. As importantly, Congress in doing so provided contemporaneous and consistent legislative history supporting the Dairy Institute position that USDA was provided discretionary authority:

> The Conference substitute adopts the House provision with an amendment. . . .
>
> The Managers intend for the Secretary to conduct a hearing prior to the issuance of an order designating the State of California as a Federal milk marketing order. The provision provides the Secretary of Agriculture with the *discretion*, if a California Federal milk marketing order is requested, to recognize the longstanding California quota system, established under state marketing regulations, in whatever manner is appropriate on the basis of a rulemaking hearing record.

H.R. Rep. No. 113-333, at 385 (2014), found at http://www.gpo.gov/fdsys/pkg/CRPT-113hrpt333/pdf/CRPT-113hrpt333.pdf (emphasis supplied).[20]

The only conclusion that can be reached is that Congress was providing discretionary authority to USDA to recognize quota in an appropriate manner, but consistent with the existing and unaltered requirements of the AMAA. The Cooperative Order is not consistent with this approach.

4. The Quota Provision provides a limited authorization for USDA to recognize California quota consistent with the Dairy Institute's approaches.

Given Congress' permissive approach to recognizing quota value, reconciling the mandatory and specific requirements of the AMAA with the Quota Provision so as to give both effect becomes a manageable task. USDA can and should, if any order is proposed, propose an FMMO with a traditional uniform price paid to out-of-state dairy farmers that holds them harmless from any quota premium payment. This is especially true as Congress is deemed to

[20] Our conclusion is that the Manager's discussion as to discretion is consistent with the plain meaning of the Quota Provision. Alternatively if the Quota Provision is ambiguous on this point, then this legislative history resolves the ambiguity in the Dairy Institute's favor. *Ratzlof v. United States*, 510 U.S. 135, 147-48 (1994). The Conference Report is the kind of work that the Court can rely on. *See Wilder v. Virginia Hosp. Ass'n.*, 496 U.S. 498 (1990) (relying on Senate Report). We do make note of the fact that the same manager's language substitutes the phrase "quota system" for Congress' actual words "quota value." This substitution cannot change the plain meaning of the term "quota value" which refers to the $1.70 premium paid under the CSO.

know that the CSO does not presently include out-of-state milk in the existing quota program, so holding that milk harmless as to quota (but not otherwise as to traditional impacts of pooling) is the only means of harmonizing both the AMAA and the Quota Provision. Recognizing quota value cannot mean increasing the types of dairy farmers that have their milk payments reduced because of quota.

Similarly, it is not necessary or consistent with the limited phrase "recognize quota" to omit critical and consistent terms of art that USDA employs in traditional FMMOs such as performance-based pooling standards for Class I handlers and voluntary pooling of milk used to produce manufactured products. This is because the $1.70 of quota value can be paid out of mandatory Class I pool proceeds and still retain all of the other features of FMMOs justified by USDA over the past 80 years. In reviewing the history of quota, USDA must reach the opposite conclusion from the Cooperatives as to performance-based pooling standards and voluntary pooling of milk. Quota allocation after the Gonsalves Milk Pooling Act was based solely on Class 1 sales and was expanded afterwards only the basis of purported growing Class 1 market. Quota is absolutely, directly and inextricably linked to the Class 1 market. Ex. 42, at 6 (Testimony of Dr. Erba). It is distinctly incongruous to "recognize quota" without recognizing this important historical connection between quota and Class 1 by refusing to provide for pooling standards when pooling standards are necessary to determine who should share in the pool in the first instance under UDSA's invariable rationale for requiring performance-based standards.

5. The Doctrine of Constitutional Doubt together with the Nondelegation Doctrine support the Dairy Institute's argument as to the Quota Provision.

USDA should presume (as the courts do) that Congress did not intend to violate the United States Constitution in adopting the Quota Provision. The doctrine of "Constitutional Doubt" requires USDA to construe the Quota Provision not only as being constitutional, but as avoiding doubt as to its constitutionality. *United States v. Jin Fuey Moy*, 241 U.S. 394, 401 (1916) (courts should construe a statute "if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts upon that score."); *Almendarez-Torres v. United*

States, 523 U.S. 224, 237- 38 (1998); *Jones v. United States*, 529 U.S. 848, 857 (2000). "[W]here an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress ...." *DeBartolo Corp. v. Florida Gulf Coast Trades Council*, 485 U.S. 568, 575 (1988) (quoting *Hooper v. California*, 155 U.S. 648, 657 (1895)). *Accord*, *Burns v. United States*, 501 U.S. 129, 138 (1991); *Gollust v. Mendell*, 501 U.S. 115, 126 (1991).[21]

USDA cannot conclude that the Quota Provision as enacted by Congress is so vague and malleable so as to say whatever the Cooperatives say it does with an "ends justifies the means" intent. As discussed above, the AMAA was enacted to amend the AAA in order to avoid and eliminate the nondelegation doctrine fatal flaws found in the AAA. *See, Schechter, supra.* Permitting USDA to fill in blanks (that don't actually exist) or add language Congress never used certainly requires USDA to escheat to itself broad nondelegated authority based on language that has no standards as interpreted by the Cooperatives. The Doctrine of Constitutional Doubt must instead mean that USDA should conclude that Congress did not mean to undo the Constitutional fixes to the AAA when adopting the AMAA especially as Congress did not amend the AMAA when enacting the Quota Provision.

The nondelegation doctrine from *Schechter* has never been overruled. USDA must be especially careful of reaching the results demanded by the Cooperatives with the AAA's Constitutional problems in mind. While the nondelegation doctrine was not much, if at all, relied upon in the 1950s or 1960s, there has been renewed interest in the doctrine and discussion of it as a viable doctrine generally. *See, e.g., Reynolds v. United States,* 132 S.Ct. 973 (2012) (dissent expressing concern that majority opinion upholding registration requirements of the Sex Offender Act with delegation to Attorney General unnecessarily violated the nondelegation doctrine); *In re National Security Agency Records Litigation,* 671 F.3d 881 (9th Cir. 2011)

[21] As discussed in Section IV, Part D, Subpart 5, the Doctrine of Constitutional Doubt also applies with respect to the issues of performance-based pooling standards and voluntary pooling of milk used in manufacturing.

(finding that grant of authority to the Attorney General to grant telecommunications companies immunization from suits did not violate the nondelegation doctrine because both the statute and legislative history provided clear standards to apply and because of the interests of national security). The Doctrine of Constitutional Doubt does not require USDA to resolve the question of where the courts stand today on the nondelegation doctrine; there is serious doubt and that is more than enough to reach the conclusion that Congress intended the narrow and reconcilable statutory constructions provided in this Brief.

E. Conclusion – The Quota Provision Does not Justify the Cooperative Order.

While the Dairy Institute maintains that its proposed result as submitted in its Proposal is perfectly justified, we recognize that the result is viewed by California quota holders as overly harsh. Leaving aside that they too are bound by the Congressional enactment and the fact that "recognize quota" does not mean all the things that they claim, USDA must at a minimum over time ensure that the primacy of the AMAA's uniform pricing rules prevails. Again the AMAA and the Farm Bill's discretionary grant of authority to recognize quota certainly supports at least a gradual return to permanent uniform pricing by phasing out or buying out (using pool funds that exempt out-of-state milk from any reduction) the quota.

Either of these two results would achieve statutory reconciliation requiring in the end that the AMAA's limited grant of authorized adjustments to uniform pricing be governed by the existing judicial principles and consistent Congressional enactment unless and until Congress clearly acts otherwise.

For all the foregoing reasons, the Cooperative Order cannot be adopted by USDA. The Quota Provision does not authorize it.

V. THERE IS NO EVIDENCE OF DISORDERLY MARKETING SUFFICIENT TO JUSTIFY FEDERAL INTERFERENCE WITH CDFA'S CSO

A. The Cooperatives Fail to Prove Disorderly Marketing Conditions Requiring Issuance of an Order.

USDA may only adopt a California FMMO if it finds that disorderly marketing conditions exist in California. USDA has always required that disorderly marketing conditions sufficient to justify federal intervention be based solely on packaged fluid milk market failures, and the Cooperatives failed to prove actual and substantial competitive disruption resulting from any regulatory advantage or disruptive sales in the fluid milk market, USDA cannot promulgate an FMMO for California.

1. AMAA Declared Policy addresses fluid milk for packaged sales.

USDA has concluded that the AMAA's requirement "to insure a sufficient quantity of pure and wholesome milk" means *fluid packaged milk for packaged milk sales ("fluid milk").* This Declared Policy of the AMAA has become a defined Term of Art after 80 years of agency and court application and interpretation. The courts have routinely accepted, applied and relied upon this long-standing USDA interpretation in deciding milk cases under the AMAA. This Declared Policy cannot now be altered just to suit the Cooperatives' needs in this proceeding.

As described above, visually, an FMMO resembles a pyramid. The upright version of this pyramid rests on a wide and solid base of Class I milk regulation. While regulation beyond Class I has been built upon this base, regulation of Class III and Class IV, for instance, is both a tangential and secondary aspect of the program that results primarily from the Declared Policy of the AMAA and the importance of uniform pricing. Regulation beyond Class I milk matters to the extent it has effect upon regulation of the fluid milk market and uniform prices paid by handlers and to dairy farmers, making it the small and narrow tip of the AMAA pyramid. To implement an FMMO solely on the basis of a discrepancy between the Class 4b and Class III prices would upend this pyramid on its head.

Milk sales competition during the Depression was the genesis for the chief mechanism for meeting the Declared Policy of the AMAA – setting a price for milk which is sufficient to call forth an adequate supply of pure and wholesome milk and being in the public interest.[22] *Milk in the Chicago Marketing Area,* 52 Fed. Reg. 38240, Col. 3 (1987) ("a major purpose of the order program is to assure an adequate supply of pure and wholesome milk *for the fluid market*") (emphasis supplied). This historical context supports the interpretation that the AMAA's purpose is to regulate *fluid* milk. In the 1920s–1930's, U.S. dairy farmers produced surplus milk (otherwise dumped or used to produce non-fluid products such as cheese or butter) and pursued with this milk the more lucrative fluid market. Competition with the existing suppliers of fluid milk resulted in extreme competition which engendered business practices that jeopardized "the quality and in the end the quantity" of the vital fluid milk supply. *United States v. Rock Royal Co-op*, 307 U.S. 533, 550 (1939).

The provisions of the AMAA were enacted to alleviate those problems by authorizing the issuance of orders to regulate the marketing of milk in the geographical market areas based upon economic market conditions in those areas. 7 U.S.C. §§608c(11) and (18). The Act provides for the classification of milk in accordance with the purpose for which it is used and the establishment of minimum prices for each class of use. The Secretary sets these prices at levels which he finds will reflect economic conditions affecting supply and demand for milk in the marketing area, will insure a sufficient quantity of pure and wholesome milk, and will be in the public interest. 7 U.S.C. § 608c(18); *United States v. Rock Royal Co-op*, 307 U.S. at 532-548. But the premise that led to adoption of the AMAA (and thus the need for intervention) is the conclusion that regulation of the *fluid* milk market prevents destructive competition among farmers:

> The problems concerned with the maintenance and distribution of an adequate supply of milk in metropolitan centers are well understood by

[22] Proponent evidence at the hearing wholly ignored the public interest prong (e.g., consumers) of the AMAA's Declared Policy. In a market with plenty of milk that must export significant quantities of NFDM (Ex. 98, pp. 13, 25 and 27 (Testimony of Mr. DeJong), the public interest is *not* served by raising milk prices.

> producers and handlers. In the milkshed and marketing area of metropolitan New York these problems are peculiarly acute. It is generally recognized that the chief cause of fluctuating prices and supplies is the existence of a normal surplus which is necessary to furnish an adequate amount for peak periods of consumption. This results in an excess of production during troughs of demand.
>
> ***
>
> Since all milk produced cannot find a ready market as fluid milk in flush periods, the surplus must move into cream, butter, cheese, milk powder and other more or less nonperishable products. Since these manufactures are in competition with all similar dairy products, the prices for the milk absorbed into manufacturing processes must necessarily meet the competition of low-cost production areas far removed from the metropolitan centers. The market for fluid milk for use as a food beverage is the most profitable to the producer. Consequently, all producers strive for the fluid milk market.
>
> ***
>
> Students of the problem generally have apparently recognized a fair division among producers of the fluid milk market and utilization of the rest of the available supply in other dairy staples as an appropriate method of attack for its solution. Order No. 27 was an attempt to make effective such an arrangement under the authority of the Agricultural Marketing Agreement Act.

Rock-Royal, supra, at 549-550.

Given this history and focus on destructive competition for Class I sales and since the highest classification price set by the Secretary is the fluid milk price, clearly the "sufficient quantity" referred to in the statute is a quantity of milk for fluid use. In addition, while other products use "pure and wholesome" milk, it is milk in the bottle which must, under all circumstances, be pure and wholesome in order to best meet public interest. *See generally Borden v. Butz*, 544 F.2d 312, 316 (7th Cir. 1976) (where testimony was given indicating that the primary purpose of a fixed price "is to bring forth an adequate supply of pure and wholesome milk" for Borden's bottling operations of fluid milk); *see also Schepps Dairy v. Bergland,* 628 F.2d 11, 17 (D.C. Cir. 1979).

The Cooperatives' misplaced focus instead on FMMO and CSO *manufactured* product price differences drives their entire proposal, yet has no basis in the statute.[23] Fundamentally, the Cooperatives' cannot seriously argue that California, with a 12-13% Class I utilization,[24] presently lacks an adequate supply of milk for fluid use. *See, e.g.*, Ex. 79, at 33 (Testimony of Dr. Schiek) and Ex. 91, at 6 (Testimony of Mr. Dryer). Whether or not California's drop in milk production in 2015 (after reaching a record high in 2014) is temporary or permanent, no argument exists that milk available for the fluid milk market in California is less than adequate. *See, e.g.*, Ex. 79, at 33 (Testimony of Dr. Schiek) and Ex. 91, at 6 (Testimony of Mr. Dryer).

2. USDA ties orderly marketing for order promulgation to the fluid market.

Orderly (or "disorderly") marketing conditions sufficient to justify federal intervention is another Term of Art that USDA, for over 80 years, applied solely to the need to remove incentives for destructive competition among farmers seeking to serve the fluid market and attendant concerns over non-uniform pricing, lack of butterfat accounting, lack of market information and handler arbitrariness. Put most simply, USDA has always found that only fluid milk market failures resulting from the above circumstances justify federal intervention. USDA has only intervened in completely unregulated markets or in markets where state regulation has demonstrably lost the ability to regulate the fluid market consistent with USDA's definition of orderly marketing.

Contrary to the Cooperatives' early and oft repeated refrain that the difference between the FMMO Class III and CSO Class 4b prices amount to disorderly marketing, USDA has *never* made a finding that such a difference is disorderly. In fact, USDA has never even held that any pricing issues for milk other than Class I and resulting non-uniform prices and other directly attendant circumstances discussed above supports the adoption of a FMMO. Instead, the *san qua*

[23] While the Cooperatives' inverted pyramid rests on the tip of the Quota Provision, their reliance on Class 4b and Class III price differences to justify federal intervention in California's fully regulated market is the body of their pyramid scheme just below the tip. It too inverts the Declared Policy of the AMAA.
[24] CDFA's California Dairy Statistics Annual 2015, at 3, ("In 2015, utilization of pooled milk for Class 1 (fluid milk) products increased slightly to 13.0 percent (from 12.8 percent in 2014)."), found at https://www.cdfa.ca.gov/dairy/pdf/Annual/2015/2015_Statistics_Annual.pdf.

non of every FMMO ever adopted has been a finding of actual, substantial failure of the Class I markets, including pricing of Class I and an equitable sharing of that price with all the order's dairy farmers. With respect to the kind of disorderly marketing that supports the need for federal regulation of the fluid milk market, USDA has succinctly concluded that:

> The problems of unstable marketing encountered by producers in the proposed marketing area are not uncommon in *fluid milk markets* where there is no overall program for effectively regulating producer milk supplies.

Milk in Georgia Marketing Area, 34 Fed. Reg. 960, 962 (January 22, 1969); *Milk in Tampa Bay Marketing Area*, 30 Fed. Reg. 13143, 13144 (October 15, 1965) (emphasis supplied).

Indeed USDA has formulated a multi-factor test for determining whether an FMMO is justified in the first instance. This test was stated most recently as a six factor test in promulgating three separate FMMOs for the Carolinas, Alabama-West Florida and Southwestern Idaho-Eastern Oregon. USDA stated the test in terms of what the FMMO will provide in lieu of the evidence of actual and substantial disorderly market conditions found in each area:

> 1. The establishment of uniform minimum prices to handlers for milk received from producers according to a classified plan based upon the utilization made of the milk;
>
> 2. Uniform returns to producers supplying the market based upon an equal sharing among all such producers of the returns from the order prices for both the higher-valued Class I milk and the lower returns from the sale of reserve milk that cannot be marketed for fluid use;
>
> 3. An impartial audit of handlers' records to verify the payment of required prices;
>
> 4. A system for verifying the accuracy of the weight and butterfat content of milk purchased;
>
> 5. Marketwide information on receipts, sales, prices, and other related data concerning milk marketing; and
>
> 6. A regular and dependable procedure that affords all interested parties the opportunity to participate, through public hearings, in

> the determination of changes that may be required in the marketing plan in order to insure an orderly market.

Milk in the Carolina Marketing Area, 55 Fed. Reg. 25618, 25623, c.1-2 (June 22, 1990); *Milk in the Alabama-West Florida Marketing Area,* 47 Fed. Reg. 5214, 5125-5128 (February 3, 1982) (identical factors in different order only); *Milk in the Southwestern Idaho and Eastern Oregon Marketing Area*, 46 Fed. Reg. 21944, 21950-21951 (April 14, 1981) (identical factors in different order only); *Milk in Georgia Marketing Area;* 34 Fed. Reg. at 960-962 (identifying as disorderly conditions the lack of enforceable classified pricing especially as to Class I, uniform pricing, verified audits and market information); *Milk in Tampa Bay Marketing Area*, 30 Fed. Reg. at 13144-13145 (finding same conditions lacking as in Georgia).[25] As discussed below, CDFA's CSO successfully accomplishes every one of these six factors; USDA cannot justify replacing the existing successful regulation with an FMMO.

Examining the four most recent FMMOs adopted in the southeastern United States (Carolinas, Alabama, Georgia, and Tampa Bay-West Florida), USDA found substantial evidence that the following actually occurred: (1) the loss by state government of the ability to regulate inter-state commerce resulted in the inability or ineffective regulation of classified use prices for milk, particularly Class I fluid milk; (2) handlers used this ability to receive lower prices for multiple accounts (e.g., large retail, schools, military bases); (3) handlers threatened or cut-off dairy farmers, especially cooperatives who refused to provide sufficient price adjustments on Class I milk; (4) when milk was relatively long, handlers cut-off producers or demanded that they ship milk at the farmer's expense to distant manufacturing locations; (5) handlers provided dairy farmers with variable and different butterfat differentials for their milk; (6) with no uniform pricing, the costs of balancing the market were not borne equally by market participants; (7) the lack of verifiable audits deprived dairy farmers of any ability to know that they were being

[25] USDA did not expressly state the six factor test in its Georgia or Tampa Bay decisions, but discussed the evidence of the disorderly marketing resulting from the lack of enforceable classified pricing (particularly Class I) and the lack of uniform pricing, verifiable audits, and transparent market information.

treated fairly; and (8) the lack of transparent market information compounded all of the other disorderly market conditions. *Id.*

The illustrative Carolina example warrants a careful review of the conclusions USDA reached with respect to North and South Carolina fluid milk market failures:

> The main reason for instability of milk marketing in North Carolina and South Carolina is that both States lack the ability to price both bulk and packaged milk moving into or out of their respective State.
>
> In 1985, the Circuit Court of South Carolina declared that the South Carolina Milk Commission's pricing authority was unconstitutional under the Commerce Clause of the United States Constitution. The Commission, as a result of this decision, decided that it was impractical to regulate in-State milk because milk becomes indistinguishable when commingled with milk flowing interstate. The Commission ceased to exist.
>
> ***
>
> It is clear from these data that South Carolina relies substantially on imported bulk and packaged milk. North Carolina, on the other hand, is relatively self-sufficient. The substantial amount of milk moving into South Carolina which cannot be regulated by the State contributes significantly to disorderly marketing in that State.
>
> Historically, Class I prices in South Carolina have been higher than Class I prices in North Carolina. The record shows for the period of October 1987 through March 1988; the Carolinas Federation's announced Class I price for South Carolina was slightly higher than for North Carolina. In April 1988, the two prices were the same and for the period of May 1988 through March 1989, the North Carolina announced Class I price was higher than for South Carolina. As a consequence of this price differential during the period of May 1988 and March 1989, a substantial amount of packaged milk was shipped from South Carolina processors into North Carolina.
>
> Historically, the Georgia Federal order Class I price has been 70 to 80 cents lower than the announced South Carolina Class I price. The record shows that in January 1988, this price difference was $1.58 ($16.00 less $14.42). For the months of February through April 1989, this price difference was $ .90 for all three months, which is closer to this historical relationship between the two States. A price difference of $1.58 versus $.90 can result in some shifting of packaged milk sales between these markets, contributing to disorderly marketing in South Carolina.

At the hearing, the two witnesses associated with the two universities testified about the disparity in pay prices received by dairy farmers delivering milk to the same fluid milk plant or to different plants located in the same general area. They testified (survey conducted for both States) that for January 1989, the pay prices received by six cooperative associations doing business in South Carolina ranged from a high of $15.36 to a low of $13.73; a difference of $1.63. In North Carolina, for January 1989; pay prices ranged from a high of $15.38 to a low of $13.99; a difference of $1.39.

Although the record shows that there has been considerable shifting of producers between handlers in North Carolina, this situation is even more prevalent in South Carolina. The disparity in pay prices caused by the individual handler pools and the individual base plans has contributed to disorderly marketing in North Carolina and South Carolina.
Another factor contributing to disorderly marketing in this two-State area is the butterfat differential used in paying producers. In both States, the butterfat differential is based on a factor of .1 of the Chicago 92-score butter price. In surrounding Federal order markets, the butterfat differential is based on a factor of .115 of the Chicago 92-score butter price. The witness testifying about marketing conditions in South Carolina estimated that the difference in the computation of the butterfat differential cost South Carolina dairy farmers about $400,000 per year. The witness testifying about marketing conditions in North Carolina estimated that the use of a factor of .115 would add 4 to 6 cents per hundredweight to producer pay prices.

From the foregoing, it is clear that the two State programs cannot assure dairy farmers associated with the marketing area of payments for their milk in accordance with its use and at minimum prices that are uniformly applicable throughout the market. These State programs, if allowed to continue, could lead to even a further dependence on outside milk supplies to meet the needs of the area. A Federal milk order providing for classified pricing at reasonable levels and marketwide pooling for distributing the returns uniformly among all producers will help provide the needed market stability. A Federal order will provide an environment of stable and orderly marketing throughout this area through the adoption of a classified pricing plan based on audited utilization of all Grade A milk purchased by handlers from producers and an equitable division among all producers of the proceeds obtained from the sale of their milk in the respective classes, including the lower-priced uses of reserve milk supplies not needed for fluid uses.

A Federal order will assure handlers that their competitors will pay not less than the minimum prices set by the order for milk and such prices will apply whether the milk comes from famers located in North Carolina or

> South Carolina, or other States, and without regard to whether the milk is disposed of inside or outside the marketing area.
>
> This record shows that the dairy industry in the two-State area, particularly in South Carolina, does not have available detailed information regarding milk procurement and milk uses. A Federal order would provide such information on a continuing basis and would contribute to the development and maintenance of stable and orderly marketing conditions. The lack of such data, by itself, does not necessarily demonstrate the need for an order. Complete and accurate market information would, however, provide a substantial benefit to producers, cooperatives and handlers.

Milk in the Carolina Marketing Area, at 25621-25623. Importantly, the disorderly marketing conditions described above were real and substantial, not hypothetical or potential. In Georgia, USDA relied on the fact that the volumes of milk governed by unregulated contracts versus that subject to Georgia state order pricing was "substantial" and the difference in pricing was also "substantial." *Milk in Georgia Marketing Area,* 34 Fed. Reg. at 961, c.1 and c.3. In each of these four markets, going back to the 1965 Tampa Bay decision, USDA found actual and complete fluid milk market failure.

Regulation for Southwestern Idaho-Eastern Oregon took a different route, but relied on the same factors described in the two FMMOs adopted most recently prior to and after it (Alabama and Carolinas). Initially after a hearing, USDA concluded that no FMMO was warranted because the necessary disorderly market conditions were not *generally* present: "The disorderly marketing conditions that often precede an order, e.g., handlers cutting producer prices, certain producers losing their market and a disproportionate sharing among producers of the market's surplus milk, were generally not present." 44 Fed. Reg. 48128, 48130, c.2-3 (August 16, 1979). While there was testimony establishing Class I price differences and some disproportionate sharing of costs of reserve supply, UDSA concluded that the evidence was insufficient and that price differences were not "substantial:"

> A primary question that needs to be addressed in this proceeding is whether a Federal milk order should be established in the absence of any major marketing problems. Proponents testified that certain "elements" of orderly marketing are lacking in the area in question. These include such

> elements as a marketwide classified pricing program and a sharing of the returns from Class I sales among all producers. However, the record does not establish that the absence of these elements of orderly marketing is resulting in major marketing problems for producers who are supplying the area. This being the case, it is doubtful that a Federal milk order to establish classified pricing, marketwide pooling and other provisions would provide any substantial benefits for producers that would justify the disadvantages of Federal government intervention. The record of this proceeding does not indicate persuasively that such intervention is necessary for orderly marketing in the area in question.
>
> The following discussion highlights particular points that were raised by proponents that might have suggested some degree of disorderly marketing conditions, and the conclusions about them that were drawn from the record evidence. *The material covers whether varying prices paid by milk dealers have resulted in competitive conditions that have rebounded adversely on producers. The material evaluates whether there is a disproportionate sharing of reserve supplies among producer groups to a degree that marketing instability has resulted. The material considers whether producers, in fact, have been cut off the market, and finally, whether that basis of pricing milk in the market has resulted in marketing stability and in regular, dependable supplies of milk.*

Milk in the Southwestern Idaho and Eastern Oregon Marketing Area, 44 Fed. Reg. 48128, 48130, c.1-2 (August 16, 1979) (emphasis supplied). From the foregoing it is abundantly clear that promulgation of any order depends not only on USDA making findings of actual adverse marketing conditions, but that USDA will also consider the degree of marketing instability, if any, that exists.

The proponents of Idaho-Oregon regulation convinced USDA to reopen the proceeding to provide additional evidence. The evidence they provided largely drew from new market conditions that arose after USDA had tentatively determined to terminate the proceeding. USDA made the following critical findings:

(1) plentiful milk supplies were exploited by Class I handlers able to pay prices slightly above manufacturing use value;

> Within the proposed order's marketing area, there is available from nearby producers a great deal more Grade A milk than can be used by distributing plants in the area. . . . This is becoming an increasingly significant factor in the market. Such a supply situation fosters disorderly marketing.

> In this supply situation, handlers have an incentive to seek milk otherwise destined for manufacturing use for Class I purposes at prices that are little more than the prices paid for manufacturing grade milk in the region, which would be below the economic value of such milk under orderly marketing conditions. . . .
>
> The record establishes that certain handlers have exploited this situation as is evidenced by the significant differences in purchasing arrangements that distributing plants serving the area have with their producers.

(2) returns to dairy farmers were decreasing;

> This wide range in plants' cost of milk is resulting in decreasing returns to producers. The plants whose Class I milk costs are low relative to others have a competitive advantage in their milk costs which they have used in lowering their resale prices to take away business from other plants. Consequently, producers supplying plants who now pay Class I prices at the high end of the range are in danger of either having their buyers lose additional Class I sales to plants paying lower prices or being forced to accept lower prices from them.

(3) wide variations in butterfat differentials further reduced dairy farmer returns;

> There are also wide variations in butterfat differential values used by the plants in adjusting prices for milk containing other than 3.5 percent butterfat. . .
>
> This lack of a uniform butterfat differential that reflects market values for butterfat results in gross inequities in the prices received by producers and, in fact, reduces returns to those producers whose milk tests above the basic 3.5 percent butterfat test.

(4) dairy farmers within a marketing area were paid non-uniform prices;

> As indicated, in the largest buyer of nonmember milk (Meadow Gold) has no uniform system of paying its producers according to the utilization of their milk. This has resulted in general dissatisfaction among many of its nonmember producers to the end that in early 1979 a number of them joined MEDA to improve their bargaining position. Shortly after this happened, Meadow Gold not only replaced these producers but also the remainder of MEDA's producers who supplied milk to Meadow Gold on a supplemental basis to balance the daily and seasonal requirements of the handler. MEDA must now channel the milk of these former producers of Meadow Gold to manufacturing plants where they receive a lower return for the milk.
>
> . . .

> The record indicates that another source of market disorder experienced by producers regularly supplying the Southwestern Idaho-Eastern Oregon market is the absence of any plan to distribute equitably among producers the burden of reserve supplies of milk necessarily associated with the fluid milk sales of the area. This is a source of much discord among dairy farmers which poses a continuing threat to orderly marketing in the area. . .
>
> Under the various supply arrangements presently existing in this market, the lower returns associated with the market's reserve or surplus milk supplies are not being equally shared among all producers in the area.

(5) dairy farmers were confused and uncertain as to proper pricing and accuracy of testing;

> The evidence in the record indicated that a great deal of confusion exists among producers over the prices (their levels and how they are computed) they are paid by handlers for their milk. When asked what the proper price level should be in this area, one producer responded that that was part of the problem—no one knew what the true value of milk was in this market.
>
> . . .
>
> Producers also expressed a great deal of concern over whether they were being paid for their milk according to accurate weights and butterfat tests. Several testified about discrepancies in their weights and tests.

and (6) an order can provide important market information.

> Another market service which is now needed and will be provided by an order is the collection and publication of accurate market data. Statistics showing the amount of milk pooled, the utilization of such milk in each class, the computation of the uniform price, and other data will be regularly published by the market administrator and sent to producers who are not getting such information through a cooperative association.

Milk in the Southwestern Idaho and Eastern Oregon Marketing Area at 21949-21950. As with the Carolinas decision and the other earlier southeastern order formulations, USDA required actual evidence of substantial fluid milk market *failure*. Such failure had nothing to do with the price levels, but was focused instead on efficiency and consistency in milk movement, predictability in the market, and ensuring that payments amongst producers were fair. Nowhere in any decision did USDA conclude that it was the manufacturing Grade A milk or its price levels that warranted discussion regarding disorderly marketing. Moreover, Idaho is especially relevant here because the Class I utilization at the time was consistent with that of California today, and it had a large supply of reserve milk available for manufacturing. USDA concluded that fluid milk market failure resulted from the ability of Class I handlers to leverage the large supply of milk to obtain lower and non-uniform prices from dairy farmers.

USDA's emphasis on fluid milk market failure for order promulgation is consistent with the 1965 Farm Bill Amendments to the AMAA discussed in Section IV. These amendments *temporarily* provided express authority for USDA to adopt milk or milk product "marketing orders . . .limited in application to milk used for manufacturing." Pub. L. 89-321, Sec. 102 (1965). As discussed in Section IV, Congress knew when crafting that amendment that USDA and the courts had concluded that the purpose of the AMAA was to correct fluid milk market failure. Thus, Congress found it necessary to include a specific provision addressing milk used for manufacturing, conveying that the statute as written would not apply to such milk. While that expired language could support regulation of milk based upon evidence of market failures outside the fluid milk market, USDA under the present AMAA lacks the authority to adopt an FMMO relying on anything other than evidence of fluid milk market failure.

3. USDA uses "Orderly Marketing" term of art almost exclusively as to Class I.

As discussed above, USDA only uses the terms "orderly" or "disorderly marketing conditions" in order formulation as it pertains to the need to stabilize the Class I market. We have reviewed and searched all 164 Federal Register pages of USDA's comprehensive decision in FMMO Reform. 64 Fed. Reg. 16026-16169. (April 2, 1999). When speaking for itself, USDA used the words "orderly" or "disorderly" a total of 27 times.[26] In every instance, the term is used to apply to determinations USDA made regarding Class I issues exclusively: for example,

[26] The term also appears in the Order language 9 times in paragraphs 13 (producer milk definition) of all orders except Order 1. 7 C.F.R. §1---.13. The term also appears once in the introduction of Appendix D (Identical Provisions Project). 64 Fed. Reg. at 16293, c.3.

defining the consolidated markets based upon Class I route disposition, Class I pricing, establishing appropriate and real performance standards, transportation credits or allowances, and using the "higher of " pricing mechanism. *Not once* did USDA in FMMO Reform Decision use the term when discussing the appropriate replacement for the Basic Formula Price (i.e. Class III or Class IV price formulas).

There are three post-Reform USDA decisions addressing manufactured milk pricing and classification. In the most recent decision from the 2007 make allowance hearing, USDA does not use either "orderly" or "disorderly" even though one commenter asserted that the NASS survey resulted in disorderly marketing. *Milk in the Northeast and Other Marketing Areas*, 78 Fed. Reg. 9248 *et seq.* (February 7, 2013). In 2004, USDA did conclude that reclassifying evaporated and sweetened condensed milk as Class IV, rather than Class III, would promote orderly marketing. *Milk in the Northeast and Other Marketing Areas*, 69 Fed. Reg. 57233, 57238-57239 (September 24, 2004). But this was in the context of existing orders and pricing within orders not raising inter-order issues and is different from order promulgation which is governed by the six factor test articulated repeatedly by USDA in formulating the southeastern and Idaho FMMOs.[27] Finally, in deciding the 2001 Class III/IV issues sent to USDA by Congress post-Reform, USDA found that pricing inconsistency between MCP and non-MCP orders "will not result in disorderly marketing" (*Milk in the Northeast and Other Marketing Areas*, 67 Fed. Reg. 67906, 67939, c.2 (November 7, 2002). It further concluded that adopting make allowances for Class III and IV formulas that would adjust downwards when milk production increases would result in disorderly conditions:

> Many dairy farmers, facing increased costs of production, would have to find alternative outlets for their milk. Decisions on the part of many processors to cease operating, use only nonpool milk, or buy milk below order prices likely would result in very disorderly marketing conditions among dairy farmers looking for outlets for their milk.

[27] USDA's six factor test is meaningless if it is replaced by a conclusion that any provision of an order that maintains orderly marketing justifies the promulgation of an order.

Id. at 67915, c.1. Again, USDA does not use the term to justify regulation in the first instance, but instead defines some parameters after regulation is adopted: price differences do not automatically qualify as disorderly marketing, but setting a price that is too high for the manufactured product market to bear would be disorderly.

4. USDA cannot abandon 80-year interpretation of Declared Policy of the AMAA.

USDA and the courts have consistently and routinely conditioned federal intervention in milk markets on the need to prevent destructive competition in the fluid milk market. USDA cannot now abandon or modify that long-held policy in order to justify the Cooperative Order without a sufficient legal rationale. The Quota Provision does not alter the need for USDA to first find disorderly marketing in California. Any change in this longstanding policy would be arbitrary and capacious. *Moto Veh. Mnfrs. Assn. of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 47-51 (1983); *see, F.C.C. v. Fox Television Stations, Inc.,* 129 S.Ct. 1800, 1822 and 1831(Justice Kennedy joined Justice Breyer's 4 Justice Dissent on central point here "that the agency must explain why 'it now reject[s] the consideration that led it to adopt that initial policy.'")

Under the six factor test articulated specifically in the last three FMMO promulgation proceedings dating back to 1981, California's CSO provides all the orderly marketing conditions necessary to dissuade USDA from issuing any proposed order at all for California: (1) CDFA already establishes (and successfully enforces) "uniform minimum prices to handlers for milk received from producers according to a classified plan based upon utilization of the milk" (Cal. Food and Agric. Code §§61931-61937 (Deering 2015); Northern and Southern California Stabilization Plans §300; Ex. 29; *see generally CSO*); (2) the CSO's Pooling Plan, except for Quota, provides for an equal sharing among all such dairy farmers of the higher-valued Class I and lower returns for reserve milk[28] (Cal. Food and Agric. Code §§62750-62756 (Deering 2015);

[28] It is not logical or legal for USDA to conclude that the non-uniform price that results from quota under the CSO justifies an FMMO and then adopt the Cooperative Order with the same non-uniform price.

Pooling Plan for Market Milk; *see generally CSO*) ; (3) CDFA provides an impartial audit of records and required payments (Cal. Food and Agric. Code § 62712(c)); (4) CDFA maintains "a system for verifying the accuracy of the weight and butterfat content of milk purchased" (Cal. Food and Agric. Code § 62242); (5) CDFA provides ample marketwide information found necessary by USDA to support orderly marketing (*see, e.g.,* Ex. 61); and (6) CDFA certainly has a "regular and dependable procedure that affords all interested persons the opportunity to participate in public hearings. . ." *See,* e.g., Exs. 36-38 and 53. These are the standards proclaimed by USDA. Notably absent is any claim by USDA that disputes over price level for reserve milk can constitute a marketing condition warranting adoption of an FMMO. Far from market failure, CDFA should be hailed for maintaining a successful program that has benefitted the entire California dairy industry.

Important principles of Federalism are at stake in this proceeding. The AMAA and USDA's regulation of milk pursuant to the Declared Policy are designed not to be alternative forms of regulation, but to only be used for corrective action. No corrective action is warranted here, and USDA as a matter of policy ought not to simply substitute its regulatory judgment for that of CDFA in the absence of fluid milk market failure.

Finally as discussed below, the alleged disorderly marketing conditions that the Cooperatives assert exist in California are at best hypothetical and potential, and certainly not actual and substantial. USDA should conclude that no FMMO is justified for California on the basis of the record before it.

5. Cooperatives failed to prove disorderly marketing exists in California.

a. Purported differences in Class III and Class 4a are irrelevant to order promulgation.

In their February 3, 2015 request to Anne Alonzo, USDA's then AMS Administrator to hold a hearing and adopt the Cooperative Order ("Alonzo Letter"), Cooperatives made a number of erroneous legal and factual claims that are at the heart of their incorrect assertion that there are disorderly marketing conditions in California justifying federal intervention in the milk market.

First and foremost, they assert that California regulations established minimum prices are disorderly because they fail to "reflect national values for classified milk uses." *Alonzo Letter* at 2. The principal problem with this assertion is that USDA is required by the AMAA to have marketing orders with "regional application," that recognize "differences in the production and marketing of [milk] in such [regional] areas," and that set prices that reflect "economic conditions which affect market supply and demand for *milk and its products in the marketing area*." 7 U.S.C. §§608c(11) and (18) (emphasis supplied). The assertion that California's system is disorderly based upon the "national value" argument finds no justification in the AMAA, fails to consider current economic conditions in California, and ignores USDA's six factor test for order promulgation. Thus this rationale cannot be the basis for finding disorderly marketing.

The Cooperatives in that letter also asserted in two pages that "the primary cause of disorderly marketing conditions in California lies in the Class 4b formula." *Alonzo Letter* at 6 – 7. This of course is another way of complaining that CDFA has established a price for Class 4b that is not the Cooperatives' preferred existing "national price" – a price which, as discussed in Section VII, is not based on current California market conditions. Moreover even assuming, as we do not, that differences between Class 4b and Class III would constitute disorderly marketing, the letter suggested no more than *potential* disorderly marketing. The Alonzo Letter provided no evidence of actual examples of so-called disorderly marketing. "The differential pricing *may* cause marketplace decisions that are solely due to different regulations and not to market fundamentals." Dairy farmers receiving different "minimum regulated prices . . . *may* make marketplace decisions that are solely the result of the different regulations. . ." *Alonzo Letter* at 7.

At the hearing, there were assertions that the differences in the Class 4b and Class III or differences caused by different product classification *could* cause market disorder. Tr. 825 – 840 (Testimony of Mr. Hollon). But there was at best only one claim involving any type of inefficient movement of milk: that Hispanic Cheese from California purportedly displaced such cheese produced in Texas. Tr. 1032:16 – 1033:5 (Testimony of Mr. Hollon).[29] The fact that cheese products can be sold significant distances cannot lead to the conclusion that price was the determinative factor and no testimony was provided by the actual plant managers or salespersons responsible for sales of that product to that effect. The fact that Hispanic Cheese can be found in Pennsylvania is no more remarkable than the fact that Cabot's cheese from Vermont was found in California during the hearing. *See, e.g.*, Tr. 4878:21 – 4884:16 (Testimony of Mr. Moore and Mr. de Cardenas, discussing the sale of Cabot Cheese from Vermont in California, and the sale of their California Hispanic cheese products in Pennsylvania). The Hispanic Cheese testimony is also notably different from the testimony of responsible salespersons who testified in specific detail regarding lost customer accounts with respect to the Producer-Distributor issue in this proceeding (Tr. 4725:4–17 (Testimony of Mr. Hofferber); Tr. 5520 – 5522 (Testimony of Mr. Britt); and Tr. 6374 – 6375 (Testimony of Mr. Williams)) and the Producer-Handler proceedings in 2003-2004 and 2009, discussed below in Section IX.

In addition to USDA's requirements for finding actual and substantial disorderly marketing in the five promulgation proceedings discussed above, USDA specifically has held that the "potential of creating disorderly marketing conditions" is insufficient to justify regulation even in the critical Class I context:

> Although the marketing of milk by producer-handlers has the potential of creating disorderly marketing conditions, it has not been found necessary to regulate fully this type of operation . . . There is no evidence of market disorder as a result of competition between such producer-handlers and fully regulated handlers.

Milk in the Texas and Southwest Plains Marketing Areas, 54 Fed. Reg. 27179, 27182, c.2-3 (June 28, 1989) *see also*, *Milk in the Rio Grande Valley and Certain Other Marketing Areas*, 56 Fed. Reg. 42240, 42248 (August 27, 1991). Potential or hypothetical claims of disorderly

[29] The same witness asserted that California condensed cream could be sold in Minnesota, but he did not account for the ability of plants in Minnesota to be able to purchase milk below class prices. Tr. 1032:16 – 1033:5 (Testimony of Mr. Hollon). In any event, the potential competition from these products (which would have to pay transportation costs) is not sufficient to justify implementing an FMMO for California.

marketing are wholly insufficient as justifications for federal intervention, especially in light of CDFA's long-standing, effective regulation.[30]

The fact that the Cooperatives have downsized, sold or closed cheese-making operations in California significantly undermines the so-called "California discount" complaint. Ex. 98, at 11 (Testimony of Mr. de Jong). Proprietary Class III investments are being made outside California. Tr.4392:9–21 (Testimony of Mr. de Jong). The Alonzo Letter asserted that marketplace decisions may be made solely due to different regulations (i.e., the difference in the Class 4b and Class III prices). *Alonzo Letter*, at 7. The stark facts are that not only has that potential "disorderly marketing" not occurred, but in fact the opposite is true – in the face of the alleged huge price benefit that Class 4b manufacturers have over their FMMO counterparts, Class 4b capacity is not increasing in California and is instead moving elsewhere.

> Facts are stubborn things; and whatever may be our wishes, our inclinations, or the dictates of our passions, they cannot alter the state of facts and evidence.

John Adams, *Argument in Defense of the Soldiers in the Boston Massacre Trials*, December 1770.

USDA cannot rely on hypotheticals or potential disorderly market conditions to justify adoption of an order, especially in light of its long history of requiring real and substantial evidence of actual fluid milk market disorder.

b. There is no evidence of packaged milk disorderly marketing.

At the hearing, the Cooperatives attempted to allege disorderly marketing on the basis of potential disorderly marketing in the packaged milk (Class I) market. Their effort here fails on the same shoals as their Class III arguments. The witness provided six hypothetical examples of interstate sales competing in Phoenix-Los Angeles, Las Vegas-Los Angeles and Reno-San Francisco. Tr. 821:24 – 823:24 (Testimony of Mr. Hollon); Ex. 19, at 13–16 (Testimony of Mr.

[30] The Cooperatives in the Alonzo Letter p. 10 also asserted that the CSO and FMMO have different timing of pricing that could result in disorderly marketing. *Alonzo Letter*, 6 – 7. They reference such a timing difference for the second half of 2014 for Class II, asserting yet again without evidence of actual (or substantial) transactions of that type occurring.

Hollon); Ex. 20,Table 1.C (Exhibits for Testimony of Mr. Hollon). Not one witness even appeared to testify that they actually knew about such conditions. That alone is sufficient to discount this ground under USDA's articulated holding that such movements of milk must be actually disruptive and substantial. Moreover, they are wrongly asserted.

First, the only California FMMO comparison that can be made is as to Arizona. The witness' claim that Las Vegas and Reno had FMMO prices to which any comparison could be made (Tr. 1389:14 – 18 (Testimony of Elvin Hollon) is specious in light of the fact that Congress has deprived USDA of the authority to regulate the state of Nevada. 7 U.S.C. §608c(11)(D). There is no evidence that any Nevada plant has sufficient route disposition to be regulated on a new FMMO. Second, any allegation that a California operation has a price advantage over a FMMO plant in Arizona for sales into Phoenix ignores USDA's long-standing unique regulation applied to California partially regulated plants selling into FMMOs – a compensatory payment requiring that the California Class I plant pay into the FMMO pool the difference between the FMMO price at the plant location and CDFA's regulated price. USDA has already addressed in permanent fashion the purported advantage that California processors have for selling into Arizona or any other FMMO (e.g., into Oregon; there was no testimony that any significant sales even occurred). No Arizona handler appeared to complain that they faced any price disadvantage or competitive disruption for sales into Southern California as a result of the California Class 1 prices.

Second, CDFA requires and enforces minimum prices for Class 1 milk sold into Nevada. Cal. Food and Agric. Code §§61931-61937 (Deering 2015); Northern and Southern California Stabilization Plans §300; Ex. 29; *see generally CSO.* And Nevada maintains its own price setting program. N.R.S. 584, *et seq.* No witness appeared to claim that there were market disruptions in Nevada whether from California or other areas not subject to federal regulation. As to Reno, the Nevada Dairy Commission maintains an effective Class I price that is equal to the Northern California price. So there is no advantage for either Sacramento or Reno plants in making packaged milk sales. Also, there is no actual market disruption described in the record. There was similarly no actual testimony regarding Las Vegas-Los Angeles.

The so-called evidence of potential disruption from packaged milk sales into or outside California in interstate commerce is not real. It certainly fails to measure up even to the evidence provided in 1979 that initially failed to justify federal regulation of Southwestern Idaho-Eastern Oregon.

c. Decreasing volumes of out-of-state milk is priced at CSO plant blend and has not resulted in actual competitive harm or market failure.

Apparently having realized that their reliance on Class III and 4b pricing differences and non-existent problems with packaged milk sales were failing, at the end of the hearing the Cooperatives decided to change tacks and assert that USDA should regulate on the basis of CDFA's inability to regulate out-of-state milk sales to California Class I plants. In the Alonzo Letter, page 13 the cooperatives mention under the category of "other order provisions" the issue of out-of-state milk, but did not then claim that it amounted to disorderly marketing. Their last minute conversion on this issue demonstrates that it was never their real or serious complaint.

Moreover, the Alonzo Letter asserts that the seller of such milk *could* receive the full Class I price. *Alonzo Letter*, at 13. The evidence at the hearing contradicts that erroneous assertion. Tr. 4081:23 – 4082:4 (Testimony of Mr. Turner), and 7591: 9 – 21 (Testimony of Mr. DeGroot). Indeed CDFA credits processors (whether Class I or otherwise) at the plant blend for such milk. Payment at the plant blend means that the plant may avoid the producer-settlement fund payment, but the Record shows the plant is paying the full use value for that milk to out-of-state handlers. Indeed the only witnesses testifying on this issue were out-of-state dairy farmers who said that they did receive at least the plant blend price. *Id.* The milk is not unpriced in the same way as it was in the southeastern orders. Tr. 4081: 23 – 4082:4 (Testimony of Mr. Turner); Tr. 7600:20 – 21 (Testimony of Mr. DeGroot).

There is no evidence that handlers have used out-of-state milk to avoid or alter contracts with California producers. No witness testified that such purchases have caused any disruptive activities within California (as opposed to the testimony of disruptive competition, discussed below, regarding Producer-Distributor milk subject to exempt quota). Indeed the volume of out-of-state milk that is allocated to Class I has dropped more than 50% from March 2009 to August 2015. Ex. 155. During this time and indeed post-*Hillside Dairy*, there are no known complaints (and certainly nothing in this Record) regarding these out-of-state milk sales. In light of USDA's most recent promulgation decisions (and tentative termination), it cannot be said that these sales constitute a disruption, and certainly not a substantial disruption to the market place.

USDA should conclude that the purported issues with the purchase of out-of-state milk by California Class I handlers is not sufficient to justify federal intervention in the California milk market that is already regulated by the CSO.

B. The Cooperative Order Does not Effectuate the Declared Policy of the AMAA.

Even if USDA were to conclude that the marketing conditions in California are sufficiently disorderly as to justify federal intervention, the Cooperative Order fails to meet the criteria of 7 C.F.R. §900.3 that "the proposed marketing . . .order will tend to effectuate the declared policy of the act." The reasons for their utter failure to meet this critical legal standard are found in Sections IV, VI, VII, VIII and X. The Cooperative Order would violate the AMAA with permanent second-class citizens receiving a price less than their California counter-parts; the Cooperative Order would establish trade barriers as to both milk and milk products; the Cooperative Order charges Class I handlers the highest regulated price and then deprives them of FMMO performance standards; and the Cooperative Order would establish excessively high prices, unjustified based on current economic conditions and exacerbated by mandatory pooling provision unique to all FMMOs.

USDA and the courts have concluded that regulation of the fluid milk market is the *raison d'etre* for milk order regulation. But the Cooperative Order pyramid turns everything on its head and in so doing would create more, not less disorder (assuming any disorder exists). Uniform pricing is destroyed as each California dairy farmer will receive a price based not solely on her volume of milk sold, but also on quota; out-of-state dairy farmers will have their uniform price lowered by payment of quota only to California dairy farmers. Illegal trade barriers are established as out-of-state milk becomes disfavored and sales of milk products are impaired and limited by antiquated and incorrect price formulas.

While USDA has concluded that performance standards are absolutely necessary for concluding who should be permitted to share in the benefits generated from the Class I market, the Cooperatives provide no real performance standards. USDA has concluded that automatic pooling (the functional equivalent of mandatory pooling) causes disorderly marketing, but the Cooperatives demand a unique pooling requirement that will disadvantage California manufactured products manufacturers. It simply cannot be said that the Cooperative Order will improve market conditions in California.

Finally, if USDA relies upon the shrinking and non-disruptive out-of-state milk sales to California Class I handlers as its justification for finding disorderly marketing sufficient to intervene in California's well managed milk market, then it cannot simultaneously permit exempt quota to continue. As discussed in detail below, the only complaint from fully regulated Class I handlers regarding under-regulated competition is about exempt quota, not out-of-state milk. In the face of such testimony, adoption of the Cooperative Order with exempt quota would be contradictory and arbitrary and capricious to an extreme level.

For all the foregoing reasons, USDA should conclude that there are not disorderly marketing conditions that can justify issuance of the Cooperative Order or any California FMMO.

VI. PERFORMANCE-BASED POOLING STANDARDS ARE THE ONLY VIABLE METHOD FOR DETERMINING WHO SHARES IN MARKETWIDE POOLING AND MANDATORY POOLING IS INCONSISTENT WITH USDA POLICY

A. Introduction

USDA should adopt the Dairy Institute's proposal for traditional performance-based pooling requirements that recognize the Class I utilization in the California market. USDA's enduring policy of incorporating performance-based pooling standards serves to ensure sufficient supplies of Class I milk, as well as fair distributions of the pool proceeds.

The Cooperatives ask USDA to abandon its additional longstanding policies defining the producers who are eligible to share in the Class I proceeds through "pooling standards" (a.k.a. performance standards) and permitting dairy farmers to voluntarily associate with the market. Their purported justification is yet another expanded redefinition of the Quota Provision so that it reaches beyond the distribution of the pool, to the size of the pool. Congress said nothing of the sort. The Cooperatives' demand for mandatory pooling not found in any other FMMO, and by extension elimination of pooling standards that exist in every other FMMO, is unjustified and not based upon legal authority.

As important context for this argument, the Cooperatives' decision to call non-avoidable, non-voluntary, anti-choice pooling "inclusive" is a propaganda tactic that could be admired by any political machine. Most people would think of "inclusive" as meaning expansive and embracing in a positive way. That is not the case here.[31] Mandatory pooling is a much more appropriate term and means precisely what will happen if the Cooperative Order is adopted – all milk received at any California Grade A plant (subject perhaps to some smaller player exemptions) will be required to be pooled. Semantics do matter and, as with the Cooperatives' effort to rewrite the Quota Provision, their efforts at misdirection fail.

B. USDA Has a Consistent Policy To Distribute Pool Proceeds Based on a Voluntary Election to Participate in Serving the Class I Market.

USDA has always found it necessary to define the parameters for which dairy farmers obtain that valuable right to share in the uniform price – a showing by a dairy farmer that he is ready, willing and able to serve the fluid milk market. USDA restated its longstanding policy in the Final Decision for FMMO Reform:

[31] This term did in fact raise some questions at the hearing. Judge Clifton: … I want to know why the word "inclusive" is regarded as adequately descriptive of what you want? Why does that word – why is the meaning of that word helpful in people understanding what milk goes into the pool? Mr. Hollon: I think it simply implies that it includes all. Tr. 2819: 13 – 18 (Testimony of Mr. Hollon).

> The pooling provisions for the consolidated orders provide a reasonable balance between encouraging handlers to supply milk for fluid use and ensuring orderly marketing by providing a reasonable means for producers within a common marketing area to establish an association with the fluid market.

Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16025, 16130 c.2-3 (April 2, 1999). USDA has clearly determined that orderly marketing requires a "test" or pooling provision requirement in order to determine who is eligible to share in the uniform price because permitting any dairy farmer to participate without a pooling provision would also be disorderly. Performance-based pooling provisions are required to meet the Declared Policy of the AMAA: "[p]ooling provisions of all orders . . . are intended to define appropriate standards for prevailing market conditions in assuring that the marketing area would be supplied with a sufficient supply of milk for fluid use." *Milk in the Upper Midwest Marketing Area,* 68 Fed. Reg. 37674, 37678 c.2 (April 9, 2004); *Milk in the Northeast Marketing Area,* 70 Fed. Reg. 4932, 4943 (January 31, 2005).

Thus, not every dairy farmer, simply by raising his hand, may automatically be entitled to a uniform price; and the obverse is that "[p]roducers may *choose* to participate in the 'pool.'" *County Line Cheese Co. v. Lyng*, 823 F.3d 1127, 1129 (7th Cir. 1987) (holding that milk must be pumped into a plant to qualify as "shipped to" a distributing plant; the court by upholding this distinction recognized and approved USDA's conclusion that pooling is not automatic). Dairy farmers in a number of the traditional FMMOs have logical incentives to elect, through their purchasing handlers, non-pool status. If the farmer's location is distant from the fluid market, his classified price at that location may be higher than the order's uniform price. Tr. 4932.13 – 20 (Testimony of Mr. Blaufuss).

It is also the case that if a dairy farmer is unwilling to serve the fluid market when needed, that he is not entitled to that uniform price. 7 C.F.R. 1---.7 and .13. This has been USDA's consistent policy pre-dating FMMO Reform. "The intent of these pooling provisions prior to reform and after reform has not changed." *Milk in the Pacific Northwest Marketing Area*, 69 Fed. Reg. 18834, 18838 c.3 (April 9, 2004).

USDA's unvarying conclusion is that pooling standards are necessary to identify the dairy farmers who provide service in meeting the fluid milk market needs:

> This is important because producers whose milk is pooled receive the market's blend price. If the pooling provisions do not reasonably accomplish these aims, *the proceeds that accrue to the marketwide pool from fluid milk sales are not properly shared with the appropriate producers and can result in an unwarranted lowering of returns to those producers who actually incur the costs of supplying the fluid needs of the market.*

70 Fed. Reg. at 4943, c.2 (emphasis supplied); 69 Fed. Reg. at 18838 c.3 ("[i]t is the pooling standards of the order that identifies those producers who are relied upon to supply the Class I needs of the marketing area"). USDA has decisively and repeatedly declared that performance based pooling standards are crucial and unavoidable: "Pooling standards that are performance-based provide *the only viable method* for determining those eligible to share in the marketwide pool." *Milk in the Central Marketing Area*, 71 Fed. Reg. 54152, 54157 c.3 (September 13, 2006) and 68 Fed. Reg. 51640, 51645 c.1; *Milk in the Mideast Marketing Area*, 69 Fed. Reg. 19292, 19298 c.3 (April 12, 2004); 70 Fed. Reg. at 4943 c.1; and 68 Fed. Reg. at 37684 c.1 (rephrased as pooling standards are "the only viable basis for determining those eligible in the pool.").

The importance and prominence that performance-based pooling standards have in establishing and maintaining orderly marketing conditions is unequivocal and unyielding. These provisions are found in the "Pool plant," "Producer," and "Producer milk" provisions of each order and specify the requirements for a producer, the milk of a producer, or a plant that must be met in order to share in the benefits of the pool. *Id.* Only the Dairy Institute Proposal provides these standards relying on the test set forth in FMMO Reform:

> Obviously, matching these goals to the very disparate marketing conditions found in different parts of the country requires customized provisions to meet the needs of each market. For example, in the Florida marketing area, where close to 90 percent of the milk in the pool will be used for fluid use, pooling standards will require a high degree of association with the fluid market and will permit a relatively small amount of milk to be sent to manufacturing plants for use in lower-valued products. In the Upper Midwest market, on the other hand, a relatively

> small percentage of milk will be needed for fluid use. Accordingly, under the pooling standards for that order smaller amounts of milk will be required to be delivered to fluid milk plants and larger amounts of milk will be permitted to be sent to manufacturing plants for use in storable products such as butter, nonfat dry milk, and hard cheese.

64 Fed. Reg. at 16130, c.3. The Dairy Institute proposes using the above language to provide a sliding scale for pooling standards that are based on the actual Class I utilization for the market. Tr. 5214 – 5223 and 5787 – 5788 (Testimony of Mr. Zolin). The reason for the sliding scale is that the choices California handlers may make for pooling are unknown given that the CSO's present requirement of mandatory pooling prevents any speculation as to how handlers may choose to pool. The Dairy Institute also supports *supplemental* "call provisions" on top of real performance-based pooling provisions that are shipping requirements found in Proposal 2 (4) 1051.7(c)(2). Tr. 6601 – 6602 (Testimony of Mr. Zolin).

The Dairy Institute also proposes that USDA adopt reasonable economic limits on the ability to pool milk in subsequent months after handlers' exercise their ability to voluntarily not pool milk. UDSA has determined that the *unlimited ability* to de-pool milk without consequence is disorderly:

> Handlers and cooperatives who depool purposefully do so to gain a momentary financial benefit (by avoiding making payments to the PSF) which would otherwise be equitably shared among all market participants. While the order's performance standards tend to assure that distributing plants are adequately supplied with fresh, fluid milk, the goals of marketwide pooling are undermined by the practice of depooling. Producers and handlers who regularly and consistently bear the costs of serving the Class I needs of the market will not equitably share in the additional value arising momentarily from non-fluid uses of milk. These same producers and handlers will, in turn, be required to share the additional revenue arising from higher-valued Class I sales in a subsequent month when class-price relationships change.

71 Fed. Reg. at 54180 c.2. However, USDA has simultaneously concluded that overly restrictive re-pooling rules "would disrupt current marketing conditions beyond what the record justified." *Id.* Thus, USDA has never concluded that de-pooling must be prevented in *toto* and in fact has rejected proposals that would prevent, rather than deter the practice. *See. e.g., id.* USDA must

find a balance between these two extremes; USDA's adoption of the Upper Midwest re-pooling provisions (with its similar Class I utilization) has proved feasible and workable. The Dairy Institute Proposal thus proposes adoption of re-pooling provisions that are identical to those found in the Upper Midwest. Proposed 2 – 7 C.F.R. §1051.13(f).

C. In their Request for Hearing, Cooperatives Wrongfully Claimed that California FMMO would have "All Characteristics of the ten FMMOs."

In the Alonzo Letter, the Cooperatives asserted that a "California FMMO will have all the benefits *and characteristics* of the ten FMMOs. . ." *Alonzo Letter*, at 3. However, they do not include the meaningful and real performance-based pooling standards found in each and every one of the ten FMMOs. The lack of performance standards is really a function of demanding yet another unique concept – mandatory pooling of all California milk, regardless of whether it is used in Class I.

In reality, the Cooperatives do want all the benefits, but none of the attendant responsibilities or obligations that USDA has found necessary to carry out the Declared Policy of the AMAA – none of the responsibilities, obligations or burdens of meeting the requirements for participation in the Pool. The Cooperatives want to retain all of the benefits of the CSO and simply replace the objectionable CSO pricing with dated FMMO pricing. USDA must reject this obvious and insidious attempt to upend the AMAA. The AMAA is not a buffet – Cooperatives cannot pick and choose the pieces they like.

D. The Quota Provision Provides no Justification for USDA's Abandonment of Performance-Based Pooling Standards Policy.

The Quota Provision must not be used to further erode and overturn decades of established USDA policy. As with nearly every unique feature proposed by the Cooperatives, mandatory pooling is a victim of the Cooperative Order trying to accommodate the quota system without accounting for the AMAA. The Cooperative Order goes much further than "recognizing" quota and actually results in *enhancing* the quota pool through the mandatory inclusion of new entities in the pool. The Cooperatives *provide no other justification* for why USDA should include mandatory pooling in the California FMMO. Without considering quota, the impact of de-pooling in California would be "quite similar" to that in other regions, like the Upper Midwest Order. Tr. 2549: 1 – 8 (Testimony of Mr. Christ). However, "to ensure the quota program remains intact, pooling provisions for a California FMMO must be strict." Tr. 3190:10-11 (Testimony of Ms. AcMoody).

There is no reasonable interpretation of the Quota Provision that can lead to the conclusion that performance-based pooling standards, the basic *quid quo pro* for charging Class I handlers the highest price and then blending it to share with other dairy farmers, can be deleted and treated as a nullity in a California FMMO. Congress did not say that the California Order "shall include all California dairy farmers." Congress did not say that the California Order "shall pool all California handlers." Congress did not say that the California Order "shall require the pooling of all California milk." Congress did not say that the California Order "shall include all milk in order to increase order proceeds which shall then be reblended and redistributed in order to maintain the quota system." Neither the Cooperatives nor USDA may rewrite the statute to create unique California FMMO requirements that eliminate "the characteristics of the ten FMMOs" (*Alonzo Letter,* at 3) or evade the Declared Policy of the AMAA to bring forth an adequate supply of milk for fluid use.

The over-arching problem is that the Cooperatives' elimination of performance-based pooling standards and requirement for the pooling of all producer milk received at California Grade A milk plants relies on their broad and unjustified rewrite of the Quota Provision. *See* Section II. Recognizing quota value does not mean as Mr. Hatamiya claims that quota "not in any way be diminished or affected." Ex. 54, at 6 (Testimony of Mr. Hatamiya). The quota value is the income stream from the $1.70 first extracted from the CSO pool. *See* Section VIII, Part A and Part B. A traditional FMMO can retain voluntary pooling and performance-based pooling standards and still pay that $1.70 quota value (if authorized).

It is true that the overall size of the federal order pool for California could well be different with typical voluntary pooling over mandatory pooling. But Congress did not speak to the size of the pool, it spoke specifically to reblending and redistributing the pool once the size is determined. It is also true that just as in typical FMMOs today dairy farmers who elect through their handlers not to participate in the pool may well in certain months be able to receive a higher price for their milk than they could from the overbase price. Since this is true under a traditional FMMO, there is nothing fundamentally wrong or unlawful with that result. That this is a function of the quota system in no way speaks to the policy issue that USDA insists is paramount – determining the eligibility of dairy farmers to participate in the pool in order to assure the high playing Class I handlers of an adequate supply of milk.

E. USDA Must Retain Performance-Based Pooling Standards to Avoid Disorderly Marketing.

The Cooperative Order by its terms would require Class I handlers both to pay the highest price for their milk, but also pay extra-order prices in order to actually obtain a milk supply. Tr. 6392: 3 – 7 (Testimony of Mr. Blaufuss); Tr. 2535:8 – 2536:2 (Testimony of Mr. Christ) (explaining that under the Cooperative Proposal, private trade transactions and premiums "will take care of supply in the Class I markets"); Ex. 58, at 13 (Testimony of Mr. Christ). Without performance-based pooling standards (and even with transportation credits that are deliberately designed *not* to reimburse for costs of full freight), USDA must conclude that milk will, without additional contract payment terms, be received at closer manufacturing plants. As USDA itself has concluded (70 Fed. Reg. at 4933 c.3 – 4934 c.4), without performance-based pooling standards, dilution of pool proceeds will defeat an order's ability to assure an adequate supply of milk for fluid use. USDA cannot adopt an FMMO that fails in meeting its most basic purpose.

In fact, DFA itself has itself voted against amending an order when Class I farmers were bearing a burden in the marketplace for which they were not compensated. As stated by DFA Corporate Board Chairman Tom Camerlo:

> Eliminating a federal order is not a decision you take lightly, but FO 135 has serious problems. Right now, dairy farmers, who market milk to Class I (fluid milk) markets are shouldering all of the costs related to balancing and serving this marketplace. At the same time, dairy farmers who sell to Class III (cheese) and Class IV (powder) plants are completely avoiding

> the expense. We felt this practice should not continue. Unfortunately, this step (ending the Order) corrects some of the practices that have not only gotten out of hand, but are counter to the purpose of federal milk marketing orders."

Ex. 66, at 1 (Article, "DFA Supports USDA's Proposal to Terminate FO 135," with a similar argument made on page 2 in the Article "DFA Says 'No' to Proposed Amendments to Western Order").

As discussed in Section VIII, the history of quota reveals that quota is absolutely, directly and inextricably linked to the Class 1 market, and USDA should not refuse to provide for the pooling standards necessary to determine who should share in the pool in the first instance under UDSA's invariable rationale for requiring performance-based standards. USDA cannot lawfully sacrifice performance-based pooling standards on the cross of the Quota Provision. *See,* William Jennings Bryan, *Cross of Gold Speech*, Democratic National Convention (July 9, 1896).

F. Mandatory Pooling is Inconsistent with USDA Policy, Would Discriminate Against and Establish Trade Barriers as to Milk Products and is Illegal as it Regulates Producers Contrary to 7 U.S.C. §608c(13).

1. Mandatory pooling cannot exist alongside performance-based pooling standards.

Mandatory pooling is unquestionably incompatible with performance-based pooling standards. Tr. 2535:8 – 2536:2 (Testimony of Mr. Christ) (explaining that under the Cooperative Proposal, private trade transactions and premiums "will take care of supply in the Class I markets"), Tr. 2926:3 – 2927:5 (Testimony of Mr. Hollon) (explaining that the "market condition" of quota means that type of performance standard in California must rely solely on third party contracts and the transportation payment system). When performance-based pooling standards are not met, the consequence is that milk is not included in the pool. As discussed above, that is the function and purpose of pooling standards. But since the Cooperatives demand that all milk be included in the pool, they eliminate performance-based pooling standards. Their last minute proposal to include in the Cooperative Order a provision akin to the CSO's call provisions is not really a performance-based pooling standard. Ex. 183 (Testimony of Elvin Hollon). It will not define who should share in the market pool, but financially penalize entities that do not comply with the call provision. This is a subterfuge to avoid creating traditional performance-based pooling standards whose intent is to determine the identity of those who can share in the pool; it merely protects their mandatory pooling.

USDA has already spoken out against the idea of mandatory pooling. Prior to 2005, the Northeast Marketing Area included a provision that allowed for limited "automatic pooling" of non-Class I plants. After a public hearing, USDA eliminated that provision, finding the provision was inconsistent with the need to identify those entitled to share in the order proceeds without causing undue dilution of pool proceeds:

> Handlers and producers are better served by eliminating the ability of a supply plant to automatically be a pool plant if the supply plant had been a pool plant in some prior period as the order currently provides. The granting of automatic pool plant status to a plant does not provide the certainty needed by distributing plants for the order to assure them an adequate supply of milk for Class I uses. Together with other pooling standard inadequacies, it provides an avenue through which more milk can be pooled on the Northeast order than can be considered as part of the legitimate milk supply of the pool plant where automatic pool plant status has been granted. The opportunity to pool milk in this way only serves to increase the volume of milk pooled (at lowered valued uses) without that milk either being committed to, or demonstrating, serving the Class I needs of the market as a condition for receiving the order's blend price.

70 Fed. Reg. at 4933 c.3 – 4934 c.4. Being generous and substituting the word "inclusive" for "automatic" results in the following fatal USDA statement: "The granting of inclusive pool status to a plant does not provide the certainty needed by distributing plants for the order to assure them an adequate supply of milk for Class I uses." The Cooperatives candidly admit that under the Cooperative Order only extra-order pricing through private contracts would provide the certainty for an adequate supply of Class I milk that is otherwise achieved by the characteristics of the ten FMMOs today. Tr. 6392: 3 – 7 (Testimony of Mr. Blaufuss); Tr. 2535:8 – 2536:2 (Testimony of Mr. Christ) (explaining that under the Cooperative Proposal, private party transactions and premiums "will take care of supply in the Class I markets"); Ex. 58, at 13 (Testimony of Mr. Christ). In short, mandatory pooling defeats the critical purpose of an FMMO to bring

forth an adequate supply of milk. This fundamental undoing of USDA policy cannot be justified by the Quota Provision.

2. Mandatory pooling discriminates against California handlers and dairy farmers and results in unlawful trade barriers.

Under the Cooperative Order, manufactured milk product companies would face unique regulated competitive problems, resulting in unlawful trade barriers. Given the voluntary nature of pooling arising from characteristics of the ten FMMOs, cheese plants in California could not qualify as nonpool plants or receive nonpool milk. *See* Tr. 388:21 – 22 (Testimony of Mr. Schaefer) (explaining that under the §1000 provisions, "[m]ilk that is diverted to a nonpool plant *may be pooled but does not have to be.*" (emphasis supplied)). All their milk would be priced and pooled under the Cooperative Order at classified prices based upon the non-updated FMMO formulas, discussed in Section VII. *See, e.g.*, Ex. 111, at 7 (Testimony of Mr. Vetne); Tr. 1363:8–22 (Testimony of Mr. Hollon); Tr. 3235:3–9 (Testimony of Mr. Schad). Unlike their FMMO competitors who can and do avoid minimum regulated prices by not pooling eligible milk (a.k.a. "de-pooling") or receiving nonpool milk as nonpool plants or as split plants under a number of the existing FMMOs (*e.g.,* 7 C.F.R. §1032.7(h)(7)), mandatory pooling will prevent only California plants from adjusting to important economic conditions, such as: (1) surplus milk that can only be economically disposed of at prices less than regulated minimums; (2) FMMO pricing levels that encourage FMMO eligible milk to not be pooled. *See* Ex. 98, at 15–17 (Testimony of Mr. de Jong); Ex. 116, *et seq.* (Testimony of Sue Taylor); Tr. 2496: 4–18 (Testimony of Mr. Christ). Both of these situations defeat arguments for mandatory pooling because FMMO competitors of manufacturers' under the Cooperative Order have opportunities to adjust their raw product costs to the detriment of California businesses. Unique mandatory pooling will result in limitations on the marketing of the products of milk that are illegal under 7 U.S.C. §608c(5)(G).

At the outset of this discussion, USDA must reject the Cooperatives' assertions that the existence of nonpool milk or the ability to disassociate milk from the pool under the existing

FMMOs is irrelevant. Voluntary pooling is a long-standing and consistent characteristic of existing FMMOs and has direct relevance to this proceeding especially as to the negative impacts on the California dairy industry that would result from mandatory pooling. *See* Section VI, Parts E and F. The Cooperatives assert that nonpool milk or eligible milk not pooled in the ten FMMOs is not economically significant. But the ability of manufacturers of cheese, butter and nonfat dry milk that may be covered by an FMMO to avoid paying regulated minimums would leave California-only manufacturing plants at the risk of competitive disadvantage created by mandatory pooling. USDA has directly addressed this issue, defining it precisely as the Dairy Institute does and concluding that the very existence of nonpool plants deprives USDA of concluding whether a competitive advantage can exist when there are product price differences driven by differences in regulated prices. USDA's conclusion in the 2003 Class III/IV Product Definition proceeding counters the Cooperatives' claims that differences in Class III and Class 4b are *per se* disorderly and that nonpool milk is irrelevant in evaluating the impacts of mandatory pooling:

> All of the proponents of Proposals 1 and 2 are handlers who operate nonpool plants and, accordingly, are not regulated by any Federal milk marketing order. However, the record reveals that these entities purchase and receive milk that is pooled and priced under a Federal milk marketing order. Unlike pool handlers, nonpool handlers do not pool their milk receipts or share in the returns that are determined through the marketwide pooling of milk. Nonpool handlers are not required to purchase milk already pooled and priced under the terms of an order. In this regard, the price paid by nonpool handlers is not known if purchased through nonpool sources, and even if purchased through pool sources, such purchase may or may not have transacted at minimum class prices. Such is especially true when a nonpool handler receives milk through diversion from pool handlers. A pooled handler diverting milk to a nonpool plant is the entity that incurs the payment obligation to dairy farmers and accounts to the marketwide pool for the volume of milk at the classified use value of milk so diverted. Consequently, the price a nonpool handler actually pays for such milk is not known. Therefore, the tentative final decision and this final decision find that it cannot be determined whether a competitive advantage or disadvantage may arise in those times when the Class III price for milk rises above the Class IV price, which results in the Class IV price being the lowest valued use of milk.

Milk in the Northeast and Other Marketing Areas, 69 Fed. Reg. 57233, 57238 c.3 – 57239 c.1 (September 24, 2004).

The Cooperatives also treated eligible milk not pooled with the casual "move along now, nothing here to see" approach. The fact is that significant volumes of eligible milk are not pooled on today's FMMOs. *See* USDA Data Request, Ex. 9, Table 9 (Total Eligible Milk Pooled/Not Pooled) (demonstrating, for example, that in 2014 Order 30 had handlers de-pool or not pool 4.5 billion pounds of eligible milk and that 8% of all eligible milk in all orders was de-pooled or not pooled); *see also* Tr. 613:19 – 614:1 (Testimony of Mr. Schaefer) (describing a period where one billion pounds of eligible milk was de-pooled from Order 30)). Handlers choose not to pool this milk precisely because there is an economic advantage to those who voluntarily disassociate or never associate milk with an FMMO by making the decision not to share Class II, III or IV values of such milk when they would be additive to the uniform price (or the Producer Price Differential). Ex. 98: 15 – 17 (Testimony of Mr. de Jong); Tr. 2529: 13 – 25 (Testimony of Mr. Christ). The ability to retain monies otherwise payable to the producer-settlement fund reduces the entities' cost of milk for making products that compete with the same or similar products produced in California. Requiring California milk product manufacturers alone in the FMMO system to always associate milk, when their competitors in the remaining FMMOs can voluntarily associate or disassociate such milk, undermines California's ability to compete and contradicts both the Cooperatives' theory that there is a Class III/Class 4b advantage in favor of California and their demand that a California FMMO impose mandatory pooling on California plants only.

The Cooperatives protest too much when they claim that de-pooling does not advantage the market as a whole. Ex. 185, at 5 – 6 (Testimony of Mr. Schad). They ignore the fact that businesses regulated under FMMOs make individualized decisions that impact their bottom line with respect to pooling and de-pooling. Tr. 588: 20 – 589:3 (Testimony of Mr. Schaefer) ("Some plants choose to be nonpool plants, and that choice is predominantly in our market made based on the economics of pooling milk in a particular month… Basically, it's based on the relationships of the prices, which lead to the producer price differential and the return that they would get from pooling."). And it is illogical to claim that de-pooling has little value when so much eligible milk is not pooled and so many in the industry fought extensively in multiple USDA proceedings over the existence of and necessity to deal with de-pooling. *See* USDA Pooling Decisions Discussed and Cited in Section VI, Part B, above. The ability to leverage eligible milk not pooled or purchases of milk below class prices in the existing FMMOs, provides an important financial benefit to businesses operating with that system that must be extended to any California FMMO. Ex. 98: 15 – 17 (Testimony of Mr. de Jong); Tr. 2529: 13 – 25 (Testimony of Mr. Christ).

As discussed in Section VII, USDA has concluded that minimum regulated prices for milk used to produce Class III and Class IV products, must be set at levels that are market clearing. In the existing FMMOs there are escape valves, in the form of voluntary pooling of milk that permit the sale and purchase of milk for use in manufactured products at prices that are at less than order minimums. Ex. 98: 15 – 17 (Testimony of Mr. de Jong). In addition to de-pooling, ample record evidence demonstrates that there are many times, especially in the last year, in which supplies of milk exceed the ability of various FMMOs to absorb that milk at regulated minimums; milk is regularly purchased at prices below classified prices. *See, e.g., Dairy Market News*, p. 3 of Vol. 82, Nos. 11 (week of March 16 – 20, 2015), 14 (week of April 6 - 10, 2015), 21 (week of May 25 - 29, 2015), and 23 (week of June 8 - 12, 2015). Milk otherwise regulated by FMMOs has been routinely and regularly sold at significant discounts below class prices. Ex. 98: 15 – 17 (Testimony of Mr. de Jong). The ability to spread the benefits of these purchases below class prices over all volumes is a benefit not available under the Cooperative Order.

In the existing FMMOs, voluntary pooling of milk is a crucial feature which allows the market to "right" itself during times of surplus. If this pressure valve cannot be released (in addition to prices being set too high, see Section VII), the results could be disastrous. "The significance of that distinction cannot be overstated. When such a firm price floor exists, establishing minimum prices above market clearing levels results in chaos. Imagine what might have happened if mandatory pooling had existed across the country this past spring when surplus milk grossly exceeded demand in several regions." Ex. 91, at 4; Tr. 4217: 13 – 19 (Testimony of Mr. Dryer).

The need to have the ability to buy and sell milk at prices below classified minimums is very real. Looking just at spot loads from November 2014 through May 2015 in the Dairy Market News showed that of the 28 weeks during this time there were 25 weeks that had examples where milk was sold under class. Ex. 98, at 15 (Testimony of Mr. de Jong). Hilmar has purchased billions of pounds of other milk under Class III prices at its Texas plant in the 12 months preceding the hearing. Ex. 98, at 15 (Testimony of Mr. de Jong). The results of overproduction that led to HP Hood enforcing their volume caps (as discussed in Section VII) would be replicated if other manufacturers could not de-pool to find an affordable home for excess milk. *See* Tr. 4355:11–24 and Tr. 4356:4–13 (Testimony of Mr. Newell), Ex. 97, at 4. Indeed the witness for Hilmar Cheese Company demonstrated the fact and benefit of de-pooling under the Southwest Marketing Area. Ex. 98, at 16 (Testimony of Mr. de Jong). With Idaho's large cheese production unregulated by any FMMO or state agency, cheese production in the Pacific Northwest, Idaho and Southwest marketing areas are very competitive with California production.[32] *See, e.g.*, Tr. 6088: 18 – 21 (Testimony of Mr. Paris); Tr. 4738:10 – 25 (Testimony of Mr. Hofferber); Tr. 5119: 21 – 24 (Testimony of Mr. Vetne). USDA cannot require pooling of milk used to produce cheese in California while simultaneously leaving Idaho unregulated and permitting voluntary pooling in the ten FMMOs that results in significant (and current) volumes of eligible milk not pooled in the geographic markets closest to California. The individualized economic benefits accruing to the businesses not required to be pooled would put their California competitors at a financial disadvantage under the Cooperative Order.

[32] Arizona is known more for production of Class IV than large supplies of competitive Class III products.

Not coincidentally, the negative effects of mandatory pooling would only apply to manufacturing facilities not owned by the Cooperatives. In an oversupply situation, the Cooperatives have stated that they would be the ones bearing the burden of selling surplus milk. Tr. 4370:18–23 (Testimony of Newell). However, the Cooperatives can internally balance losses with any decreased payments to producers so that they can dampen any associated losses with dealing with the oversupply milk. Independent manufacturers cannot do the same if they are not allowed to de-pool. *See* Tr. 602:3 – 11 (Testimony of Mr. Schaefer) (Q. What enforcement is there of the minimum price regulation for Order 30 on pooled milk that is received by a nonpool plant? A. If the milk is pooled and received at a nonpool plant, we enforce minimum payment. Now that is true for proprietary handlers. Cooperatives are – because they're a cooperative are allowed to pay the price that their members have decided is appropriate for that month."); Tr. 2503:9 – 20 (Testimony of Mr. Hollon) ("Coops have a reblending privilege that they can market their products to their members in a variety of markets and reblend, and they can distribute the income... So they have that flexibility."). Thus, the Cooperatives are putting a straightjacket on their manufacturing competitors while leaving themselves room to escape.

Mandatory pooling also adversely affects available plant capacity. Ironically since DFA and LOL have sold off, closed or otherwise limited their cheese making capacity, Ex. 98, at 11 (Testimony of Mr. de Jong), there have already been recent circumstances where milk could not be economically received at California plants because of mandatory pooling even with the FMMO Premium. *See* Section VII. CDFA's responses to these then-current economic conditions was to adjust the whey factor within the Class 4b price in order to be more realistic and economically-based, as well as to provide ability for prices to be more market clearing. USDA should not ignore that economic reality. In order to function properly, FMMOs should not create disincentives either to increase capacity or to receive surplus milk when the market requires – that is the very definition of setting prices or establishing regulations that *are not* able to clear markets.[33] *See, e.g.*, Tr. 3638:9-10 (Testimony of Dr. Schiek); Tr. 3718:10-13 (Testimony of Mr. Metzger).

Witnesses supporting the Dairy Institute position uniformly presented evidence that present capacity will moved or be reduced if the Cooperative Order is adopted (*see* Section VII); in addition, witnesses testified that new cheese capacity is already being built or planned is building elsewhere in response to uncertainties created by the CSO and the potential for an FMMO with mandatory pooling. Tr.4392: 9–21 (Testimony of Mr. de Jong). If there is any disorderly condition in California it is mandatory pooling and the problems, issues, and decisions that must be made by CDFA and industry when setting market clearing prices in light of mandatory pooling. USDA should not import those problems in the FMMO system. Instead mandatory pooling should be denied and the Dairy Institute's treatment of pooling under proposed 7 C.F.R. §§1051.7, 12 and 13 adopted.

Last, but not least, USDA cannot adopt a mandatory price for California's milk used to produce manufactured milk products and simultaneously ignore unregulated milk such as in Idaho and the ability of manufacturers under the ten FMMOs to avoid payment of minimum classified prices. Without the escape valves found in existing FMMOs that result in the voluntary pooling or not of milk used to produce cheese, cheesemakers in California would face competition from sources that can, and the evidence shows will, use the cost advantage that results from avoiding the payment of regulated minimum prices to sell cheese into California. This is the reverse of the situation that the Cooperatives claim is disorderly today, but would result solely from USDA differential treatment. Requiring mandatory pooling for California only violates the AMAA's prohibition that no provision of an order may "in *any manner limit*, in

[33] Nationally the dairy industry has been struggling to address lack of capacity issues that have resulted in extended and unusual volumes of dumped milk on dairy farms. Ex. 9, Table 10; Tr. 3641:12, 15 (Testimony of Dr. Schiek); Tr. 6087:14 -21 and 6127:6 – 18 (Testimony of Mr. Paris); *see also*, AMS, Federal Milk Order No. 1, http://www.fmmone.com/Misc_Docs/TemporaryDumpedMilkPolicy031716.pdf (last visited March 29, 2016) and AMS, Federal Milk Order No. 1, December 2, 2015 Notice (found as Attachment 1 to Findings of Fact). Mandatory pooling that limits economic means for buying milk below classified prices can only increase the risk in California that dumped milk will become a preferred option. Another option would be to have milk shipped from California farms to plants not located in California. Both options, made more likely by mandatory pooling, would be evidence of disorderly marketing conditions caused, not corrected, by the Cooperative Order.

the case of the products of milk" the marketing of those products in the marketing area. 7 U.S.C. §608c(5)(G). The Cooperatives assert that it is the Class 4b price that is disorderly, when in fact their proposed correction would result in USDA violating the AMAA.

3. Mandatory pooling is illegal as it results in regulation of dairy farmers contrary to 7 U.S.C. §608c(13)(B).

Even though all Class I distributing plants have always been treated as pool plants under FMMOs (whether under individual handler pools or marketwide pools), dairy farmers have always been able to voluntarily disassociate with the pool by not shipping to a Class I plant or other voluntarily pooled handler. *See County Line Cheese, supra.* This ability to choose whether or not to be pooled means that dairy farmers are not presently regulated in their capacities as "producers" as proscribed by the AMAA at 7 U.S.C. §608c(13)(B): "No order issued under this chapter shall be applicable to any producer in his capacity as a producer." Producers can and do opt-out under the ten FMMOs. But as with everything else in the Cooperative Order, the Cooperatives ignore this characteristic of the ten FMMOs. And it is an unlawful result.

Mandatory pooling removes this opt-out choice from dairy farmers who ship to California Grade A milk plants. For a huge percentage of California dairy farmers not located near the Arizona or Nevada borders this removes any economic ability to opt-out. The voluntary nature of pooling as found in the ten FMMOs is removed precisely to force all these dairy farmers to participate in the quota program which increases the size of the California pool by reducing the pay prices to producers who, like their FMMO counterparts, would otherwise choose not to pool. Extracting those funds without giving choice is a form of regulation of these dairy farmers in their capacity as producers. It is thus unlawful under the AMAA.

USDA, without more specific Congressional authority than the Quota Provision cannot abdicate its FMMO operational policies that are designed to maintain orderly marketing of milk relying upon the Quota Provision.

G. USDA Must Conclude that the Quota Provision Cannot Be Applied to Violate the Due Process and Equal Protection Clauses of the United States Constitution.

The only purported justification for deviating from USDA's unwavering conclusion that performance-based pooling standards are the only viable method for determining who may share in the pool (and by extension that all milk be pooled) is reliance on the Quota Provision. As described above, the problem with this interpretation is that the Cooperative Order would uniquely deprive California Class I handlers of the *quid quo pro* given all of their FMMO counterparts and uniquely regulate the production of Class II, III and IV products to their competitive detriment. This result would violate the Due Process and Equal Protection Clauses of the United States Constitution. United States Constitution, 5th and 14th Amendments. USDA should avoid interpreting the Quota Provision as justifying the Cooperative Order under the doctrine of "Constitutional Doubt," discussed above.

The legal analysis of the problem with the Cooperative's Order unique treatment of performance-based pooling standards and mandatory pooling is no different from the result in *In re: Kraftco,* AMA Dkt. No. M 4-15 (1974). In a rare (perhaps unique) rebuke to the Secretary, the Judicial Officer vacated underpayment notices issued to Kraftco that had been based on Kraftco's deductions for quality control work performed by Kraftco from its independent dairy farmer patrons minimum price payments charges. The charges for quality control work resulted in the dairy farmers receiving less than the minimum regulated price for their milk. Kraftco defended its practices on the grounds that handlers with cooperative milk paid the minimum price, but the cooperatives then provided the same quality control work – economically Kraftco's competitors were receiving the same work for free. While the Judicial Officer remanded the matter on the grounds that further evidence was necessary to establish discrimination, he nonetheless concluded that if proved as alleged by Kraftco, "a serious question would arise under the Due Process Clause to the Constitution and under the uniformity provisions of the [AMAA]." *Id.* p. 100.

As early as 1886, the United States Supreme Court has consistently and repeatedly held that the government cannot be permitted to enforce its laws with an unequal hand so as to discriminate between persons in similar positions to their detriment. *Yick Wo v. Hopkins*, 118 U.S. 356 (1886) (municipality could not enforce rules banning wooden laundries against Chinese owners only); *Metropolitan Life In. Co. v. Ward*, 470 U.S. 869 (1985) (state may not lawfully impose greater tax burden on out-of-state corporation as opposed to in-state corporation).

The legal solution is to avoid this Constitutional Doubt by rejecting any interpretation of the Quota Provision that reaches this far. Mandatory pooling must be denied and performance-based pooling standards proposed by the Dairy Institute adopted.

VII. THE AMAA REQUIRES USDA TO ADOPT ACCURATE AND UP-TO-DATE PRICES, AS PROPOSED BY THE DAIRY INSTITUTE

A. USDA Must Adopt Current Prices.

The AMAA requires USDA to adopt prices driven by factors found in the marketing area – California for this proceeding.

> The Secretary of Agriculture, prior to prescribing any term in any marketing agreement or order, or amendment thereto, relating to milk or its products, if such term is to fix minimum prices to be paid to producers or associations of producers, or prior to modifying the price fixed in any such term, shall ascertain the parity prices of such commodities. The prices which it is declared to be the policy of Congress to establish in section 602 of this title shall, for the purposes of such agreement, order, or amendment, be adjusted to reflect the price of feeds, the available supplies of feeds, and *other economic conditions which affect market supply and demand for milk or its products* ***in the marketing area*** to which the contemplated marketing agreement, order, or amendment relates. Whenever the Secretary finds, upon the basis of the evidence adduced at the hearing required by section 608b of this title or this section, as the case may be, that the parity prices of such commodities are not reasonable in view of the price of feeds, the available supplies of feeds, and *other economic conditions which affect market supply and demand for milk and its products* ***in the marketing area*** to which the contemplated agreement, order, or amendment relates, he shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest. Thereafter, as the Secretary finds necessary on account of changed circumstances, he shall, after due notice and opportunity for hearing, make adjustments in such prices.

7 U.S.C. § 608c(18) (emphasis supplied). USDA cannot lawfully adopt patently out-of-date minimum prices developed for other FMMOs, as such prices would not be based on actual factors found "*in the marketing area*." The overwhelming evidence proves that such prices from other FMMOs do not reflect economic reality in California, and as such are an unlawful basis for USDA's development of prices in a California FMMO.

The AMAA prohibits USDA from adopting out-of-date prices that are too high in the current market. "[T]he Federal Milk Marketing Order (FMMO) program is not designed to be a price or income support program since it is not authorized to establish minimum prices above the relative market value of the products of milk." Ex. 112, at 51–53 (Letters of September 17, 2012 from Agriculture Secretary Vilsak and AMS Deputy Administrator for Dairy Programs); also published online at http://www.dairyprogramhearing.com/getfile55055505.pdf?d DocName=STELPRDC5100786. Thus, "[t]hrough a public hearing, the Secretary of Agriculture evaluates the marketing conditions in an area and considers the price of feeds, the available supply of feeds, and other economic conditions that affect [sic] *the market supply and demand for milk and its products in a marketing area*." *Id.* (emphasis supplied). Supply and demand drives the USDA's analysis, playing paramount importance in USDA's decision regarding minimum pricing.

In addition to the AMAA requiring up-to-date analysis and related prices, the market in fact demands such for an FMMO to be effective. If USDA decides against adopting current prices in California and relies instead on old prices, it will cause intense disruption in the California dairy industry (as discussed in detail below). Thus, it behooves every participant in the dairy industry to support adoption of updated prices since the dairy market cannot function if its regulatory system is wholly misaligned with reality. CDI itself made this argument in a CDFA hearing in late fall of 2009: "[t]he Class 4a formula should reflect *the most currently available cost-justified changes*." Tr. 1881: 1 – 20 (Testimony of Dr. Erba) (emphasis supplied). National All Jersey also agreed that prices should be up-to-date. Tr. 3752:4 – 7 (Testimony of Mr. Metzger). USDA should continue with this well supported and clearly mandated policy.

B. USDA Must Adopt Market Clearing Prices.

Directly correlating with the AMAA's charge for USDA to adopt current market prices, these prices also must be market clearing. A market clearing price is the price at which goods can be sold and will be purchased; in other words, when supply and demand are equal or the equilibrium price where supply and demand intersect. Tr. 115:24–116: 3 (Testimony of Ms. Steeneck); Ex. 133, at 9. Ever-changing markets make it impossible for USDA to establish a perfect equilibrium price in real time. Thus, "FMMO's have regulated minimum prices that must be paid and have tried to set that standard somewhat *below* market clearing price." Tr. 5956: 2–7 (Testimony of Dr. Stephenson), Ex. 133, at 9 (emphasis supplied). USDA affirmed and applied this principle in FMMO Reform when establishing Class III and Class IV prices in the ten FMMOs:

> The importance of using minimum prices that are market-clearing for milk used to make cheese and butter/nonfat dry milk cannot be overstated. The prices for milk used in these products must reflect supply and demand, and must not exceed a level that would require handlers to pay more for milk than needed to clear the market and make a profit.

64 Fed. Reg. at 16094 c.3 – 16095 c.1. USDA must apply this principle in this promulgation proceeding by relying on current economic conditions in California, not dated economic conditions from the 1990s that underlie those prices in the ten FMMOs.

Proponent Land O'Lakes has argued this exact point in regards to its manufacturing facilities:

> Through Federal Order Reform and other Decisions, the Secretary has repeatedly stated that the Class III and Class IV prices are meant to represent market clearing prices. To that end, the Secretary has adjusted the relative weighting of the cost surveys so that balancing costs are reflected in make allowances. When the make allowance formulae no longer represent current processing costs, those handlers who provide a market balancing functions suffer the greatest pain. As already stated, Land O'Lakes operates a [sic] multiple manufacturing plants with in the federal order system.

Ex. 187, at 2 (Letter from Land O'Lakes to Ms. Dana Coale, USDA – AMS Dairy Programs, Deputy Administrator, September 27, 2005).

The importance of setting market clearing prices (and applying Dr. Stephenson's conclusion that USDA should set the price somewhat lower than market clearing levels) is heightened when the regulated minimum prices are mandatory rather than elected voluntarily as under the ten FMMOs:

> The risks of setting the minimum regulated price too high in a system of binding minimum prices are significantly amplified. These include, amongst other things, threats to the financial viability of manufacturers and the plant capacity they provide and inefficient movement of milk in order to clear the market to out-of-area entities that are not subject to binding minimum regulated prices. This inefficient movement of milk in order to clear surpluses also results in lower producer returns due to increased cost to transport.

Ex. 116, at 3 (Testimony of Sue Taylor). CDI itself eloquently testified to this fact in an argument to CDFA in 2009:

> Class 4a and 4b are market-clearing classes of milk, and process 75% of the milk produced in California. The products from these plants compete in national and international markets where price is a dominant consideration for buyers. The California dairy industry is wholly dependent on the continued operation of its manufacturing facilities. To burden these plants with higher minimum prices that cannot be extracted from the market, even for a brief period, would have potentially devastating consequences.

Ex. 44, at 1 (Letter by Dr. Eric Erba on behalf of California Dairies Inc., referring to CDFA's current mandatory minimum pricing system). As implied by Dr. Erba above and explicitly concluded by Dr. Stephenson, setting prices at overly-high levels in itself would result in disorderly marketing conditions.

> The combination of a low enough price move and geographically different Class I values has historically allowed blended pool values to represent an approximate spatial price for producer milk. Any differences could be made up with voluntary premiums paid above the regulated minimum. A real concern is with minimum pricing setting the regulated level above the market-clearing price. At this point, producers are willing to supply more milk to markets than consumers wish to purchase. This would certainly be evidence of disorderly marketing.

Ex. 133, at 9.

In addition to causing disorderly marketing, establishing minimum prices that fail to acknowledge current market realities would result in creating a trade barrier. First, ignoring the current location value of milk used to produce manufactured products would limit, in a way, the ability of California businesses to market their products in California. And second, ignoring the changes in markets and market conditions both in California and nationally since 1996 would also limit, in a way, the ability to market in California. The AMAA's trade barrier language is both strict and broad, and applies to price-setting.

Obviously all parties involved in this hearing put their blood, sweat, and tears into creating more demand for dairy products. If consumer demand could increase and end-product prices in turn increased, all would be better off. But merely reciting it, or even regulating it, does not make it so. Markets are driven from the top down, not the bottom up, and USDA cannot (nor should it) regulate consumers. The ultimate consumers determine how much milk is worth to them, and then suppliers and producers respond accordingly, not vice versa.

C. The Dairy Institute's Proposal Reflects Current Economic and Market Conditions in California, and is the Only Proposal to Do So.

USDA's required analysis of California's current market regulations should lead it to adopt the Dairy Institute's updated and accurate pricing proposals. The Dairy Institute developed and introduced significant evidence regarding the current state of the California dairy market, both from the production and manufacturing sides (as detailed below in Parts D and E). Considering the size of California's dairy industry, USDA cannot ignore the supply and demand realities of the market. Independent, neutral expert witness Dr. Mark Stephenson affirmed the Dairy Institute's conclusions in his highly complex, credible, and accurate model charting the California milk industry. All of this evidence unquestionably requires USDA to adopt up-to-date and market clearing prices appropriate for the marketing area.

Consequently, USDA must reject the Cooperative Order's adoption of prices from other orders that have no application to or relevance in a California FMMO for two primary reasons. First, the prices adopted by USDA during FMMO Reform have become outdated and fail to reflect the current dairy market. Second, prices USDA previously adopted during FMMO Reform did not contemplate California (and its 20% of national milk) being a part of the FMMO system. If the department thinks uniformity between FMMOs is necessary, it would need to put this proposal on hold and have a national hearing. In fact, if USDA wishes to adopt the FMMOs' Class III and IV prices for milk in a California FMMO, it must put this proposal on hold and institute a national hearing on Class III and IV prices. But under the AMAA, USDA cannot lawfully subject California for even one month, let alone longer, to an improper price for the sake of uniformity.

The Cooperatives' attempt to argue that price uniformity is akin to uniformity of other provisions (like voluntary pooling or performance standards) fails. The Dairy Institute does not propose abandoning any long-held principle of USDA or violating the provisions of the AMAA. In fact, the Dairy Institute is only asking that USDA give the California order the same care and consideration it gave to the other orders during FMMO Reform, and to each of the orders when they were initially promulgated. During reform, USDA did not decide that all orders had to have the same prices, but that the marketing conditions in all of the then-existing orders warranted similar prices. USDA is fully free – and, in fact, compelled by the AMAA – to undertake a full analysis of the California market to determine if it warrants similar or differing prices from other FMMOs.

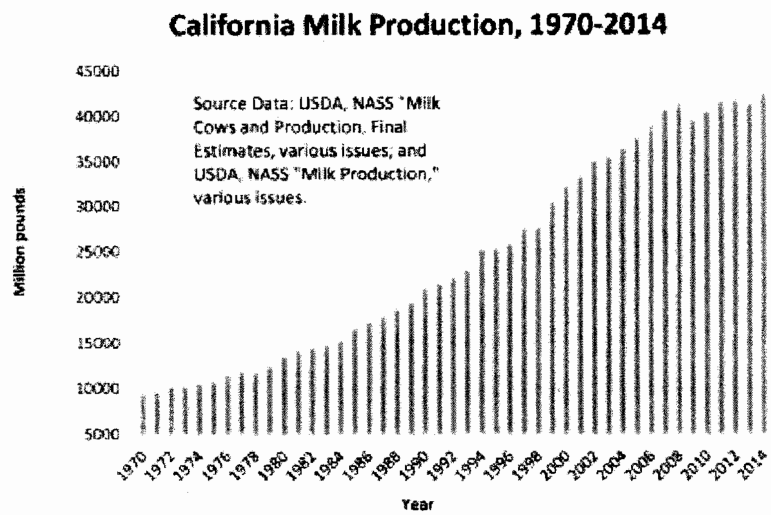
D. Analysis of Marketing Area for California FMMO.

1. Since FMMO Reform, California has experienced a trend of increasing milk production.

Step one of the USDA's analysis of the California dairy market is to consider the current production trends in the state. Production reflects the "supply" side of the supply and demand equation which serves as the economic guiding principle for a price analysis. Furthermore, production provides an unbiased, numbers-driven indicator of the health of the industry in light of current input and cost factors.

Without question, milk production in California has been on an upward trajectory for the last couple of decades. In fact, California producers have more than tripled their milk production since 1980 (through 2014). Ex. 91, at 4. Increased milk production in California is not an argument – it is a fact. The Cooperatives plainly and unequivocally admit these facts: "[T]he *rate* of milk production increases [ ] has been simply extraordinary. California milk production has [increased] by nearly 300% over the last 25 years. Year-over-year growth has been negative only twice in the last 26 years…" Ex. 51, at 3 (Testimony of Dr. Erba) (emphasis in original). This simple chart demonstrates the fervor with which production has increased over the last 45 years:

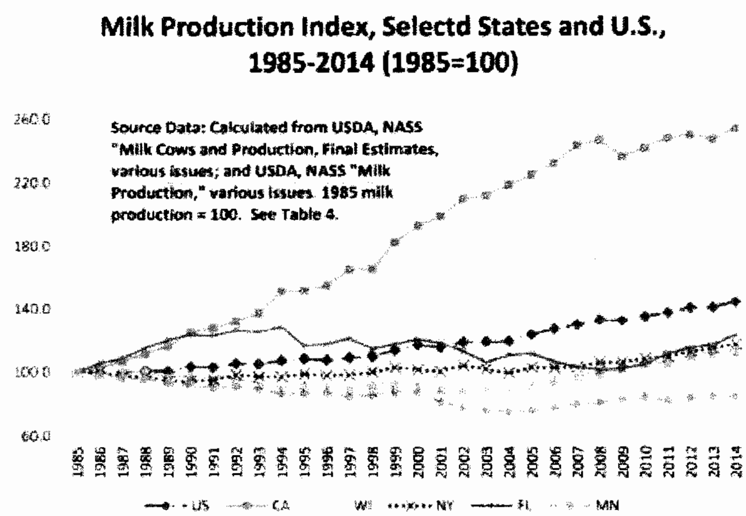
Figure 3.



Source: See Table 3.

Ex. 80, at 7 (Exhibits to Testimony of Dr. Schiek). This growth in California is unparalleled in other dairy states.

Figure 4.



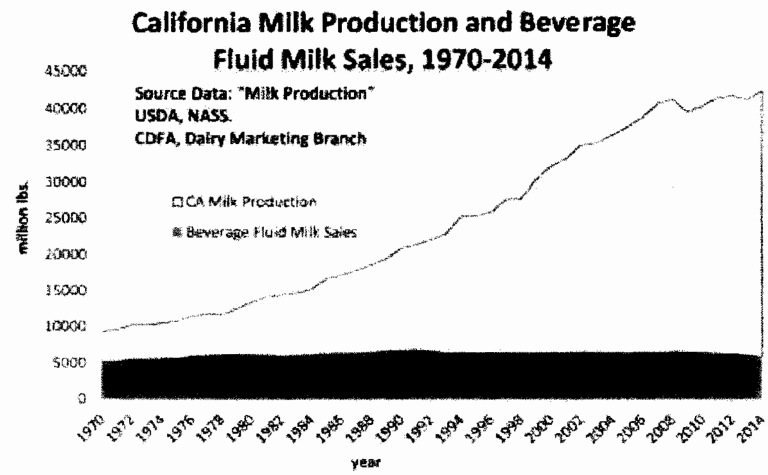
Ex. 80, at 9 (Exhibits to Testimony of Dr. Schiek).

A multitude of forces drove increased production in California, even in light of CDFA's regulatory prices. California's average cow-per-herd is among the highest in the U.S. Ex. 91, at 7 (Testimony of Mr. Dryer). Average costs of production, per hundredweight of milk produced, are lower in these larger herds found in California. Ex. 91, at 9 (Testimony of Mr. Dryer). In fact, California has the second lowest average costs of all states, lower than Wisconsin, New York, and Minnesota and only higher than Idaho. Ex. 91, at 9 – 10.

The Dairy Institute by no means wishes to downplay the financial stress that farmers testified to experiencing over the last several years. Manufacturers consider themselves to be on the same team as producers, working ultimately towards many of the same goals. Surely manufacturers could not exist if it were not for dairy farmers and their hard work. However, the point cannot be dismissed that amidst these economic pressures, dairy farmers continued to produce milk in record volumes.

It is important to recognize that the enormous increase in production was not demand driven, but a result of increasing efficiencies and a drive towards profits. As is well-known in the industry, Class I sales have stalled and have no correlation with the frenzied growth in California milk production (as demonstrated by Figure 7 below).

Figure 7.



Source Data: See Table 3 and Table 12.

Ex. 80, at 17 (Exhibits to Testimony of Dr. Schiek).

California's advantages in its economies of scale are not sufficient to explain this unparalleled growth in the face of such significant decreases in the industry's highest value sector. The continued push for profits and lack of effective production controls has left the market oversaturated. The production-side of the California dairy market needs a period of readjustment to counter the effects of this growth. As stated by the Milk Producers Council:

> The dairy industry in California continues in its addiction of over-production of milk. Dairy producers seem to have only one clear focus: produce more milk. As costs go up, as milk prices decline, we product more milk. As coops battle to place milk and milk products, we produce more milk. With 3x milking, rBST, advancing genetics, gender-specific semen, we produce more milk… [T]he reality is, dairymen produce in an unrestrained fashion with no consideration of demand, leaving the industry in a perpetual state of overproduction which causes a myriad of problems…

Ex. 92, at 1 (November 2008 Newsletter by Sybrand Vander Dussen, Milk Producers Council President).

Notwithstanding current global market and local production levels, the fact that California dairymen continue to produce milk at the rate they are serves as an initial clear indicator of the health of the California dairy industry. As stated by the Cooperatives, "[i]f local prices were not adequate to cover [a high cost production area], you would experience a declining milk production industry. In an area where milk production costs are below available prices, you might expect expanding milk production." Tr. 2553: 10 – 12 (Testimony of Mr. Christ). As production expanded in California and exceeded willing capacity, USDA can only conclude that prices exceed costs for at least a majority of farmers. USDA needs to set prices at a level that send the proper production signals to California producers based on the current realities of high levels of production and nearly-saturated manufacturing capacity. Overvaluing milk has caused production problems in the past. In 2007, California did just that – it overvalued the milk and it stimulated production beyond what capacity could handle. Tr. 5322: 1 – 10 (Testimony of Ms. Taylor). Increased prices will lead to increased production. Ex. 116, at 4 – 5 (Testimony of Ms. Taylor); Tr. 5302: 1 – 8 (Testimony of Ms. Taylor). It is a simple market concept and undoubtedly will be the case in California.

The current market conditions provide no basis for USDA to drive up California's production through artificially high prices unsupported by demand. Milk Producers Council acknowledged this reality in its November 7, 2008 newsletter: "We don't need Sacramento. We don't need minimum prices. We don't need the support price program." Ex. 92, at 6 (November 2008 Newsletter by Sybrand Vander Dussen, Milk Producers Council President). California farmers need to recalibrate the production levels in the state, and USDA will disrupt any chance of that adjustment if it sets mandatory prices above market-justified levels. Increased prices will transform the rising tide of California production into a tidal wave that will overwhelm manufacturing capacity and disrupt the national milk market.

The Cooperatives' focus on the recent 15-month trend in milk production which is too narrow in light of the 30+ year trend that shows dramatic gains. Historically, when looking at price level changes, USDA has instead focused on longer-term production declines:

> The record of this proceeding reveals that *for many years* production has declined in the southeast region and supplying the region with

> supplemental milk has demanded the sourcing of milk supplies from ever farther distances from the marketing areas.

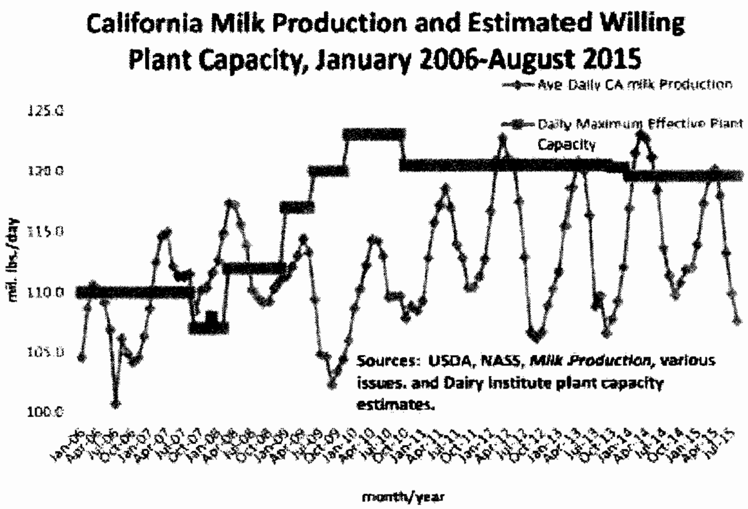
Milk in the Appalachian, Florida and Southeast Marketing Areas, 79 Fed. Reg. 12963, 12976 c.3 (March 7, 2014) (emphasis supplied). Over-order premiums can deal with a 15-month trend. Tr. 4324:6 – 19 (Testimony of Mr. Dryer); 4402:3 – 8 (Testimony of Mr. de Jong). Additionally, this temporary decrease in production reflects a long-delayed recalibration that the California market needs to undergo. What is happening with production must be put into context with the significant problem of imputing revenues to plants that they cannot in turn obtain from the marketplace. As discussed below, this in turn is a function of the risks inherent in using dated pricing that does not consider location values.

2. Since FMMO Reform, manufacturing capacity in California has been largely saturated.

Step two of the USDA's analysis of the California dairy market is to consider the current manufacturing capacity in the state. Manufacturing capacity reflects the "demand" side of the supply and demand equation for milk in the marketing area.

The following chart maps California milk production alongside estimated willing plant capacity based on data published by National Agricultural Statistics Service (as listed in Exhibit 80, Table 1) for all classes from January 2006 until August 2015.

Figure 2



Source: See Table 1.

Ex. 80, at 2.

As shown by the chart, producers largely meet milk demand (a.k.a, plant capacity) in California. In the 2006 – 2008 period, there were as many as 19 months when milk production in the state *exceeded* willing capacity. Ex. 79, at 28; Tr. 3639: 2-5 (Testimony of Dr. Schiek). The excess milk had to be moved to out-of-state plants located in states as distant as Idaho, Texas, and New Mexico. From the second half of 2008 until 2012, plants had some capacity after a decline in milk output, the opening of new plants, and the expansion of others. *Id.* But by early 2012, milk production was again outpacing plant capacity. Producers exceeded plant capacity again in 2014. *Id.*

The Cooperatives agree with this assessment. "About five years ago, the California dairy industry began to recognize that a problem was brewing – gains in milk production were far outstripping gains in milk processing capacity." Ex. 51, at 5 (Testimony of Dr. Erba). In fact, according to the Cooperatives' estimation, on average only 5% - 10% of processing capacity sits idle. "Given that seasonal fluctuations in milk supply do occur in California, this puts California production during the spring flush months of March, April, and May very close to the State's processing capacity. *There are no short-term fixes available to increase processing capacity…*"

Id. at 5–6 (Testimony of Dr. Erba) (emphasis supplied); see also Ex. 7678:15 – 24 (Testimony of Mr. Hollon) (explaining that, under the Cooperative Order, transportation allowances would not be extended to out-of-state-producers because "there's adequate milk supplies in the state to meet the needs."). Manufacturers affirmed this conclusion at the hearing, testifying that production currently meets their manufacturing demand needs. Producers easily fulfill Class 1 needs in California. Ex. 91, at 6 (Testimony of Mr. Dryer).

In fact, California manufacturers run into problems dealing with the oversupplies of milk. For example, in 2006 HP Hood reported having to take the drastic step of enforcing volume caps in their purchase agreements, because they could no longer find a home for all of the excess milk. Ex. 97, at 3 and Tr. 4368:3-10 (Testimony of Mr. Newell). While HP Hood had previously sought to help their suppliers by accepting milk in excess to what they had agreed to purchase in their contracts, this approach became untenable with the significant surplus of milk they were receiving. Tr. 4351:1–4352:3 (Testimony of Mr. Newell).[34]

The Cooperatives have sought to address the problem of excess milk production by enforcing caps on production in the form of base plans.[35] *See, e.g.*, Ex. 21, at 5 (Testimony of Mr. Kasbergen); and Ex. 39 (Article, "Land O'Lakes Western Initiating Supplemental Base Reduction Measures"). These plans were instituted in the last six or seven years, around the time that Land O'Lakes had to start moving milk out of state due to plant capacity issues. Tr. 975:1–10 (Testimony of Mr. Kasbergen). However, the state does not mandate these base plans and the Cooperatives can terminate them at any time. Tr. 974:4–20 (Testimony of Mr. Kasbergen). And the effectiveness of these plans must be questioned. These plans did not prevent the capacity issues in 2012 that led to Land O'Lakes moving milk out of state. Tr. 1661:1–14 (Testimony of Mr. Wegner) and Tr. 1734:15–1735:18 (Testimony of Mr. Wegner). Additionally, even in light of the intense increases in production and tight capacity issues of the last two decades, one

[34] An overvalued mandatory minimum in the form of whey factor values led to this result. Ex. 97, at 4.

[35] Not to be confused with the "base plans" temporarily authorized by Congress in 1965 - 1999 discussed, for example, by Mr. Christ at Tr:2455:25 (Ex. 58, at 7). The two are totally separate and unrelated concepts.

farmer testified that he has never had the base plan enforced for his milk. Tr. 1012: 16 – Tr. 1013: 20 (Testimony of Mr. Fernandes). The limitations of the effectiveness of such base plans have been questioned before:

> Cooperative efforts to control production have met with variable success. To be effective, such voluntary programs require complete control of the market. Cooperatives seldom control 100 percent of the producers in a market. Even where they do control a very substantial proportion of the volume, they have been unable to restrict entry of new producers. Within the present legislative framework, there appears to be little likelihood, that cooperatives will, on a voluntary basis, be able to effectively control the normal production response to higher prices on a national basis.
>
> This is not to suggest that cooperatives on an individual local market or regional basis might not have at least short or even intermediate term success in restricting production and, on that basis, raise producer returns."

AMS Knutdsen report, Milk Pricing Policy and Procedures, Part I, at 14-15; found at http://dairy.wisc.edu/PubPod/Reference/Library/Knutson,etal.1972.pdf. Notably, even when such plans are in place and at their most effective, they cannot restrict production (just payment for such production). Additionally, they are conditional and only apply at times of insufficient plant capacity. Thus, even under the best case scenario (an unlikely scenario, at that), base plans are a weak solution to a large problem.

The Cooperatives themselves have vastly decreased their own cheese manufacturing capacity, even in light of an alleged "California discount." Ex. 98, at 11 (Testimony of Mr. de Jong). A DFA cheddar cheese plant in Petaluma closed May 2004, a DFA cheese plant in Corona closed December 2007, and a LOL cheese plant in Tulare closed September 2010. Ex. 98, at 11 (Testimony of Mr. de Jong). One cooperative also had to take some rather dramatic steps to reduce its incoming milk supply in light of the strained capacity. Ex. 79, at 28 (Testimony of Dr. Schiek) and Ex. 39 (Article on LOL Supplemental Base Reduction).

3. California's market has unique features not found in other FMMO area markets.

California produces approximately 20% of the nation's milk. CDFA Bi-Annual and Annual Summaries, Statistics and trends Annual Tables and Data 2015, found at https://www.cdfa.ca.gov/dairy/dairystats_annual.html. In the 19 years from 1995 to 2014, California milk supplies had increased by about 67%, with western states milk supplies increasing by more than 82%. Ex. 133, at 8 (Dr. Stephenson Study). During the same period, the California population had increased by 23% and the western states by 34%. Milk production has far outpaced local demand in the region. *Id.*

The per-capita consumption of milk and dairy products has also risen over that 19-year time period, but not at the same rate as production growth. Taking into account the per capita demand for milk and dairy products, California had a 7.2 billion pounds net surplus of milk in 1995, which increased to a 18.7 billion pound surplus in 2014. As a region, the western states are about 34.4 billion pounds net surplus. *Id.*

A large percentage of California's manufacturers are cheese plants. California Dairy Statistics Annual 2015, at 11, found at https://www.cdfa.ca.gov/dairy/pdf/Annual/2015/ 2015_Statistics_Annual.pdf. Just three of those cheese plants processed more than 56% of the 4b milk in the state, which means they processed in excess of 25% of the state's entire milk supply. Ex. 91, at 16. In other words, three cheese plants process one-fourth of all of the state's milk. To put this result in context for the greater dairy industry, on an annual basis these three plants process more milk than is *produced* in 45 of the 50 states. Ex. 91, at 16.

California manufacturers produce large amounts of Monterey, Cheddar, and Mozzarella cheeses. CDFA, 2015 Annual Dairy Data, available at http://cdfa.ca.gov/dairy/uploader/docs/ DataArchives /2015AnnualDairyData.xlsx (last visited Mar. 29, 2016). California also has significant Hispanic cheese manufacturing. *Id.* California manufacturers also make other products, including butter, nonfat dry milk, ice cream, sour cream, buttermilk, cottage cheese, and yogurt. *Id.* As of February 2015, the manufacturing plants operating in California included 63 cheese plants. Information regarding all manufacturing dairy plants in California can be found at: CDFA, California Dairy Plant List (2015), available at https://www.cdfa.ca.gov/ dairy/pdf/CaDairyPlantList.pdf (last visited March 29, 2016).

California has sufficient population and demand for most fluid milk finished products to be marketed locally. When simulating the lowest-cost (in other words, the most efficient) movement of fluid milk from farms to plants to consumers, California milk can move almost exclusively within the state. The below map shows the most efficient movement of milk from farms to plants to demand centers. The green lines represent the movement of milk from a producer to a plant (indicated by a triangle). Triangles or plants with no obvious green line have a local milk supply. The orange lines represent the movement of the finished product from the plant (indicated by a triangle) to a demand center (indicated by a square). As shown in the California portion, producers and manufacturers only have to make local shipments to get fluid milk to the market.

Figure 1. Least-Cost Fluid Milk Processing Locations and Flows, USDSS Primal Solution, March 2014.

Ex. 133 at 4.

On the other hand, the primary market for California's finished cheese products is located a substantial distance east of the state. Simulating the lowest-cost (most efficient) movement of cheese products from farms to plants to markets shows that this movement is only local in nature for the farm to plant transaction. As overwhelmingly demonstrated in the table below, cheese products from California are most efficiently marketed east of the state, to Texas and the East

Coast. While California manufacturers can market their cheese in California, there is ample evidence of cheese from elsewhere being marketed in California and displacing California-produced cheese. *See, e.g.*, Tr. 4884: 2–16, (Testimony of Mr. Moore and Mr. de Cardenas) (discussing the sale of Cabot Cheese from Vermont in California). Thus, even more California cheese necessarily must be sold east in order to be successfully marketed. Ultimately, the market for finished cheese products from California is primarily *not* California, but demand centers much further east.

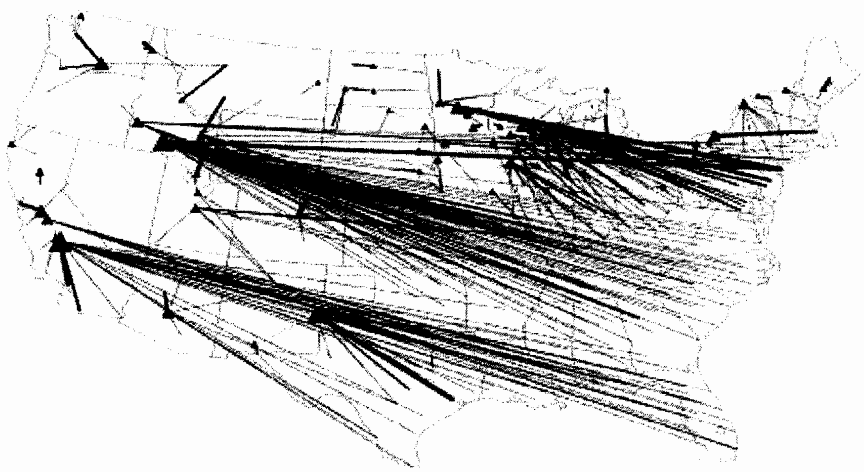


Figure 2. Least-Cost American Cheese Processing Locations and Flows, USDSS Primal Solution, March 2014.

Ex. 133 at 4.

While the milk market for manufacturers purchasing milk must be local, the market for manufacturers selling finished cheese products is national. Due to the extreme cost and perishability of the product, the most efficient movement of milk for processing requires that the plant be located closely to the production center or farm. However, locations east of the Rockies are the primary market for cheese products from California, requiring increased transportation and distribution costs. This means that the wholesale price for cheese in California that can generate value for dairy farmers must be less f.o.b. California than f.o.b. Wisconsin. *See* Ex. 135, at 9 (Testimony of Ms. Taylor) ("The cost of trucking cheese from our California plants to the Midwest where many of our customers who produce frozen foods or shred and package cheese for retail distribution around the country are located is in excess of $0.10 per pound and the cost of trucking to the northeast and southeast is roughly $0.15 per pound, plus or minus a penny depending on location."); *and* Tr. 4234: 20 – 4235:1 (Testimony of Mr. Dryer) ("The argument that California cheese plants can afford to pay the same price as those in the Midwest is false, given the cost of doing business in California including transportation of product to population centers in the East. It costs about 12 cents per pound to ship cheese from California to the Midwest and about 16 cents to the East Coast."

E. Only the Dairy Institute's Proposal Sets Prices at the AMAA's Required Up-to-Date and Market Clearing Levels.

Step three of the USDA's analysis is, in fact, the simplest of all – identify where supply meets demand. As noted above, the result from this step is referred to as the "market clearing" price. Adoption of outdated, unrelated FMMO prices wholly ignores this step and results in prices that the market cannot support. Ample record evidence supports the conclusion that only the Dairy Institute's proposal properly takes into account the unique features of a California dairy market and results in market clearing prices.

1. The Dairy Institute's prices send proper market signals to producers regarding their rate of production.

The Dairy Institute's Proposal considers the historic production increase in California and seeks to balance that production while still meeting the goals of the Declared Policy of the AMAA. While prices will nonetheless increase moderately under the Dairy Institute Proposal, it would result in a softer upward production trend than the intense upward trajectory of California milk production that would result from the Cooperative Order. Increased prices indicate to farmers that manufacturers need more milk and it is worth your while to produce it. However, as demonstrated above, manufacturers in California are seldom in need of more milk. If USDA considers the long-term production trends in California, as it did in the Southeastern United States in establishing higher "temporary" Class I differentials, it must accept that the Dairy Institute's Proposal is the only proper mechanism by which to address that production.

With the known historic pattern of increasing milk output from California's dairy farms, the even higher prices proposed by the Cooperatives will only exacerbate the disconnect between supply and demand. USDA's Preliminary Regulatory Impact Analysis confirms this hypothesis, showing that California production will grow, on average, 54 million pounds per year under the Cooperative Order over the baseline.

TABLE B5: Milk Production Changes under the Cooperative Proposal

	Units	2017	2018	2019	2020	2021	2022	2023	2024	Average	Min	Max
U.S. Milk Production	Bil. LBS	0.41	0.60	0.60	0.61	0.62	0.62	0.62	0.60	0.58	0.41	0.62
NE Milk Production	Bil. LBS	0.00	-0.01	-0.01	-0.02	-0.02	-0.02	-0.02	-0.02	-0.01	-0.02	0.00
AP Milk Production	Bil. LBS	0.00	-0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.01	0.00
FL Milk Production	Bil. LBS	0.00	0.00	-0.01	-0.01	-0.01	-0.02	-0.02	-0.02	-0.01	-0.02	0.00
SE Milk Production	Bil. LBS	0.00	0.00	-0.01	-0.01	-0.02	-0.03	-0.05	-0.07	-0.02	-0.07	0.00
UM Milk Production	Bil. LBS	0.00	-0.02	-0.06	-0.08	-0.10	-0.12	-0.14	-0.15	-0.08	-0.15	0.00
CE Milk Production	Bil. LBS	0.00	0.00	-0.01	-0.02	-0.02	-0.02	-0.03	-0.03	-0.02	-0.03	0.00
ME Milk Production	Bil. LBS	-0.02	-0.03	-0.03	-0.03	-0.03	-0.03	-0.04	-0.04	-0.03	-0.04	-0.02
PN Milk Production	Bil. LBS	0.00	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	0.00
SW Milk Production	Bil. LBS	0.00	-0.02	-0.05	-0.07	-0.10	-0.12	-0.14	-0.17	-0.08	-0.17	0.00
AZ Milk Production	Bil. LBS	0.00	0.00	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	0.00
CA Milk Production	Bil. LBS	0.32	0.41	0.49	0.54	0.59	0.62	0.66	0.69	0.54	0.32	0.69
FW Milk Production	Bil. LBS	0.12	0.29	0.31	0.33	0.36	0.38	0.41	0.44	0.33	0.12	0.44
UW Milk Production	Bil. LBS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
HIAK Milk Production	Bil. LBS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Ex. 5, at 27 (emphasis supplied). By comparison, the Dairy Institute's Proposal would generate a much more modest rate of growth of 6 million pounds per year over the baseline.

TABLE B53: Milk Production Changes under the Dairy Institute Proposal

	Units	2017	2018	2019	2020	2021	2022	2023	2024	Average	Min	Max
U.S. Milk Production	Bil. LBS	0.19	0.44	0.53	0.54	0.52	0.49	0.46	0.42	0.45	0.19	0.54
NE Milk Production	Bil. LBS	0.00	0.01	0.01	0.01	0.00	-0.01	-0.02	-0.02	0.00	-0.02	0.01
AP Milk Production	Bil. LBS	0.01	0.01	0.00	0.00	0.00	0.00	-0.01	-0.01	0.00	-0.01	0.01
FL Milk Production	Bil. LBS	0.00	0.01	0.01	0.01	0.01	0.01	0.01	0.00	0.01	0.00	0.01
SE Milk Production	Bil. LBS	0.00	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.00	0.01
UM Milk Production	Bil. LBS	0.00	0.12	0.20	0.25	0.29	0.31	0.32	0.33	0.23	0.00	0.33
CE Milk Production	Bil. LBS	0.00	0.01	0.02	0.02	0.02	0.02	0.02	0.01	0.02	0.00	0.02
ME Milk Production	Bil. LBS	0.04	0.04	0.01	-0.01	-0.03	-0.04	-0.06	-0.07	-0.01	-0.07	0.04
PN Milk Production	Bil. LBS	0.01	0.01	0.01	0.00	0.00	-0.01	-0.01	-0.01	0.00	-0.01	0.01
SW Milk Production	Bil. LBS	0.01	0.06	0.11	0.14	0.16	0.17	0.18	0.17	0.13	0.01	0.18
AZ Milk Production	Bil. LBS	0.00	0.00	0.00	0.00	-0.01	-0.02	-0.03	-0.04	-0.01	-0.04	0.00
CA Milk Production	Bil. LBS	0.08	0.10	0.08	0.06	0.04	0.03	0.04	0.03	0.06	0.03	0.10
FW Milk Production	Bil. LBS	0.03	0.07	0.05	0.03	0.02	0.01	0.01	0.01	0.03	0.01	0.07
UW Milk Production	Bil. LBS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
HIAK Milk Production	Bil. LBS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Ex. 5, at 42 (emphasis supplied).

If California milk producers are producing too much milk, they cannot solve their economic woes by shifting their problems to others throughout the FMMO system. Indeed, the economic model prepared by the USDA shows that there will be a negative effect on the prices received by milk producers through the Federal Milk Marketing Order system if California enters and the California producers also continue to receive a quota price for their milk. See Ex. 5, at 26–30 (Preliminary Regulatory Impact Analysis).

2. The Dairy Institute's prices reflect the actual costs and needs of manufacturers – their demand – and thus are the only appropriate prices for a California FMMO.

The Dairy Institute's Proposal adopts minimum prices which reflect the actual demand of manufacturers in relation to the supply described above based on evidence of their current costs and manufacturing capacity.

While higher prices will incentivize production beyond current demand, it will in turn actually *decrease* demand as manufacturers cannot afford to purchase milk at increased prices. Setting minimum prices that are too high can shut down processing capacity which cannot afford to profitably purchase and process the milk. Ex. 98, at 8 (Testimony of Mr. de Jong); Ex. 107, at 11 (Testimony of Mr. Hofferber) ("To build a guaranteed price level at too high a cost to us, removing any ability to mitigate the costs of clearing the market in times of excess supply, would certainly put our operation at greater risk than we already face [under current whey prices].").

To put it plainly, California's manufacturers cannot afford the extreme increase in prices in the Cooperative Order. Outdated milk price formulas resulting in artificially high regulated minimum milk prices today cannot reflect today's market – in other words, while farmers may be (more than) willing to sell milk at these prices, manufacturers will *not* be willing to purchase it. There will be no intersecting point between the supply line and the demand line on that graph. USDA cannot adopt a proposal with that result and remain consistent with its policy of setting market clearing prices.

Dairy Institute's updated prices reflect a few key realities of manufacturing dairy products.

1) Recognized the location value of milk used in making manufactured dairy products by adjusting national prices to account for the lower prices received by dairy manufacturing plants operating in California.

2) More accurately captures the value of whey to the spectrum of cheese plant operations inside (and outside) California by accounting for how the bulk of the whey stream is actually used.

3) Reflects more current costs of manufacturing block cheddar cheese, which is by far the dominant form of cheddar cheese manufacturing in California, and costs for manufacturing butter and nonfat dry milk. Accurate representations of current manufacturing costs are crucial for end-product pricing formulas to properly reflect the value of milk to a dairy product manufacturing plant.

4) Will not over-value producer milk in California as the Cooperatives' Order does by failing to take the above analysis into account.

An over-valued minimum milk price will be especially felt by cheesemakers, a devastating result for California's cheese-heavy manufacturing class.[36] "[Hilmar] expects that the current FMMO Class III and IV pricing, if applied to a California marketing order combined with mandatory pooling, will result in extended periods of net losses to California manufacturing plants and depressed prices for California milk producers." Ex. 98, at 32. Hispanic cheese makers in particular will undoubtedly be victim of unjustified high prices. Ex. 105 (Testimony of Mr. Maldonado). Cacique testified as to how operating costs in California and transportation costs to other markets has already left them at a price disadvantage to their competitors in places like Texas, Ex. 108, at 3 (Testimony of Mr. de Cardenas and Mr. Moore), a problem that would be exacerbated by further increased prices. Pacific Gold Creamery – a cheese company owned and operated by dairy farmers – is in a unique position to understand the struggles of both cheese manufacturers and producers in California. Mr. Vandenberg, testifying on behalf of Pacific Gold Creamery, stated that his company utilizes whey in the most efficient manner it can, and still is barely able to break even notwithstanding CDFA's Class 4b prices (which the Cooperative Order would increase substantially). Pacific Gold can barely survive at the so-called California

[36] Additionally, California's manufacturing growth has mostly been bulk commodities plants which command lower margins than other specialty plants. Ex. 91, at 15 (Testimony of Mr. Dryer).

discount. Ex. 119, at 3 (Testimony of Mr. Vandenberg). Production realities of cheese and the resulting whey stream do not support the artificial valuation of whey that the Cooperatives seek. *Id.* (Ex. 119, at 3 – 4). California has already seen how unsupported Class III level whey values can lead to a loss of investment. The high whey prices in California in the 2000s led to Hilmar making such a decision and building a new plant in Dalhart, Texas, instead of California. Tr. 4392:9–21 (Testimony of Mr. de Jong).

USDA does not need to see individualized balance sheets or profitability analyses to appreciate the magnitude of the impact of overvalued prices on manufacturers. The Preliminary Regulatory Impact Analysis shows an annual Class III increase of $1.84 per hundredweight, resulting in a combined cost of $196.5 million annually combined for the three cheese plants that process the one-fourth of California milk. Ex. 91, at 16 (Testimony of Mr. Dryer). This increase represents a 10% increase in the cheese's gross value. Ex. 91, at 6. Regardless of the specific operating expenses of these plants, "[i]t is unrealistic to believe an increase of such magnitude could be absorbed without threatening their viability." *Id.*

Class III and IV prices impact all classes, so the magnitude of the pricing decisions related to these classes cannot be overstated. Considering that the Class III and IV prices are inflated under the Cooperative Order, building the Class I and II prices upon those prices will only compound the problem. Class III and IV are the platform for the pricing system – when the market fails to support the higher prices brought on by those misguided pricing levels, Classes I and II will follow like dominos. Even without considering this compounding negative effect, the Class I price proposed by Cooperatives fails on multiple levels, as discussed below in Section VII, Part I. The Dairy Institute's Proposal provides a strong, supported (by law and fact) based upon which USDA can build an FMMO pricing system.

Even CDI has admitted that the California market does not align with FMMO prices: "an acceptable level of price difference between California prices and federal order prices is demonstrated." Ex. 53, at 8 (page 55 of the Exhibit, lines 1 – 3) (Testimony of Dr. Erba before CDFA Dairy Marketing Branch 5/20/2013). A study commissioned by the Cooperatives from

Drs. Mark Stephenson and Chuck Nicholson (which they have refused to put into the Record) confirms that the "California price for milk used for cheese ought to be 70 cents less than the Federal prices." Tr. 2131:12 – 2132: 15 (Testimony of Dr. Erba).

Manufacturers cannot pass these increased costs on to wholesale consumers. No record evidence supports the alternative – that prices can be increased without a significant impact on demand. To relay the producers' price increases to consumers will spell disaster for all, as it will only drive more consumers away from dairy products and into the welcoming arms of more affordable alternatives.

Raising minimum prices above market clearing levels for milk used to make manufactured products will also disrupt one of California's primary markets – international exports. When the U.S. regulated minimum milk prices are set too high, manufacturers have less flexibility to withstand global market downturns and remain consistent suppliers to international customers. Ex. 98, at 27 (Testimony of Mr. de Jong). This is especially true for California, which has a large percentage of butter and powdered milk. Ex. 98, at 13 (Testimony of Mr. de Jong). "The California market for milk and its products is uniquely dependent upon product exports. In recent years, nearly 30% of California milk solids have been exported…." Ex. 98, at p 25 (Testimony of Mr. de Jong). These features further highlight the need for USDA to consider supply and demand "in the marketing area" under 608c(18). If USDA adopts the Cooperative Order, California would not only be at a disadvantage in regards to other international suppliers, but also in its competition with other domestic suppliers seeking to sell dairy products to those international customers.

The loss of manufacturing capacity due to overvalued minimum prices reverberates through the entire dairy industry. Such a loss leaves farmers without a purchaser for their milk. Ex. 98, at 8 (Testimony of Mr. de Jong). It also harms the economy as a whole, with the resulting loss of investment and loss of jobs for plant workers. Ex. 98, at 8 (Testimony of Mr. de Jong). National commodities customers would then seek competitively priced cheese from other sources within the U.S. Ex. 98, at 30–31 (Testimony of Mr. de Jong).

A short-sighted decision to sacrifice manufacturers for the sake of increasing producer profits will have long-term negative effects on the local, national, and international health of the dairy industry. A California FMMO would result in 20% of the nation's dairy being incorporated into the FMMO system. This massive influx of milk, coupled with the Cooperatives' proposed increase in prices, would in fact cause disorderly marketing conditions. Tr. 6023:16 – 6024:4 (Testimony of Dr. Stephenson). Eventually, "markets will win." Tr.6024:17 – 18 (Testimony of Dr. Stephenson). "At some point along the way they are going to have to express what they need to express in one form or another, and if we regulate a minimum price above market clearing levels, there are relatively few release valves for that kind of a problem." Tr. 6024:18 – 22 (Testimony of Dr. Stephenson).

3. The unforgiving nature of a "minimum" price requires USDA to set the price well within market-clearing levels.

Normal markets balance the disparity of supply outpacing demand in one of two ways: 1) decreasing the price to meet demand; or 2) decreasing demand to meet the price. The problem with USDA setting the price above a market clearing level is that they are setting a "minimum" price – there will be no room left to decrease the price. While normally a corresponding decrease in price accompanies a run-up in production unmet by demand (as demonstrated by simple supply and demand laws), the Cooperative Order's minimum prices system will not allow for this natural market-correcting effect. Thus, USDA would leave California only with Option 2 – decreasing demand in the form of manufacturers decreasing production, closing entirely, or moving their operations to a different market.

Premiums complement minimum prices set below market clearing levels so that manufacturers purchase milk at its actual value. Current CDFA prices are only minimums – individual producers and cooperatives have the ability to seek higher prices if they are so justified. Ex. 98, at 9. If producers are not able to obtain the prices they desire, then it can only be concluded that the demand that raises premiums over the minimum price does not exist. To put it plainly, the milk is not worth more than the minimum price being paid. In the last CDFA hearing in June 2015, Pete Garbani (VP of Member Relations for Proponent Land O' Lakes) was asked by CDFA what prevents LOL from getting what they think 4b milk is worth; he replied, "supply and demand." Cal. Dept. of Food and Agric., Department of Marketing Branch Hearing, June 3, 2015, Tr. 293:18–20 (Testimony of Mr. Garbani); *see also* Ex. 98, at 10 (Testimony of Mr. de Jong). Cooperatives know that the market cannot value milk at the level they wish to recover, so they are seeking regulations to enhance the price to their desired level.

Destroying room for premiums makes the FMMO minimum, in fact, a regulated maximum price. USDA's authority is limited to setting *minimum* prices, leaving room for premiums to work as intended. For example, Hilmar has paid $120 million in premiums over the last several years. Ex. 98, at 10 (Testimony of Mr. de Jong). However, with the temporary CDFA change to the 4b formula raising prices, those premiums have gone down. Ex. 98, at 10 (Testimony of Mr. de Jong). The market mechanism of premiums ensures that milk receives its true value on the market. If the regulated minimum rises through that premium margin, it takes away the market's ability to value milk. It also prevents milk from moving to its highest and best use. *Id.*; see also Ex. 116, at 3–4 (Testimony of Ms. Taylor), and Tr. 5858: 13 – 16 (Testimony of Mr. Vetne). USDA policies are supposed to encourage (not discourage) both of these results, which is why it is limited to setting minimum prices.

The unforgiving nature of this regulated minimum price is softened for cooperative-owned manufacturing plants. As with mandatory pooling, the strain from overly-high prices will be felt exclusively by private manufacturers, with cooperative manufacturing facilities being able to counterbalance their losses on the manufacturing side with the higher profits on the producer side. Ex. 133, at 9 (Dr. Stephenson Study). In fact, when the Pacific Northwest experienced prices above market-clearing levels, the effects were minimized as most of the milk was cooperatively marketed and they were able to reblend the lower milk price back to its member-owners. Ex. 133, at 9. "The same mechanism cannot be implemented for proprietary transactions." *Id.*

F. The Cooperatives Introduced no Reliable Evidence Supporting Their Proposed Price Levels.

Neither the Cooperatives nor any other party have introduced sufficient evidence to justify their proposed pricing levels based on the current dairy market. When the factual evidence failed to support the Cooperative Order prices, they turned to generalized justifications for price enhancement for price enhancement's sake. Arguments for enhanced prices for dairy farmers have no business at an FMMO hearing and no basis in the AMAA. Letters of Sept. 17, 2012, from Agriculture Secretary Vilsak and AMS Deputy Administrator for Dairy Programs), also published online at: http://www.dairyprogramhearing.com/getfile55055505.pdf?dDocName = STELPRDC5100786.

An examination of the specific evidence serving as the foundation for the Cooperatives' prices reveals a total dearth of reliable (or even existing) factual support. The Cooperative Order fails to rely on any correlation to current market conditions or realities. For example, the Cooperatives did not know if the cost conversion that serves as the 70 cent Price II differential had changed since FMMO Reform, 64 Fed. Reg. at 16104. Nor did Cooperatives study that conversion for this proceeding. *Id.* Thus, the Cooperatives cannot say if the market justifies, or can even bear, their proposed Class II price. Cooperatives have done no price elasticity studies, nor are they basing their proposal on any known, current study from USDA. Tr. 1363:8–22 (Testimony of Mr. Hollon). The Cooperatives acknowledge that Class I sales have fallen and that Class I processors face increasingly challenging markets, but then invested no time or resources into ensuring that their proposal would not exacerbate these problems. The Cooperatives have done no analysis of the increasing basis risk as a result of their PPD allocation. Tr. 1610:1 – 13. (Testimony of Mr. Wegner). The Cooperatives have done no study of the impact that their omission of a fluid carrier in Class I prices would have on Class I handlers. Tr. 1613: 3 – 14 (Testimony of Mr. Wegner). The Cooperatives did not provide the Record with any study of what the National Price Surface looks like post-1999. Tr. 3235:3–9 (Testimony of Mr. Schad), nor have the cooperatives done any study of the impact of their proposed prices on manufacturers. Tr. 3240:5 – Tr. 3241:15 (Testimony of Mr. Schad).

The Cooperatives' sole arguments for increasing prices are that dairy farmers are not receiving enough money to cover their costs and that the existing FMMO prices should be extended to and uniformly imposed on California. While the Dairy Institute sympathizes with the struggles of dairy farmers, this allegation is neither reflected in the production data above nor the proper basis for setting prices in an FMMO. Congress never intended for the AMAA to serve as a price enhancing tool, divorced from the realities of the market (contrary to the Cooperatives' argument). And, as discussed above, USDA must rely on current marketing conditions in California, and not incorporate *val non*, the FMMO prices. The AMAA clearly provides that the Secretary shall not utilize parity prices when those prices are not reasonable as defined under 7 U.S.C. §608c(18). For over 50 years, USDA has consistently concluded that parity prices are *not* reasonable and has established minimum regulated prices based instead on market area economic conditions in light of demand and supply conditions. 30 Fed. Reg. at 13158, c.3 (Tampa Bay Decision). It is readily apparent that the Cooperatives for their Cooperative Order prefer to "whistle past the graveyard" when it comes to any USDA Declared Policy that interferes with their results oriented demands.

Most recently, USDA, in rejecting dairy farmer emergency requests for a FMMO national hearing to address low dairy farmer milk prices, restated its position that FMMOs are *not* a price or income support program: "[T]he Federal Milk Marketing Order (FMMO) program is not designed to be a price or income support program since it is not authorized to establish minimum prices above the relative market value of the products of milk." Ex. 112, at 51 – 53, (Letters of Sept. 17, 2012, from Agriculture Secretary Vilsak and AMS Deputy Administrator for Dairy Programs), also published online at: http://www.dairyprogramhearing.com/getfile 55055505.pdf?dDocName=STELPRDC5100786. USDA should certainly not depart from this well-reasoned principle now.

G. California is a Unique Market that Requires Individualized Pricing.

A number of features make the California dairy market unique from other order areas. In addition to the current factors discussed above, these factors warrant lower comparative prices in a California FMMO than in other FMMO's. Accordingly, USDA may not simply adopt prices from other Federal Orders for the California FMMO in violation of the AMAA.

1. The AMAA prohibits adopting Federal Order Reform Prices in an FMMO.

The FMMO prices do not properly or fully incorporate current economic conditions for California so they cannot be used in a California FMMO. First, USDA did not contemplate California's massive milk supply being a part of the FMMO system when it developed Federal Order Reform Prices.

> The preliminary reports, the proposed rule, and this final decision concerning order consolidation were prepared using data gathered about receipts and distribution of fluid milk products by all known distributing plants located in the 47 contiguous states, ***not including the State of California.***

64 Fed. Reg. at 16044, c.2 (emphasis supplied). USDA has never made the determination of what the price should be in California based on *any* economic conditions, let alone current market conditions. USDA did consider California prices in certain aspects during FMMO Reform, but California was not part of an FMMO at that time. *See* Tr. 5121:5 – 5122:2 (Testimony of Mr. Vetne). Thus, even though USDA included California milk in some of its analyses, it did not include the variable of California milk being part of an FMMO in its analyses or that impact on California. In other words, USDA only considered how California milk would affect other orders, not how a California order itself (especially a California order with mandatory pooling) would operate. Thus, FMMO prices cannot serve as a default justification for California FMMO prices.

Second, USDA's inclusion of the Pacific Northwest in pricing developed during Federal Order reform gives no support to extending FMMO Prices to California. This region nowhere near matches California's output. *Compare* Ex. 100, at 2 (showing approximately 2.8 billion pounds of Class III Producer Milk for 2014 in the PNW) *with* Ex. 61, CDFA – E, D.4 (showing approximately 19.6 billion pounds of Class 4b Producer Milk in 2014 in California). Similarly, during 1993 not a lot of milk products needed to move east from that location. Tr. 5124:12 – 15

(Testimony of Mr. Vetne), Ex. 112, at 58. Nearly two decades later, USDA cannot use these wholly different markets interchangeably when developing prices for California.

Third, the prices previously adopted by USDA for other orders have become outdated and fail to reflect the current dairy market in the proposed marketing area. The Cooperatives urge USDA to adopt prices in California based on 1996 reports, which were themselves based on data from 1993. Ex. 111, at 7 (Testimony of Mr. Vetne). Not only has the national dairy industry seen changes since 1993, but California's milk supply and milk market have changed *significantly* over the past 23 years. Ex. 111, at 7 (Testimony of Mr. Vetne); *see also, e.g.,* the production changes indicated above in Part D.1.

Any subsequent reviews of these prices have fallen short of making them relevant to manufacturers in today's market.

> Current FMMO make allowances in the Class III and IV formulas were implemented in October 2008, over seven years ago. Furthermore, the data used in these allowances came from a 2007 hearing, which relied on even older data. As such, the current data is getting close to a decade old and new cost studies are needed in the formula. HCC costs for cheese and our expected costs for milk powder are not covered by these make allowances, while dry whey is difficult to judge because we make whey protein and lactose. Nonetheless, our lactose and whey protein costs have gone up considerably over this time.

Tr. 4422: 11 – 20 (Testimony of Mr. de Jong).

An approach that fails to consider the current economics of the California milk market and instead uses historical numbers that the Cooperatives find more favorable certainly does not satisfy Section 8c(18) of the AMAA. Ex. 111, at 7 (Testimony of Mr. Vetne).

2. California's current economic market conditions warrant incorporation of location values of raw milk in establishing market clearing prices.

The features unique to California described above require USDA to set comparatively lower prices for a California FMMO than found currently in other orders. This issue is best described by Dr. Mark Stephenson in his report, "Testimony on the U.S. Spatial Value of Milk and Whey Practices in Cheese Plants." Ex. 133 (hereinafter "Dr. Stephenson Study").

Dr. Stephenson attended the hearing of his own volition – he did not appear as a witness in support of, or opposition to, any particular proposal. Tr. 5938: 11–18 (Testimony of Dr. Stephenson), Ex. 133 at 1. Rather, he came the hearing as an expert dairy economist wishing to offer his insight and knowledge to the process. *Id.*

To aid in the understanding of the principle that markets require spatial pricing, Dr. Stephenson utilized the Cornell U.S. Dairy Sector Simulator (USDSS). Ex. 133, at 1 (Dr. Stephenson Study). This model is highly detailed and technical, but addresses a simple problem: "how to get milk from dairy farms to plants to be processed into various dairy products and distribute those products to consumers in the most efficient way (lowest cost) possible." Ex. 133, at 1 – 2. The model takes into account total milk supply, plant locations, product mix, and consumer demand. It then simulates the most efficient movement of the dairy products (raw milk, manufactured goods, and final consumer products) based on existing road networks. The amount of data and detail in this invaluable model provides an incredibly clear and accurate snapshot of these movements. For example, the model considers the 200,000 possible road routes for connecting locations and optimizes movement to the top route. Ex. 133, at 3. These routes are even limited based on road weight limits by state law. Ex. 133, at 3. The model breaks per capita demand down to a county level, providing a honed-in reflection of actual consumer demand. Ex. 133, at 2. USDA has used this model a number of times, as has Congress in evaluating and making policy decisions. Tr. 5973:5–25 (Testimony of Dr. Stephenson).

The USDSS computes two solutions instructive as to the movement and value of milk in various locations. The first is the "primal solution." Ex. 133, at 3. This solution describes the optimal physical flows of product through the dairy supply chain network. The second solution is the "dual solution." This solution represents the relative monetary values of milk and dairy products at each model location. Ex. 133, at 3.

The primal solution describes how market participants should structure purchases and sales of dairy products in order to maximize efficiency. Essentially, this solution is the "best case scenario" for the producers, manufacturers, and consumers. As described above, California producers and manufacturers only have to make local shipments to get fluid milk to market.[37]

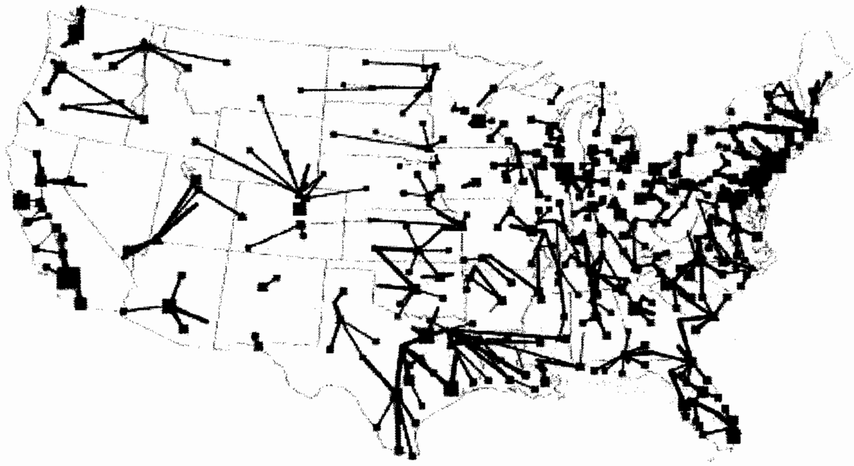


Figure 1. Least-Cost Fluid Milk Processing Locations and Flows, USDSS Primal Solution, March 2014.

Ex. 133 at 4.

However, the most efficient market for finished cheese products from California is primarily *not* California, but demand centers much further east.

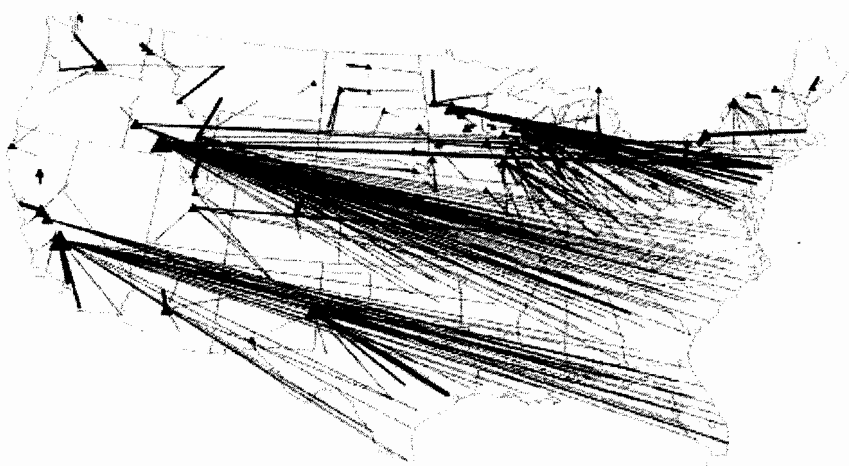


Figure 2. Least-Cost American Cheese Processing Locations and Flows, USDSS Primal Solution, March 2014.

Ex. 133 at 4.

[37] Recall that the green lines represent the movement of milk from a producer to a plant (indicated by a triangle). Triangles or plants with no obvious green line have a local milk supply. The orange lines represent the movement of the finished product from the plant (indicated by a triangle) to a demand center (indicated by a square).

Dr. Stephenson correlated this model with observed values of products for these months and observed greater than a 0.88 correlation for all products, and as high as 0.99 for cheese products. Additionally, the model results are not sensitive to changes of plus or minus 5% in demand values or estimated transportation costs. According to Dr. Stephenson, "[b]oth outcomes suggest a high degree of confidence in the sensibility of the model outcomes." In other words, Dr. Stephenson has proven to a high degree of probability that his models accurately reflect efficient dairy industry markets.

The primal solution serves as the first step for the broader question: how does demand and location affect the actual value of dairy and dairy products? Dr. Stephenson describes this question as follows:

> If you were to ask fluid plant owners how much more they would be willing to pay for another hundredweight of milk, they would have to consider all of their options for other milk supplies and the cost of transporting that milk to their plant. And, they would have to consider the additional sales opportunities for the finished product and the cost of distribution to those locations. This value would never be more than the cost of transportation from the closest supply region and it will be minimal in some locations where there is plenty of milk and little nearby demand. **Thus, supply, demand, and transportation costs become the important determinants for the relative spatial values of milk.**

Ex. 133, at 5 (emphasis in original).

Dr. Stephenson used this model to show the relative value of milk in various regions in the country. The USDSS Model generated the price surface for milk based on 1995 data. At this time, milk used to produce cheese in Central California was worth about $0.30 less than milk used to produce cheese in Chicago. Ex. 133, at 6. While the California farmer may have the same milk as the Illinois farmer, a Central California cheese manufacturer could only afford to pay a price $0.30 less than an Illinois cheese manufacturer in order to still be competitive. Ex. 133, at 6.

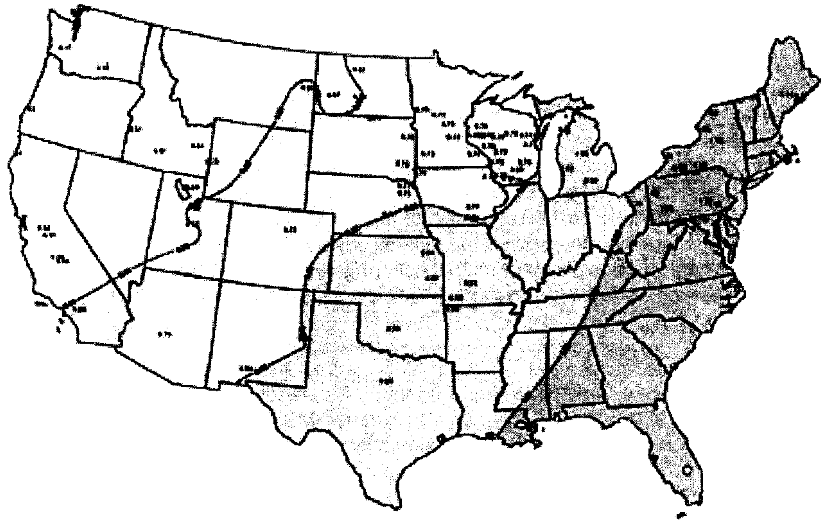


Figure 3. USDSS Model-Generated Cheese Differentials, May 1995.

Dr. Stephenson then updated the model with 2014 prices and discovered that "the difference in marginal value between central California and Chicago is now about $0.70 per hundredweight of milk." Ex. 133, at 7. In other words, the competitive advantage of the Illinois manufacturer has *more than doubled* since 1995.

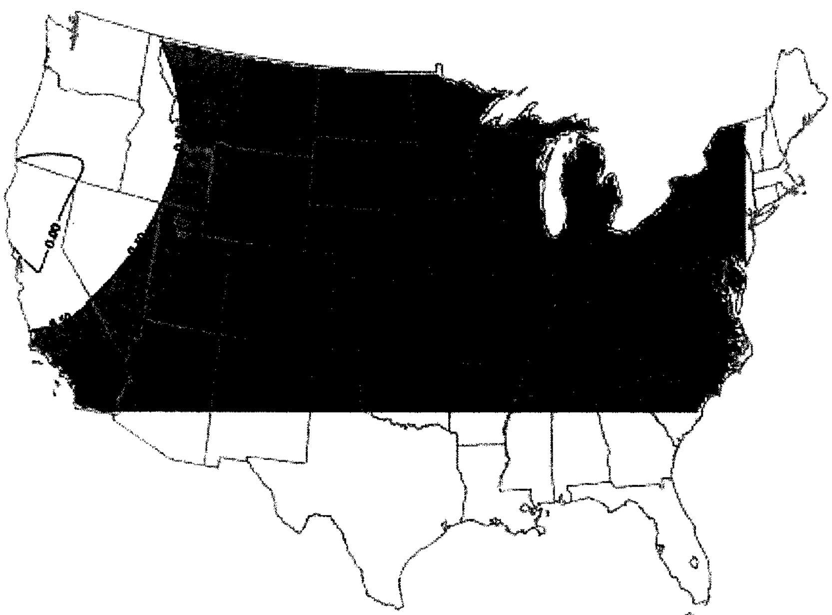


Figure 4. USDSS Model-Generated Cheese Difference in Marginal Value of Milk at Cheese Plants[5] from Low Value-Point, March 2014.

Ex. 133, at 7.

As detailed above, milk production in California and the western states has been steadily growing. Dr. Stephenson noted that over the last five decades, milk production has grown faster in the west, further affecting the spatial value of milk. Ex. 133, at 9. "A fundamental conclusion from these analyses is that spatial milk values for milk cannot be considered static for long periods of time – and this has implications for minimum regulated milk prices." Ex. 133, at 9. Dr. Stephenson inarguably and empirically demonstrated that the value of milk changes over time and, specifically, that the value of milk in California has changed significantly from 1995 until 2014.

Failure to recognize spatial pricing in a "minimum" price system would lead to problems in other FMMOs. The harms from establishing a minimum price that is too high in California have been clearly and extensively laid out above. USDA cannot adopt prices from other orders in California. Similarly, USDA cannot and should not force the California minimum market-clearing price upon other markets. "The problem with a flat, but lower, minimum price is that the price may be so low in the higher value regions of the country as to be meaningless if premiums are asked to carry too much value." Ex. 133, at 9. Thus, recognizing the spatial value of milk protects the national dairy industry from disruption and potential disorderly marketing.

Dr. Stephenson's powerful conclusion warrants a full and careful read:

> I have many friends and acquaintances employed in the California dairy industry – producers, cooperatives and processors – and I am well aware of the problems they have been addressing over the last several years. It is my measured opinion that there has been room for a higher milk price for producers than was regulated by the California state order. But it is my caution to regulators when considering the implementation of a uniform manufacturing price from coast to coast that the markets will punish a price that is above clearing levels. I would fear that imposing our current Federal Order Class III product price formula upon the California dairy industry could, over time, affect cheese plant profitability sufficiently to cause a significant shift in ownership of cheese plants from proprietary firms to a cooperative structure where losses can be re-blended back to members.

Ex. 133, at 14 (Dr. Stephenson Study).

USDA has already adopted the logic and economic theory behind spatial values of milk. When discussing the use of the USDSS pricing model for FMMO Reform pricing, USDA described "shadow pricing" and how it reflected the marginal value of a unit of milk at a particular processing location. "This notion of marginal value is consistent with economic theory on how prices are determined in a competitive market." 64 Fed. Reg. 16109, c.1. While this discussion focused primarily on the price for Class I milk, the logic certainly extends to Class III milk. USDA should not now choose to ignore this economic reality when determining the hugely important minimum prices for a California FMMO.

The existence of this spatial value of milk cannot be denied by the Cooperatives. In fact, Dr. Erba cited the $0.70 difference in 4b and Class III prices found in a study by Drs. Mark Stephenson and Chuck Nicholson as support for the price he proposed CDFA adopt. Tr. 2131:12 – 2132: 15 (Testimony of Dr. Erba). However, at the hearing, the Cooperatives about-faced and disingenuously denied the existence of any location value of products.

> MR. ENGLISH: Isn't it a fact that major products used in classified pricing, such as cheese, butter, and nonfat dry milk, tend to sell at higher premiums the more east they move?
>
> MR. HOLLON: I'm not aware of that.
>
> MR. ENGLISH: You are not aware that cheese products sold, say, into New Jersey command a higher price than cheese products sold in Chicago?
>
> MR. HOLLON: No.
>
> MR. ENGLISH: And if I ask that question about other geographical regions, the answer would be the same, you are not aware of differences?
>
> MR. HOLLON: Correct.

Tr. 1366: 11–25 (Testimony of Elvin Hollon). Neutral expert witness Dr. Stephenson and his unrefuted, data-driven conclusions set the record straight on this point.

Additionally, no argument can be made that the comparatively lower pricing in a California FMMO would be detrimental to the Pacific Northwest ("PNW") Order and in Arizona. Cooperatives control the vast majority of manufacturing in the PNW and Arizona. Ex. 133, at 9 (Dr. Stephenson Study). If the manufacturing price of milk is overvalued, they can re-blend it so that it is appropriately valued to their plant operations. In California, non-cooperative cheesemakers produce the vast majority of the cheese so it is more crucial that the regulated price be appropriate for the location value, manufacturing cost, and whey value. Ex. 133, at 9 (Dr. Stephenson Study); Tr. 5370:20 – 5372:5 (Testimony of Mr. Murphy). Of course, review of prices in other orders may warrant a national hearing, but the Cooperatives have not asked for that here. They must be bound by their request and USDA must consider the pricing for the marketing area before it – California.

3. While location values of milk are undoubtedly local in nature, finished products must compete on a national market.

Similarly, USDA's Preliminary Regulatory Impact Analysis does not appear to take into account the results of Dr. Stephenson's Study that while milk products are marketed nationally, due to transportation costs milk itself is only marketed locally. Recall that green lines in this graph represent purchases of raw milk. A lack of green line means that the milk is local to the plant (essentially, too close to warrant a line with this degree of zoom).

Figure 2. Least-Cost American Cheese Processing Locations and Flows, USDSS Primal Solution, March 2014.

One strains to identify any green lines in California for cheese products. This means that, under optimal conditions, all California milk being made into cheese is being purchased locally. In other words, the value of the milk on the market is the value of that product to a California cheese manufacturer.

However, the orange lines representing the sale of the finished product for cheese range from California to all over the country (primarily to Texas and the East Coast). Thus, manufacturers must offer a price that competes against milk on a national level. The products that are made from this locally produced milk must be transported to these consumption centers. The value of the locally-produced products is thus subject to f.o.b. pricing with naturally rises as one moves from west to east. Regardless of who incurs the cost of transportation, the value of the underlying product must be adjusted to account for this economic fact.

The USDA model does not take into account the lower value of finished products in California, but assumes parity between the ultimate consumer price for all finished products. The USDA analysis does not show that the market will clear regionally in California for Class III and IV prices, only that the products will clear at national prices. Tr. 137: 13–22 (Testimony of Ms. Steeneck). However, as proven above, while markets for dairy products clear nationally, milk markets have to clear locally. Tr. 4155:23–24 (Testimony of Dr. Schiek). For instance, record evidence demonstrates that the NDPSR prices reported by USDA which include California, but also the remainder of U.S. cheese production, are higher than the prices actually received by California cheese plants. Tr. 4436 – 4437 (Testimony of Mr. de Jong). This is also true as to other manufactured products. Tr. 4437 – 4438 (Testimony of Mr. de Jong). The Cooperatives failed to adduce any affirmative evidence to the contrary.[38] An analysis that fails to incorporate this fundamental principle cannot be the basis for an FMMO pricing scheme.

[38] There was also a failed effort to assert that California prices could be found in Dairy Market News prices for delivered products in less than carload mixed lots as evidence that California prices are not that different. Tr. 5666:4 – 18 (Testimony of Dr. Schiek). But that measure is entirely different from what NDPSR, the CME or CDFA measures.

Dr. Stephenson testified to Northwest manufacturers facing exactly these types of problems when competing on the national level with their finished products. Tr. 6060:1–4 (Testimony of Dr. Stephenson). The regulated minimum price in that area made it difficult for manufacturers to remain competitive with other sources of dairy products. *Id.* Transportation costs cannot be discounted in valuing manufactured milk products.

As specifically explained by Ms. Taylor at the hearing, the record evidence indicates that the valuation in the existing price formulas is not based upon industry experience.

> The current formula assumes that all of the fat received at the plant that is not captured in cheddar cheese is recovered and converted to grade AA butter. Whey cream outlets are very limited in California... Our prices net well below the CME AA market price regardless of outlet for our whey cream. Pricing in Wisconsin is at or below flat market (CME grade AA butter) depending upon the market conditions. The cost of transport on our whey cream delivered to Wisconsin exceeds $0.54 per pound fat. The number of buyers for whey cream nationally continues to shrink, placing additional downward pressure on whey cream returns as sellers are forced to ship whey cream greater distances to find markets.

Ex. 135, at 11 – 12 (Testimony of Ms. Taylor). Marquez Brothers International testified to separating the whey cream and using it as animal feed. Tr. 4674:22 – 4676:1 (Testimony of Mr. Maldonado). Cheese manufacturers testified at length as to the difficulties of processing, and recovering value, for whey. See, e.g., Ex. 105, at 3 (Testimony of Mr. Maldonado).

As discussed in paragraphs that follow, USDA has in fact already altered the nationally coordinated price surface for Class I pricing (to make it "steeper" in the southeast) based upon what USDA found (and DFA argued) to be current market conditions in the Appalachian, Florida and Southeast Marketing Areas. Tr. 3232:16 – 3233:4 (Testimony of Mr. Schad). The Cooperatives cannot "eat their cake and have it too" (John Heywood, *Proverbs*, pt. I, ch. 4 (1546)) – only when it suits DFA's purposes does it look to USDA to use current market conditions in the affected marketing areas.

H. USDA must follow Ratemaking Legal Precedent in Setting Minimum Regulated Prices.

The Dairy Institute incorporates by reference and concurs with the Ratemaking legal standards' analysis in the Brief submitted by Hilmar, specifically found at pages 31 – 37 of Hilmar's Brief. The Dairy Institute has researched and analyzed the legal arguments in that section and approves it as if found in these pages. We reserve the right to comment further regarding this important legal analysis in our Reply Brief.

I. USDA Cannot Adopt Class I Pricing Proposed by the Cooperatives.

The Cooperatives did not provide evidence of marketing conditions in California to support their proposed Class I differentials, or even whether Class I differentials remain justified in 2016.[39] They largely attempt to bootstrap in outdated prices using FMMO Reform pricing and the underlying analysis establishing the Class I base differential; they ignore Class II. The Class I and II arguments suffer from the same dated data flaws as for those manufacturing products. But for Class I, the lack of evidence of current marketing conditions is far worse and indeed fatal to the Cooperative Order. While already quoted above, it bears repeating that USDA *did not* as part of the FMMO Reform process in any analysis consider the flows of raw milk or fluid milk distribution in California when establishing its price formulas or the so-called nationally coordinated pricing:

> The preliminary reports, the proposed rule, and this final decision concerning order consolidation were prepared using data gathered about receipts and distribution of fluid milk products by all known distributing plants located in the 47 contiguous states, ***not including the State of California***.

64 Fed. Reg. at 16044, c.2 (emphasis supplied). While bootstrap arguments are usually suspect, especially in an order promulgation proceeding, in this case there is *no boot* upon which one can

[39] The Dairy Institute also as a placeholder used for its proposal the FMMO Class I price surface as well as Class II differential of 70 cents per cwt. However, the Dairy Institute expressly asserted that someone must prove the need for and level of these differentials. Tr.782:17 – 25 (Opening Statement of Mr. English); Tr. 5892:18 – 23 (Testimony of Mr. Blaufuss); Tr. 5898:14 – 19 (Colloquy between Ms. Erin Taylor and Mr. English).

attach a strap. USDA cannot and must not conclude that 1996 data and FMMO analyses that excluded California can now be utilized to set Class I price levels in California.

In the face of falling absolute and relative sales of fluid beverage products (Class I), the Dairy Institute challenges the need for Class I differentials in 2016. Ex. 155. While the prevailing market opinion was historically that fluid milk prices were inelastic, the current market no longer reflects that conclusion. *See* Tr. 4374:11 – 25 (Testimony of Mr. Newell). The industry is already seeing consumers move to alternative beverages like fruit punch when milk gets too expensive. *Id.* (Testimony of Mr. Newell) (sharing an anecdote where an employee saw a consumer tell her child "I'll buy you red milk" when she purchased fruit punch at a time of high fluid milk prices).

In the face of these significantly different facts from when FMMOs were first adopted and in light of the fact that this is an order promulgation hearing, USDA must answer a number of tough questions if it wishes to include Class I differentials in a California FMMO. Excluding conclusions based upon 1930-1970s economics, where is the evidence that fluid milk products are presently price inelastic or as price inelastic as they were when FMMOs were adopted or reformed? Where is the 2015 Cooperative analysis that, without Class I differentials enforced by the federal government, "destructive and ruinous completion" would result? *Cf.* Judge Posner's incredulous description of modern views of "ruinous competition in *Alto Dairy v. Veneman,* 356 F.3d 560, 562-563 (7th Cir. 2003) ("For a near unintelligible description of conditions thought to render competition among dairy farmers unworkable, see *Nebbia v. New York*, 291 U.S. 502 . . . (1934)"). Where is the affirmative evidence from those with the twin burdens of proof and persuasion, that bottled water, juices, coffee, energy drinks, diet sodas and non-dairy "milk" products do not constitute real world competitive alternatives to milk that require USDA's consideration and incorporation into any Class I analysis for a brand new FMMO? Where is the Cooperatives' analysis of 2015 economic data supporting the level of a Class I price differential if the justification of such can still be proved? As Eliza Doolittle argued in rejecting Freddy Eynsford-Hill:

Words, words, words!
I'm so sick of words
I get words all day through
First from him, now from you
Is that all you blighters can do?
. . .
Sing me no song, read me no rhyme
Don't waste my time, show me!
Don't talk of June, don't talk of fall
Don't talk at all!
Show me!

Alan J. Lerner and Frederick Lowe, My Fair Lady, *Show Me* (1964) (emphasis supplied).

In this order promulgation proceeding, no shortcuts are permitted. Nothing can be assumed. *Everything* must be proven by the Cooperatives. The Dairy Institute does not have the Burden of Proof or Burden of Persuasion with respect to issues such as the establishment of Class I differentials or their proper level. The Cooperatives simply fail to even make the effort to do so. This alone should result in termination of this proceeding.

If there is any evidence of potential Class I differential price levels, it comes not from the Cooperatives or USDA data and analysis that intentionally excluded California, but from Dr. Mark Stephenson and another study relying on 2006 data (Ex. 30).[40] This study includes analyses and results that are in the record, but are likely different from what may be lurking in the invisible, but much discussed, study commissioned by the Cooperatives.[41] California milk production has significantly increased further since 2006 and economic fundamentals have shifted ever westward, as shown in Dr. Stephenson's testimony found in Ex. 133; nonetheless Exhibit 30 shows on pages 15-16 a consistent spatial Class I value difference of at least a $1.00 between California's Central Valley and Chicago. This compares to a $0.20 difference adopted by USDA in FMMO Reform, in which USDA made no effort to analyze any fluid market milk flows in California. *See* 7 C.F.R. §1000.52 for Cook County, Illinois ($1.80) and Fresno,

[40] Unlike the 2014 data that was utilized by Dr. Stephenson in his updated and accurate Class III study.
[41] The Dairy Institute relies on the negative inference it asserted at the hearing to conclude that the never produced expert study commissioned by the Cooperatives and relied upon affirmatively by Dr. Erba in testimony before CDFA undermines and contradicts the Cooperatives' economic theories underlying not only Class III pricing, but also its unproven claim for Class I price differentials based upon FMMO Reform. Ex. 78.

California ($1.60). Thus, the *only* record evidence (and it is 10 years old) of potential Class I price differentials clearly supports a reduction in the California Class I price surface by 80 cents per cwt.

A Land O'Lakes witness attempted to justify Class I differentials loosely based on FMMO Reform analysis. Tr. 31. The Land O'Lakes argument is fundamentally flawed as it attempts to mimic the buildup of the Class I Base Price without taking into consideration either actual current California dairy market conditions or the spatial value of milk analysis found in the "2006 Study." Ex. 30. The FMMO base price for Class I differentials was set at $1.60 to recognize the value of Grade A milk. To this was added a spatial value for milk. 64 Fed. Reg. at 16111 c.3. This resulted in a Chicago Class I differential of $1.80. Assuming that USDA on the basis of this record can find that the Chicago Class I differential is still accurate and justifiable, USDA should then subtract from the Chicago differential the increase in the spatial value difference established in the 2006 Study from Fresno to Chicago in establishing any Class I differential – this would for the first time recognize California raw and packaged milk flows in the way down in FMMO Reform for everywhere other than California.

Moreover, the four pricing factors included in the Land O'Lakes testimony are flawed, duplicative, and fail to take into consideration actual California marketing conditions. First, the Grade A compliance cost in 2015 has not been updated by USDA or the Cooperatives. More importantly, in 2015 this compliance cost cannot be relevant since almost all U.S. milk is Grade A.[42] There is no reason that Class I should bear that cost uniquely. Tr. 4366:17 – 19 (Testimony of Mr. de Jong); Tr. 3816: 7 – 10 (Testimony of Dr. Schiek). The other costs also were not discussed in FMMO Reform by USDA and are duplicative. The Land O'Lakes witness made no effort to address these deficiencies. The so-called marketing costs include give-up charges in the Upper Midwest, not shown on this Record to be necessary in California where competition for milk supplies is constrained by plant capacity; competitive premiums in the Upper Midwest (not

[42] Milk produced in California that meets Grade A standards can elect Grade B status which undermines any evaluation of California Grade B milk volumes. Tr. 4552:23 – 4554:23 (Testimony of Mr. DeJong).

proven to exist in California) are included to some extent in give-up charges listed by the witness; and finally the Cooperatives advocated for a special category of transportation costs, which USDA found to be included in marketing. Ex. 70, p. 31. Without a trace of irony the witness wants USDA to adopt these Class I differentials based upon purported order value provided to Class I handlers even though without performance-based pooling standards, not one drop of milk will be required to move to Class I plants under the Cooperative Order. Thus, there is no "value" underpinning the increased costs unjustifiably forced upon Class I handlers. The Quota Provision does not justify the suspension of economic logic especially in light of the neutral testimony on cross-examination from Dr. Stephenson that establishes a new spatial value difference between Chicago and Fresno of at least $1.00.[43]

The Land O'Lakes witness also relied upon price alignment as a further justification for the Cooperatives' Class I price levels. This argument again presupposes that the prices in the markets to the east are correct in 2015, a fact not in evidence. This argument also ignores that the primary consideration in setting Class I differentials is the need to draw forth an adequate supply of milk for fluid use – alignment of prices is important, but tertiary according to USDA. In merging multiple orders to create the pre-FMMO Reform Upper Midwest Order, USDA established the relative importance of these factors:

> In designing a pricing structure, the first and foremost consideration must be to provide the economic incentive to transport milk from the production areas to the Class I distribution area. Without such encouragement built into the order, a handler would have to pay for the hauling of milk to his plant out of his own pocket.
>
> . . .
>
> As mentioned in other parts of this decision, resale *price alignment is only a peripheral consideration* in establishing proper price level at any particular location. *Of paramount importance is the question, "what price level is necessary to insure an adequate supply of milk for the location?"*

[43] USDSS 1996, http://dairy.wisc.edu/pubPod/pubs/SP9606.pdf. The butter and powder price surface maps are on p 11 of the publication. USDSS results for 2014 Class IV Spatial Price Differences are accessible at http://dairymarkets.org/CA/

Milk in the Minneapolis-St. Paul and Certain Other Marketing Areas, 59 Fed. Reg. 12436, 12461 c.1 and 12462 c.3 (March 25, 1976). The 2006 Study answers these questions emphatically in support of a lower Class I price surface for a California FMMO.

USDA's justification for its deviation from the FMMO Reform Class I pricing structure for the southeastern United States supports the Dairy Institute's conclusions. Any Class I differentials to be adopted for the first time in California must reflect current marketing conditions and recognize that local values for milk must be the determining factor:

> The adopted pricing surface better reflects the economic conditions affecting the supply and demand for milk in the three southeastern marketing areas by providing greater pricing incentives indicative of actual milk movements and the cost of supplying milk from alternative locations. The adopted Class I price adjustments result in a steeper Class I price surface that correlates with the higher location value fluid milk has in the southeastern region.
>
> . . .
>
> In this regard, *the location value of milk needs to consider local milk supplies, local demand, and transportation costs.*

79 Fed. Reg. at 12977 c.3 and 12978 c.1. Now take this decision and lay on top of it two other facts that USDA must consider: 1) an analysis of the most recent 2006 study data for Class I; and 2) that USDA, in adopting a national price surface for Class I, expressly did so considering only the market conditions for 47 states, *excluding California.* This analysis leads to the inevitable conclusion that even if a Class I Differential can be justified at all, a California FMMO with significant milk supply, limited capacity competing for milk (unlike the Upper Midwest) and falling Class I usage, should lead to a more "gradual slope" and lower Class I differentials for California than in other FMMOs.

Interestingly, the Land O'Lakes witness made the following argument regarding the southeastern order decision:

> That Decision to increase the differentials within the marketing areas was based on testimony that the Southeast was experiencing an increase of demand concurrent with a decline in milk production. All three marketing areas were described as milk deficit. Adjustments to the county differentials were based on a transportation cost function from the nearest

> surplus supply region to the Southeast markets. (73 Fed. Reg. 11194 (2008)) None of the supply-demand factors, referenced in the Southeast decision are present in California.

Ex. 70, p. 32. The Dairy Institute agrees with the last sentence of this statement because it encompasses the principle that any Class I differentials should be driven by the supply and demand in a specific marketing area. As discussed above, California has a milk surplus and a long-term significant decrease in fluid milk; and long-term production growth– differentials should (in the Cooperatives' own words) reflect these facts. Paraphrasing the Land O'Lakes witness's logic, but inserting instead the *real* marketing conditions in California should lead USDA to establish, if any, lower Class I differentials for California consistent with the 2006 Study:

> The decision to decrease the differentials within the marketing area is based on testimony that California is experiencing a decrease of demand concurrent with an increase in milk production. The marketing area was described as milk surplus.

USDA should seriously reevaluate the need for Class I differentials, justify them if possible based solely on this record without reference to FMMO Reform (which deliberately ignored any California Class I analysis), and, if justified, establish Class I differentials based upon current marketing conditions in the marketing area pursuant to 7 U.S.C. §608c(18) with a starting point of $0.80 per cwt in Fresno based upon the 2006 Study.

J. Conclusion

USDA's refusal to acknowledge current market realities and adopt updated prices would be not only unlawful, but would be in fact futile – the market is an unstoppable force that will correct itself one way or another. The only question will be how much damage is caused to California dairy farmers and manufacturers in the process. USDA can and should continue to support the California dairy industry as a whole by setting realistic, up-to-date prices.

VIII. QUOTA

A. The Cooperatives' Proposal on Quota Expands the Quota Provision and Violates Core Features of the AMAA.

The Quota Provision states: "The order covering California has the right to reblend and distribute order receipts to recognize quota value." The meaning of this provision must be interpreted in light of the ten statutory construction principles described above. *See* Section IV.

According to those principles, the word "right" means that USDA has the discretion to undertake whatever action follows this word. *See* Section IV, Part D. Like all rights, the entity that is the bearer of that right has the option to choose not to exercise the right that has been conveyed. It is a right, not an obligation. Congress has given the California FMMO the right or "option" to reblend order receipts, not a mandate. Additionally, this "right" exists within the confines of the <u>obligations</u> that are set forth in the authorizing legislation (AMAA as amended). Because the Quota Provision did not specifically amend, nor did it repeal, the various provisions of the AMAA, they remain in force. Thus, to the extent that the California FMMO decides to exercise its right to "reblend and distribute order receipts to recognize quota value" it must do so in a manner that is in accordance with the existing provisions of the Act.

The analysis next turns to the meaning of the phrase "recognize quota value." In order to understand how to recognize quota, USDA must first answer the question: what is quota? Quota is a construct under California law by which the holder of quota may receive an extra $0.195 per pound of nonfat solids on their milk production covered by quota. Ex. 145, at 3 (Testimony of Dr. Schiek). Cal. Food and Ag. Code instructs a producer to be paid for his pool quota as follows (after determining total milk fat, transportation allowances, and regional quota adjusters):

> (d) After taking into consideration the effect of the regional quota adjusters, the solids not fat announced quota price for those areas in which there is no regional quota adjuster shall be nineteen and one-half cents ($0.195) per pound greater than the announced solids not fat price for all milk produced in excess of pool quota.

Cal. Code of Food and Ag. §62750. Based on this statute, the California Pool Plan calculates quota as follows:

> (b) The total value of the quota premium pool shall be the sum of the following computations:
>
> > (1) Multiply the total solids not fat quota pounds by $0.195 and subtract the total amount of regional quota adjusters, computed pursuant to Article 9.1;
> >
> > (2) Multiply the total solids not fat of other source milk by $0.195.

CDFA Pooling Plan for Market Milk § 906(b). According to California law, "quota" consists of a calculation whereby this $0.195 per pounds of solids not fat is added to qualifying producers' payments.

The quota premium (the extra amount paid to quota holders per unit of quota they hold that is above the amount paid for non-quota milk) is not analogous to location adjustments or component adjustments. Why? The quota premium of $1.70 per hundredweight, or more correctly, $0.195 per pound of nonfat solids, is an extremely large adjustment that serves no orderly marketing goal and has no basis in dairy regulatory economics. *See, Zuber, supra.* The Cooperatives have failed to show how quota creates more efficient movements of milk, nor have they demonstrated how it directs any milk to fluid uses.

The Cooperatives have failed to make any convincing arguments to suggest that quota plays a role today in ensuring that milk supplies are adequate for fluid milk purposes – and they ignore for performance-based pooling standards the historical connection behind quota creation and pooling. Quota therefore has no economic or policy basis. It runs counter to the purpose of pooling and fails to treat producers equally because milk that is otherwise of equal value i.e., of the same quality, component levels, and location is treated differently simply because of an historic or purchased entitlement. California quota was originally allocated based on individual producers' historic shipments to Class I usage (Ex. 42, at 6 (Testimony of Dr. Erba)) and it is therefore directly analogous to the "nearby differential" that was in place in old Federal Order 2, which was struck down by the courts because it was in conflict with the central provisions of the

AMAA. *See, Zuber, supra,* and Tr. 6650-6652 (Testimony of Dr. Schiek) (discussion of *Blair v. Freemen*, 370 F.2d 229 (D.C. Cir. 1966)).

Thus, "quota" itself can only be considered this $0.195 payment; no more, no less.

B. Payment of Quota Premium of $0.195 Per Pound of Quota Nonfat Solids ($1.70 per Hundredweight of Standard Quota Milk) Sufficiently "Recognizes Quota Value."

The record is clear that the economic value of quota is derived from the flow return that is generated by owning it. In other words, quota has value because of the $0.195 a farmer receives (and will receive in the future). "'Economic value is defined in several ways but is commonly recognized as the value of an asset calculated according to its ability to produce income in the future." Ex. 54, at 7 (Testimony of Mr. Hatamiya). Without the flow return (which is the extra $0.195 per pound of quota SNF that quota milk receives, and is also referred to as the quota premium or quota income stream), there would be no return for dairymen owning quota and it would have no economic value. Therefore, as long as the quota premium is being paid, quota value has been recognized by the FMMO.

Witnesses in support of the Cooperatives' proposal seemed to suggest that the California FMMO needed to be constructed in such a way that both the quota income stream and the current quota asset price (i.e., the sale price) be maintained into the future. However, none of the testimony related to quota received at the hearing suggested that an individual producer can currently (under the CSO) realize both the quota income stream *and* the quota asset transactional price (quota selling price) simultaneously. Either a producer sells the quota to realize the capitalized value of the asset at that particular point in time and consequently gives up the income stream in the process, or he holds the quota and realizes the income stream but cannot draw on the asset value, merely carrying the transactional price of the asset on his balance sheet. The Cooperatives appeared to seek compensation for both at the same time.

Some witnesses in support of the Cooperative Order suggested that banks are more willing to lend to dairy farmers who own quota, but no hard evidence was submitted to demonstrate that quota's balance sheet value is what makes a quota holder a better customer than a producer without quota in the bankers' eyes. Rather, the quota holder's enhanced ability to obtain credit is just as likely to derive from the extra income generated by quota, and the increased ability to produce a positive cash flow versus a dairy farmer without quota – again not getting credit for both simultaneously.

Furthermore, the transactional price of quota does not remain constant over time but varies according to a number of conditions that are outside the control of policy makers as described in Exhibit 146, page 33, where Dr. Sumner and PhD Candidate Yu in their paper "The Agricultural Act of 2014 and Prospects for the California Milk Pool Quota Market," *Journal of Agribusiness* 32, 2 (Fall 2014) illustrate that the price of quota has been highly variable even though the flow return has not changed. This historic variability in the price of quota is in itself evidence that maintenance of the quota asset price has not been a particular policy goal of the state of California, as no changes to quota policy have been made since 1994 to address this variability.

Sumner and Yu note that the quota asset price is derived from a producer's willingness to pay to purchase quota. Ex 146, at 34-35 (Exhibits to Testimony of Dr. Schiek). This willingness to pay is a function of the quota flow return and the subjective discount rate that each individual producer applies to a quota purchase. The discount rate is a function of the farmer's current liquidity, his expected long-run rate of return to dairy farming, how the acquisition of quota impacts the variability of dairy farmer's portfolio returns (risk premium), and finally the risk quota associated with the program ending or being substantially changed in the future (policy default risk). Other than the flow return, none of these variables are directly under control of the policy maker. Profitability of dairy farming, liquidity of dairy farming, and policy and portfolio risk are determined by a host of factors other than the regulated price, including the price of dairy farming inputs and changes in the global supply and demand for milk and dairy products.

Therefore, given that all quota value is ultimately derived from the extra revenue that owning it generates for the dairymen, that the quota asset price has been highly variable over time (*see* graph in Exhibit 42, page 19, Testimony of Dr. Erba), and that quota asset price variability is subject to factors beyond any policy maker's control, any focus on current quota asset price levels as a means of recognizing quota value is beyond the policy makers scope and ability. Consequently, quota value is appropriately "recognized" according to the Farm Bill and consistent with the AMAA and California law as long as the quota premium of $0.195 per pound of quota nonfat solids (roughly $1.70 per hundredweight at milk testing 8.7% nonfat solids) is paid.

C. The Dairy Institute Proposal is Consistent with the AMAA Prohibition of Discrimination Against Out-of-Area Milk; this Provision Prevents the Adoption of the Cooperative Order.

1. The AMAA prohibits discrimination against out-of-area milk.

The AMAA prohibits an FMMO from discriminating against out-of-area milk under any California FMMO because it requires uniform prices be paid to dairy farmers under an FMMO and prohibits trade barriers. 7 U.S.C. §§608c(5)(B) and (G).

As discussed in Section IV, the uniform price requirement and trade barrier prohibition are clear. Together, and indeed even separately, they prevent USDA from adopting a provision that would discriminate against any milk, including milk from outside the order, pooled on the Order. The U.S. Supreme Court has upheld the enforcement of this prohibition against FMMO provisions that result in discrimination against out-of-area milk. In *Lehigh*, *supra,* the Court analyzed the New York-New Jersey FMMO and the Secretary's inclusion of a provision for compensatory payments on non-pool milk sold in the marketing area by outside handlers. The compensatory payments provision required a handler who brought outside packaged fluid milk into the marketing area to pay the pool producers through the producer-settlement fund an amount equal to the difference between the minimum prices for the highest (Class I) and lowest use (Class III) classification prevailing in the area. Essentially, this compensatory payment provision ensured that the pool received the benefits of the higher class of milk, regardless of where the handler purchased that milk and where that handler was located. The arguments in support of the compensatory payment were that it kept outside milk from undercutting milk purchased by pool handlers. When such outside milk went to fluid milk uses (the highest value use), it diminished the value of the pool overall since the pool did not benefit from those higher-value sales. *Id.* at 82. In practice, where the purchase price for the outside milk exceeded the Class III price within the area, it became economically unfeasible for a handler to bring such milk into the marketing area. *Id.* at 84.

The *Lehigh* Court concluded that "as regards milk the word 'prohibit' refers not merely to absolute or physical quota restrictions, but also *encompasses economic trade barriers of the kind effected by the subsidies called for by this 'compensatory payment' provision.*" *Lehigh, supra,* at 97 (emphasis supplied). The compensatory payment provision had the consequence of requiring non-pool milk to subsidize pool milk, which was thus insulated from competition. Therefore, the Order set up an economic trade barrier specifically prohibited by 7 U.S.C. §608c(5)(G). The Court concluded that the true motivation for the program was the preservation of the pool value for in-area producers.

> A close examination of the workings of the present compensatory payment provision reveals that its effect is to preserve for the benefit of the area's producers the blend price that they would receive if all outside milk were physically excluded and they alone would supply the fluid-milk needs of the area... In effect, therefore the nonpool milk is forced to subsidize the pool milk and insulate the pool milk from the competitive impact caused by the entry of outside milk.

Id. at 89 – 90.

The Cooperative Order's treatment of out-of-area milk results in a subsidization of California dairy farmers, as discussed below.

2. The Dairy Institute Proposal permits farmers to be paid an equal out-of-quota-pool blend price or to participate in quota.

The Dairy Institute's Proposal complies with the AMAA and does not create any trade barriers with respect to out-of-area milk. Under the Dairy Institute Proposal, all out-of-area producers will receive the traditional FMMO blend for their milk pooled in California.[44] Ex.

[44] Unlike Proposal 4, under the Dairy Institute Proposal there will be no problems with a handler keeping track of the source location of milk as all producers, regardless of location, will fall into one of two categories: quota participants (who will receive the overbase price) and those who opted out of the quota program (who will receive the traditional FMMO blend price).

145, at 10. Out-of-area dairy farmers would be paid directly or as a handler payment to their cooperatives for their milk based upon this method, unadjusted for quota. *See* §1051.72(b) and (c)(1)).

The nature of the quota system is such that USDA must establish a traditional FMMO producer-settlement fund outside of the quota pool in order to avoid discriminating against dairy farmers who cannot own quota. The quota system requires that the quota premium be paid first from the overall producer settlement fund proceeds. This initial payment results in reduced proceeds to distribute to other producers in the form of the overbase price. Historically, out-of-area farmers' milk was credited not at this lower overbase price but at the plant blend under the California State Order (CSO). Ex. 145, at 6. In other words, the quota program as it exists today does not require out-of-area farmers to participate in the quota pool – the record shows that they are paid the plant blend, and their handlers are not required to contribute to the proceeds which pay quota holders. *Id.* Those out-of-area farmers could not, and did not, own any quota and the plant blend they received compensated them for the fact that they did not have the opportunity to receive a quota price. *Id.* Undoubtedly, the current system of paying out-of-area farmers outside of the quota pool system was born from this inherent inequality in the quota program. *See* Tr. 7548:13–18 (Testimony of Mr. Tosi).

It is, of course, the case that FMMOs have the right to pool out-of-area milk, unlike the CSO. However, the out-of-area milk producers cannot be required to subsidize a quota program in which they are not allowed to participate. Ex. 145, at 6. Out-of-area producers, under current California law, are not permitted to purchase quota. *Id.* And even if out-of-area producers were permitted to now purchase quota, original-issued quota was free. *Id.* Finally, even if a compromise was proposed to open quota to out-of-area producers and its price was subsidized in some way, neither the cooperatives nor the USDA could affect such a change – only the California legislature may amend the California quota program. *Id.*

In light of the limitations above, the Dairy Institute's Proposal establishes what it has found to be the only mechanism by which quota may continue to operate within a Federal Order without resulting in unlawful trade barriers – that out-of-area farmers receive a plant blend and are not forced to participate in the quota pool. Adoption of a forced participation system is unlawful under § 608c(5)(G) and, in light of the clear Supreme Court pronouncements in *Lehigh,* would expose any California FMMO to a likely successful court challenge.

3. The Cooperative Order discriminates against out-of-area milk.

The Cooperative Order would violate 608c(5)(G) and make second class citizens of any out-of-area producer who wants to market in a California FMMO.[45] Tr. 5169:13-18 (Testimony of Mr. Vetne). "It would provide the worst possible price available to that [out-of-area] producer and treat in-state producers better in many ways." *Id.*; *see also* Tr. 7495:22 – 7496:6. (Testimony of Mr. Tosi). USDA cannot and should not adopt the self-serving and unlawful pooling provision in the Cooperative Order because it would result in a lower handler credit being applied to all out-of-area milk, subsidizing the in-area dairy farmers and resulting in in trade barriers to out-of-area producers.

Including out-of-area milk in the pool, as acknowledged by the Cooperatives, increases the value of the pool. Tr. 1860:8 (Testimony of Dr. Erba). When milk from out-of-area, which is currently paid at the plant blend outside of the pool, is included in the value of the pool, it creates a larger producer-settlement fund from which the quota value may be withdrawn prior to the payment of the overbase price. *Id.* at line 12; *see also* Tr. 1863:14–22 (Testimony of Dr. Erba). This results in in-area producers receiving both a higher quota and overbase price as they benefit from the proceeds of the out-of-area sales. Conversely, the out-of-area producer who used to instead receive the plant blend price would then receive the lower overbase price. Tr. 1857: 1–8 (Testimony of Dr. Erba). The benefit of a higher quota price is exclusively shared by in-area producers, with the loss being born solely by out-of-area producers. Quota holders benefit twofold, both from the higher quota and overbase prices and by the larger pool providing a stronger base whereby to support quota payments (increasing the certainty of quota payments

[45] USDA importantly raised this issue at the hearing, Tr. 1163:20 – 1164:6 (Testimony of Ms. AcMoody, Examination by Mr. Hill); the record and legal analysis herein prove that these concerns were well-founded.

and, thereby, the value of quota). As shown in this exchange, the cooperatives are acutely aware that their proposal is designed to lead to such an outcome.

> JUDGE CLIFTON: So, Mr. English, I think I understood, but what you are saying is if, if as a result of Proposal Number 1 there's more value in the pool, that's going to help quota holders? Is that your question?
>
> MR. ENGLISH: I think it was – it's more than that. It's, in essence, that out-of-area milk is going to be treated different differentially than it is today, and that differential treatment inures to the benefit of in-state dairy farmers.
>
> DR. ERBA: You know, if you had said that, we could have been done with this section 20 minutes ago.
>
> MR. ENGLISH: Would you agree with that?
>
> DR. ERBA: I think that wasn't...
>
> MR. ENGLISH: You would agree with that?
>
> DR. ERBA: I think that's an accurate description.

Tr. 1864:11 – 21 (Testimony of Dr. Erba).

The Cooperatives further admit that no justification exists for such discrimination other than that the out-of-area producers do not live in California. *See* Tr. 2935: 2 – 12 (Testimony of Mr. Hollon). While the Cooperatives may claim that they did not "make the rules" regarding who can own quota (Tr. 2935:6), if they seek to enforce those rules within a federal system then they are responsible for the consequences of such a proposal. The Cooperatives assert that "preserv[ing] the value of quota" (an objectionable goal in itself, as discussed in Section IV) is a justification for the net effect of reducing the blend price for other producers. Tr. 3517: 1 – 5 (Testimony of Mr. Hollon). However, out-of-area farmers cannot be required to sacrifice their income so that California farmers can both preserve their favored quota program while obtaining the benefits of an FMMO.

Compounding the discrimination that out-of-area farmers face in having the overbase price forced upon them is that, since they are not residents of California, they are also excluded from participating in any discussion of changing quota or how to divide that pool. Tr. 7544:7–7545:3 (Testimony of Mr. Tosi) ("[T]hat's one of the things that's just fundamentally wrong here. The people who get to sit down at the table to decide how you do that, Ponderosa [an out-of-area entity] doesn't get to sit down at the table for that."). Under the Cooperative Order, out-of-area farmers would become beholden to a system within which they have no standing to object or appeal. Since the quota program is a state-run program, USDA would be similarly hamstrung in both holding hearings to consider out-of-area producers' concerns or ultimately making revisions to the quota program to account for discriminatory practices (a concern discussed further in Part E of this section).

The impact of the Cooperative Order on out-of-area farmers could be devastating. Mr. Charles Turner of Desert Hills Dairy in Nevada explained how the Cooperative Order would harm his family's dairy farm. Desert Hills Dairy has been shipping milk into California since the 1990's. Tr. 4080: 22–24 (Testimony of Mr. Turner). The farm ships milk both independently into California and also for Dairy Farmers of America. Tr. 4080:6–8. Desert Hills currently receives the plant blend price for milk shipped into California. Tr. 4082:5–8. Should the Cooperative Order be adopted, Desert Hills would receive the non-quota federal blend price which would, absent extraordinary circumstances, be less than the plant blend price it receives today. Tr. 4082:9 – 4083:1. As Desert Hills cannot own quota, Mr. Turner sees their inclusion in the quota pool as unfair. Tr. 4083:18–24. Having to subsidize the quota pool would cause significant damage to Desert Hills, estimated at well over $1.00 /cwt. Tr. 4089: 20–24. They have even discussed selling their cows if the USDA adopts the Cooperative Order. Tr. 4084:14–25. A California FMMO cannot come at the expense of farmers like Mr. Turner.

Real-world application of the Cooperative Order reveals that its shortcomings extend to dairy industry participants beyond just out-of-area producers. As discussed by Dr. Schiek, under the Cooperative Order, a plant in Arizona that receives milk from Arizona and California farmers would ultimately pay those two farmers different prices – the Arizona producer would get the traditional blend price and the California producer would receive the lower non-quota blend price. Ex. 145, at 8. Thus, not only would out-of-area producers suffer under the Cooperative Order, but California dairy farmers would find themselves comparatively disadvantaged when selling milk to the same source. *Id.* at 8. The other problem noted in this example is that the Cooperative Order would also force that Arizona plant to contribute to the quota premium through the pool on any of the California milk it purchases (which is not be required under the Arizona FMMO today). Not only do out-of-area producers suffer, but out-of-area plants are forced to subsidize a system over which they have no say or control. That out-of-area plant would also face adverse changed economic circumstances as its California dairy farmers from whom it purchases milk today would no longer receive the Arizona FMMO blend price on their milk, and would receive instead the overbase price on their milk shipped to the same plant and distributed to the same locations as before the California Order was adopted.

The Cooperative Order also creates a barrier to entry for any new dairy farmer in the form of the overbase price that has been reduced by the payment of the quota value. No new dairy farmer can, without incurring the cost of buying into the quota system, receive the traditional uniform price for her milk. Even when Congress authorized Base plans in the 1965 and 1970 Farm Bills, discussed in Section IV, it expressly provided for new producers to be able to receive some base over time. The Cooperative Order freezes them out forever. USDA should not, and never has been, be in the business of erecting barriers to entry for new dairy farm businesses.

D. The Dairy Institute Proposal is Consistent with the AMAA Requirement of Uniform Prices Paid to Producers.

1. The AMAA uniform price requirement prevents adoption of the Cooperative Order.

As discussed above in Section IV, the AMAA requires that all pool producers under an FMMO must be paid uniform prices. 7 U.S.C. §608c(5)(B). Any exception to this uniform payments requirement must fall within the specifically enumerated adjustments set out in the provision. *Id.* at (5)(B)(ii).[46] This provision is integral to the FMMO system; "[t]he foundation of the statutory scheme is to provide uniform prices to all producers in the marketing area, subject only to specifically enumerated adjustments." *See Zuber, supra,* at 179. Regulatory schemes which violate this provision are unlawful under *Zuber*. The nearby differentials struck down as unlawful in *Zuber* were not protected since they lacked an economic cost justification. Also, justifying these kinds of adjustments to the uniform price requirements based upon historical pricing allocations was insufficient.

The Supreme Court noted the problems associated with letting historical payment agreements drive modern milk policy:

> The Government's proposed reading of the Act, bottomed, as it is, on the historical payment of a premium to nearby farmers during the monopolistic era of the cooperative pools, would come to perpetuate economic distortion and freeze the milk industry into the competitive structure that prevailed during the 1920's.

Id. at 180. Accordingly, since the Quota Provision must be reconciled with the AMAA uniform price requirements, USDA may not adopt any payment provision which would result in mandated non-uniform payments to producers, regardless of the seeming historical import of the proposed compensatory program.

2. The Dairy Institute Proposal provides for uniform payments to producers.

Under the Dairy Institute Proposal, producers receive uniform payments for their milk. Any variation on the uniform payment received by a producer would occur only due to a voluntary election of the producer to participate in the quota program and redistribute his

[46] "(ii) 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; subject, in either case, only to adjustments for (a) volume, market, and production differentials customarily applied by the handlers subject to such order, (b) the grade or quality of the milk delivered, (c) the locations at which delivery of such milk is made, and (d) a further adjustment, equitably to apportion the total value of the milk purchased by any handler, or by all handlers, among producers and associations of producers, on the basis of their marketings of milk during a representative period of time, [(e) omitted] and (f) a further adjustment, equitably to apportion the total value of milk purchased by any handler or by all handlers among producers on the basis of the milk components contained in their marketings of milk"

proceeds accordingly. Specifically, under §1050.68, producers within the marketing area can elect to abstain from participation in the quota program:

> Any producer whose farm is located in California and whose milk is received at such a plant located in California unless such producer irrevocably notifies the market administrator in writing before the first day of any month for which he first elects to receive payment at the applicable prices announced under §1050.62(h).

Thus, producers have a right (should they so choose) to receive uniform payments. This election option applies to in-area producers while out-of-area producers would receive the traditional FMMO blend price, meaning both would be able to receive a uniform price.

While participants in the California Quota Program will not receive uniform payments to those who opt out of the program, such a scenario is not a violation of §608c(5)(B) because the resulting non-uniformity is a voluntary decision by the producers. Producers surely can choose to distribute their own proceeds in any manner they see fit just as USDA permitted in the Oregon Order, (34 Fed. Reg. 17684, 17700 (October 31, 1969)); what neither USDA nor the producers can do is to force others to contribute to a program which results unquestionably in non-uniform payments. The Dairy Institute Proposal is the only proposal that provides for the continuance of the quota program, while complying with §608c(5)(B).

3. The Cooperative Order results in non-uniform prices paid to producers.

The option to opt out of the quota system is what makes the Dairy Institute's proposal compliant with §608c(5)(B) – without the option to opt-out of quota participation, the quota system as it exists today results in non-uniform prices paid to dairy farmers. The Cooperative Order's wholesale adoption of the quota system maintains mandatory participation of all producers in the quota pool, including out-of-area farmers who cannot participate in quota. If farmers cannot opt out of the quota system or if out-of-area milk is not provided an alternative traditional FMMO blend price, then the regulation will result in non-uniform payments to dairy farmers: some dairy farmers will receive the quota payout of $1.70 plus the overbase price, while others will only receive the overbase price. The AMAA prohibits such a result.

Quota has no economic justification under the AMAA and is an improper price adjustment to uniform prices under 7 U.S.C. §608c(5)(B). Like the nearby differentials rejected in *Zuber*, quota is a California historical artifact, based at its inception on then-existing service of the fluid market and with no economic justification for departing from the AMAA's core principle of requiring uniform payments paid to dairy farmers. When a traditional FMMO is adopted for an area previously unregulated, those dairy farmers shipping to Class I plants naturally received the FMMO blend price in lieu of the higher Class I price that they were able to achieve prior to regulation. USDA never provided (except as discussed and found unlawful in *Zuber*) "compensation" for those historical Class I sales. The compromise that the Supreme Court rejected in *Zuber* as an improper justification for non-uniform payments was the same compromise producers in California made that led to quota. Tr. 1866: 8–16 (Testimony of Dr. Erba). As original-issued quota was free, the fact that quota now garners a sale price fails to constitute any kind of "economic" justification for the payment.

The problem of unequal treatment of farmers exists currently in the quota system and will subsist unless a change is made to the manner in which farmers participate in the quota pool. If participation in the quota system is not voluntary, the problem of unequal payments extends to both in-area farmers and out-of-area farmers. Moreover, out-of-area farmers face dual layers of discrimination, as not only will they not receive uniform prices to quota-holding farmers, but they have no opportunity to ever become a quota-holding farmer. In-state farmers without quota (particularly those who never had the opportunity to receive the free, originally-issued quota and dairy farmers who first start farming after a California FMMO is adopted) will also receive non-uniform prices.

This disparate payment situation is a reality for non-quota farmers currently in California. At the hearing, some California farmers voiced their objection to this unjustified distinction which has created two classes of farmers in the state:

> It just amazes me that in 1968, when the Milk Pooling Gonsalves Act was enacted in California, 95 percent of our milk was Class I sales, and so the

> quota system worked great. And now we got a 13 percent Class I sales with the same quota system, and it is broken. And that's the real pink elephant in the room. And I'm not belittling the quota holder, and I'm not belittly [sic] the guy that tries to buy it when he get a 13 to 17 percent return on the quota, if I was him, I would do the same. But now we have created two classes of dairymen in the state of California that doesn't work.

Tr. 5468:20 – 5469:4 (Testimony of Mr. Vandenberg). While such a situation may be tolerable under California state law, it is unequivocally prohibited within the Federal Milk Marketing Order system.

E. The Cooperative Order Prevents USDA from Orderly Administration as Quota is Subject to California Law.

Under any FMMO incorporating California quota, USDA faces the unique challenge of incorporating a system into the FMMO that is wholly controlled by state law. Without full administrative control over an important element of the Cooperative Order, USDA will lack the ability to correct any disorderly marketing conditions that may arise as a result of quota or changes to quota under California law. It would be as if USDA owned the FMMO car, but there are two drivers who may or may not drive in the same direction.

Quota and its accompanying \$1.70 payout exist solely under California law. *See* Cal. Food and Agric. Code, § 62700 *et seq.*; *see also* CDFA Glossary of Terms (Quota: "Part of a two-tiered pricing system in California. Essentially, quota is an entitlement that allows a producer to receive a price for milk that is \$1.70 per hundredweight higher than the overbase price. Originated with the inception of the milk pooling program in 1969."), found at https://www.cdfa.ca.gov/dairy/appendix.html. Any change to the ownership restrictions of quota must be made by the California legislature. *Id; see also* Tr. 2142: 3–11 (Testimony of Dr. Erba).

This dependency created between the two regulatory systems will undermine USDA's administration of any California FMMO in two ways. First, if USDA incorporates quota wholesale it will be unable to make any changes to the quota program in order to correct for features that violate the AMAA. Second, USDA will be "along for the ride" for any changes that the California legislature makes to quota after the adoption of a California FMMO. For example, the producer-handlers admitted that, if USDA were to adopt their proposal and permit exempt quota within the California FMMO, there is nothing to stop the producer-handlers from then turning to the California legislature to obtain more exempt quota. *See* Tr.7053: 9–18 (Testimony of Mr. Shehadey); *see also* Tr.2208:3 – 2210:25 (Testimony of Mr. Erba) (noting similar problems associated with Regional Quota Adjusters or RQA's). Such a scenario could upend any carefully crafted balance that USDA struck in incorporating both traditional and exempt quota into a California FMMO.

Admittedly, this challenge is a shortcoming faced by all proposals to the USDA, including the Dairy Institute's.[47] Accordingly, this complication underscores the necessity for a revised FMMO-friendly quota system that addresses all issues with trade barriers, uniform pricing, and all other non-standard FMMO Provisions. Under the Dairy Institute Proposal, the voluntary nature of quota participation lessens the impact of the USDA's lack of control over the quota program. Additionally, the Dairy Institute Proposal has corrected for any features of the quota system which are in violation of the AMAA. To the contrary, under the Cooperative Order's wholesale adoption of the quota system, if any aspect of the quota program results in disorderly marketing conditions or otherwise violates the AMAA USDA will be without recourse to change the quota program. Thus, for instance, USDA would be in the impossible position of either having the entire California FMMO struck down by a court or having to hold an entirely new California FMMO hearing to approve a revised FMMO that is not beholden to the California quota program (or both).

[47] As noted above, the Dairy Institute based its quota provisions on those from the former Oregon FMMO. 34 Fed. Reg. 17684, 17700 (October 31, 1969). However, the Dairy Institute cannot represent that Oregon's quota system had proper legislative authority and approval.

F. Changes to Participation in the Quota Program After Adoption into the FMMO Would be Economically Justified, Market-Driven, and Consistent with the AMAA.

Much was made at the hearing that the quota program would become obsolete under the Dairy Institute Proposal due to opt-outs. However, critics overemphasize both the likelihood and effects of such an event.

First, considering the social and communal importance that quota has in the California dairy industry, it is unlikely that farmers will be so quick to abandon the system regardless of whether or not participation is voluntary. A USDA expert testified that the Oregon quota program lasted for 18 years and 2 months even though the economic decisions were identical to those that might be made in California. Tr. 301:7–17 (Testimony of Ms. Warren). The Dairy Institute Proposal is mirrored off of the Oregon quota program, so California farmers would be facing the same motivations and constraints as the Oregon farmers who supported their quota program for almost two decades. Beyond the pure numbers and calculations used to predict producer behavior, there must have existed some other mental or market force that kept participants in the quota system. Testimony from some California dairy farmers that they support the quota program, even if not quota-holders, supports the point that they would continue to do so under a voluntary system. Tr. 1016:23 – 1017:9 (Testimony of Mr. Avila). Thus, in light of the dedication California farmers have for the quota system, there is no reason to think they would act any differently than the Oregon farmers and provide continued support for and participation in the program.

Second, this result has no legal relevance as the Dairy Institute Proposal is consistent with the Quota Provision and the AMAA. On the day a new California FMMO with such provisions is implemented, quota value will be recognized. Those farmers holding the quota will receive their \$1.70 per hundredweight, along with their overbase price. This result will not change under the Dairy Institute Proposal, nor will it change based on any level of participation in quota. If dairy farmers over time, however fast or slow, elect otherwise, that is of no legal significance because quota holders would still get their \$1.70 paid as quota from the remaining pool. What they will no longer receive is the subsidized overbase price which non-quota holding farmers are currently supporting in the quota pool. The USDA must ensure that the primacy of the AMAA's uniform pricing rules prevails, and must do so regardless of any resulting change in participation in the quota program.

Third, decisions made by rational, educated, self-interested dairy farmers seeking to maximize their own profits must be an accepted part of any FMMO. If, by a certain decision period, farmers opt-out of quota participation (as suggested by Mr. Hatamiya (Tr. 2279:23 – 2284: 20)), it can only be concluded that such a result is the most beneficial outcome for the farmers. While there is (obviously) support for quota among quota-holding farmers, some non-quota holding farmers currently wish they were not forced to participate in and subsidize the quota program. Tr. 5468:20 – 5469:4 (Testimony of Mr. Vandenberg). These farmers, particularly those who were not around early enough to be given quota, have been left at a permanent disadvantage in the California dairy system. Considering the percentage breakdown of quota ownership (42% of farmers own no quota, and 20% of farmers own only 1%-20% quota (Tr. 1814:25–1816:12, Ex. 42, at 21)), opting out of the quota system would lead to *higher* prices for the majority of farmers in California. Thus, the results of moving away from the quota system (either through opt-outs or a buy-out) will in fact result in better income for the majority of farmers in California. It is unquestionable that farmers will act in their own best interests, and pejorative to suggest that USDA must prohibit them from doing so.

Lastly, USDA may revise the Dairy Institute's proposed quota system to support participation as long as such revisions do not violate the AMAA. Such a revision could be made to the revocability element of the quota pool opt-out. As noted above, the Dairy Institute adopted the provision making the opt-out non-revocable because that requirement mirrored the Oregon quota program. However, the decision to opt-out could be made revocable, possibly with a transition-period requirement similar to that of opting out of a pool. Such a revision would allow farmers to rejoin the quota pool after opting out, thereby providing farmers greater autonomy, and undermining the economic analysis that suggests that the quota program would end quickly. The farmer could test out receiving the non-quota blend price (or do so only in certain financial situations) and ultimately decide each month if participation is the best outcome for the business. If a farmer can revoke his decision to opt-out, it certainly would lead to at least some increased participation (and call into question the results suggested by Mr. Hatamiya).

G. USDA May Consider Compromises on Quota.

As the Dairy Institute noted in its testimony (Tr. 6651:17-6661:8 and 7993:17-8009:17) (Testimony of Dr. Schiek), there are likely alternative ways that quota value could be "recognized" under a California FMMO. Quota value could also be "recognized" under the Quota Provision if the asset value is paid back at the termination of the income stream or on some basis over time. The asset value could be based on the quota transaction price at the time the income stream is terminated or on the basis of an average quota price over a period of time. While not endorsing a particular proposal, we explored a couple of approaches in our testimony. We believe that USDA could consider compromises on the manner of recognizing quota value, so long as these do not interfere with the promotion and maintenance of orderly marketing in the marketing area and are accomplished without violating the AMAA as it has been interpreted by the courts and USDA through 80 years of application and interpretation.

If California is permitted to join the Federal system and California producers are also allowed to receive a quota price for their milk, then the Department under the AMAA must limit the time period for receipt of such quota. One possible solution is to treat quota as a form of "good will" and to allow quota to be paid over a specified period of time and then "written off." Effectively, the Secretary would "recognize quota value," and the California producers would then be given the choice of continuing with the quota system and remaining in a California state order only, or joining the Federal Milk Marketing Order system and permitting their recognized quota value payments to "sunset" over a specified period of time. The California producers cannot be allowed to join the Federal system and to continue to receive quota indefinitely because this is not the "only practical means pursuant to the declared policy of the AMAA of advancing the interest of producers." 7 U.S.C. § 608c(9)(B).

By doing the above, USDA could reconcile the AMAA and the Quota Provision.

IX. USDA MUST REJECT PROPOSALS 3 AND 4

A. Proposal 3 Relies on an Expansive Interpretation of the Farm Bill Language that Would Add More Unique Provisions to the Cooperative Order.

Proposal 3 seeks to introduce into the FMMO framework the unique and special treatment given to producer-distributors under the CSO ("PDs"). PDs operate both dairy farms and processing plants (*see* Tr. 6820: 5 – 7 (Testimony of Mr. Gonsalves); Tr. 6948: 13 – 18 (Testimony of Mr. Shehadey)) but their similarity to FMMO producer-handlers ends there. PD processing plants can and do receive significant outside milk supplies in addition to the volumes received from their related business farms. Tr. 7086 – 7088 (Testimony of Mr. Shehadey) (describing how CDI helps the PD balance its milk supply); Tr. 7319:23 – 7320:16 (Testimony of Mr. Ortis) (stating that 85% of their milk comes from outside sources, and that they use a broker to balance their milk supplies); Tr. 7567:20 – 24 (Testimony of Mr. DeGroot). The PDs also operate large volume Class I plants. Tr. 6948: 13 – 18 (Testimony of Mr. Shehadey). The two most significant factual distinctions between PDs and "producer-handlers" under traditional FMMOs are:[48] (1) PDs do not operate fully integrated farms and processing plants (Tr. 6383: 15 – 24 (Testimony of Mr. Blaufuss)); and (2) PDs distribute large volumes of Class I milk in commercial channels. Tr. 6422: 3 – 19 (Testimony of Mr. Blaufuss). USDA has concluded that the producer-handler exemption critically rests on self-sufficiency of farm and plant operations and a route disposition limitation. The PDs meet neither criterion and thus are not entitled to a new form of exemption from pooling and pricing requirements in any California FMMO. While both prongs would have to be met to support any consideration of any kind of exemption, we argue that the PDs fail to meet either prong.

Proposal 3 seeks to retain, unaltered, the CSO treatment of a California quota system construct for PDs called "exempt quota." Under the CSO, large Class 1 handlers with historical

[48] At the hearing, both examiners and witnesses would routinely refer alternatively to PDs, P-Hs, producer-distributors and producer-handlers. Except in transcript quotes, this Brief uses PDs only refer to CSO producer-distributors with exempt quota under Option 70. Tr. 6945 (Testimony of Mr. Shehadey). Producer-Handlers in turn mean only producer-handlers as defined in paragraph 10 of any of the existing FMMOs. *See all* 7 C.F.R. §1---.10.

Class 1 sales predating the adoption of pooling under the Gonsalves Milk Pooling Act were issued regular quota and could make limited purchases of regular quota, both of which could be converted to exempt quota for those handlers. *See, generally*, Ex. 139 (Testimony of Mr. Blaufuss) and Ex. 150 (Testimony of Mr. Gonsalves). Exempt quota is quota solids nonfat ("SNF") converted into an equivalent volume of milk per cwt that is exempt from the pricing and pooling provisions of the CSO. *Id.* Handlers with exempt quota are then exempt from the pooling and pricing provisions of the CSO on the equivalent volume of milk covered by their exemption. *Id.* This means that unlike other Class 1 handlers under the CSO that have to account for and pay minimum regulated Class 1 prices, including the payment into the producer-settlement fund, these privileged few Class 1 handlers do not contribute to the producer-settlement fund on the exempt quota volume of milk. *See, generally*, Ex. 139 (Testimony of Mr. Blaufuss) and Ex. 150 (Testimony of Mr. Gonsalves).

These exempt-quota holding Class 1 handlers presently are not on an equal playing field with the remainder of Class 1 handlers with respect to the requirement to pay the minimum uniform regulated price. Moreover, as to the dairy farmer side of these operations, they are not sharing all of the value of their Class 1 sales with their fellow dairy farmers. If incorporated into a California FMMO, this arrangement would be yet another exemption from or adjustment to the uniform price requirements of the AMAA (both the requirement that handlers pay uniform prices and the requirement to dairy farmers receive a uniform price).

In order to consider Proposal 3, USDA would have to conclude that the Quota Provision reaches even beyond the authority presumed to be granted in support of the Cooperative Order. As discussed above in Part II, the Farm Bill language does not amend the AMAA uniform price requirements and the Quota Provision can be reconciled with the AMAA without incorporating the California quota system wholesale. But even if such were not the case, the PDs seek to stretch the already broken envelope in a way that would adversely affect more regulated businesses and create additional competitive problems for fluid milk processors (e.g., beyond the lack of performance-based pooling standards).

In the first instance, the term "exempt quota" is not the same thing as "quota value." If Congress had intended to provide USDA authority to address exempt quota, it knows how to say that and chose not to do so. As discussed above, Congress knows precisely how to provide detailed and specific exemptions to the uniform price provisions of the AMAA. *See*, Section II.B(2)(d) (1965 and 1970 Farm Bill amendments to 7 U.S.C. §608c(5)(B)). In addition, to the extent the PDs argue that Congress intended a different result for the PDs in the Quota Provision, both the 1965 and the 1970 Farm Bill temporary amendments contradict that argument. Congress has before acknowledged USDA's exemption of producer-handlers from the pricing and pooling provisions of the AMAA, and did so be explicitly and clearly referencing the AMAA:

> The legal status 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 as it was prior thereto.

Pub. L. 89-321, Sec. 104 (1965); Pub. L. 91-524, Sec. 201(b) (1970). In this example, Congress was making certain that no one would conclude that those express Farm Bill amendments to the AMAA altered the legal status of producer-handers. *Ideal Farms v. Benson*, 288 F.2d 608 (3d Cir. 1961); *Freeman v. Vance*, 319 F.2d 841 (5th Cir. 1963). Congress made no such pronouncement in regards to exempt quota and PDs – accordingly, USDA can only conclude that Congress intended for PDs to receive no special treatment and to be subject to the provisions of the AMAA.

Moreover, as noted in cross-examination of Foster Dairies by Mr. Vandenheuvel (hardly an examiner sympathetic to the Dairy Institute's positions), when exempt quota was issued and when subsequently purchased, exempt quota's price was precisely the same as regular quota. Tr. 8130, lines 2-13 (Testimony of Mr. Lund). Exempt quota has no differential transactional price from regular quota. And yet, underpinning Proposal 3, exempt quota would be entitled to additional differential treatment (exemption from both the pooling and pricing provisions of the

FMMO) further exacerbating the issue of adjustment to the uniform price not granted by the Quota Provision.

Congress did not say as the PDs claim that the entire quota program has to be preserved or maintained. *See* Section IV. USDA cannot go even further and undermine or ignore the AMAA's uniform pricing requirements not only as to minimum regulated prices paid to dairy farmers, but also those minimum regulated prices paid by Class I handlers.[49] The Quota Provision certainly does not encompass permitting large Class I handlers to have a regulatory competitive advantage over other Class I handlers competing for the same commercial customers. The Quota Provision simply is not the panacea that so many in California claim.

B. Producer-Distributors Fail to Qualify as FMMO Producer-Handlers.

While the PDs do not make any effort to justify their proposed preferential status based upon FMMO treatment of producer-handlers, the fact that these entities would not qualify as producer-handlers under any FMMO undermines their argument for yet more special treatment. *See* Tr. 6383: 15 – 24 (Testimony of Mr. Blaufuss) (all four PDs could not qualify as producer-handlers because they buy significant amounts of milk outside their own system); *and* Tr. 6422: 3 – 19 (Testimony of Mr. Blaufuss) (at least three of the four PDs could not qualify as producer-handlers because they have more than three million pounds milk route distribution). USDA's existing handler exemptions from the pricing and pooling provisions of orders are all based on the conclusion that the exempt entities do not have a competitive impact on the regulated market and do not undermine the uniform pricing requirements of an FMMO. PDs, on the other hand, fail on both fronts.

There are five existing categories of exempt plants under FMMOs: government operated plants without commercial distribution; college or university operated plants selling only internally and again without commercial distribution; plants operated with distribution to charitable entities without remuneration; plants processing less than 150,000 pounds of milk; and

---

[49] At the hearing the cooperatives could and would never make a determinative decision whether or not to support Proposal 3 precisely because it requires reading the Quota Provision ever more broadly.

producer-handlers. 7 C.F.R. §1000.8(e). Producer-handlers in turn must be essentially fully integrated operations, with minimum purchases of outside milk and restrictions on the disposal of surplus milk. *See, e.g.,* 7 C.F.R. §§1124.10 and 1131.10. In addition, these entities are limited to three million pounds of route disposition. *See all* 7 C.F.R. §1---.10.

USDA carefully crafted these exemptions based on the conclusion that exempt plants *do not* operate in the commercial, competitive environment or do so in a way that does not undermine the purposes of the AMAA. 64 Fed. Reg. at 16038, c.1–2. USDA concluded that the fact that producer-handlers receive and make non-uniform payments does not lead to disorderly marketing because the producer-handlers have a negligible impact on the market. Nonetheless, USDA has always recognized that producer-handlers by their very nature and sales have the *potential* to create disorderly marketing conditions. The problem is stated as follows by USDA:

> The marketing of milk by producer-handlers in a regulated market has the potential of creating disorderly marketing conditions. When milk of a producer-handler is sold in a Federal milk marketing area, such milk is not priced by the order. In such case, the order does not provide uniform regulated pricing among competing handlers since fully regulated handlers must pay the minimum order Class I price for milk in fluid uses while producer-handlers are not required to do so. This raises the potential for competitive inequities among handlers. Furthermore, there is not an equal sharing among all dairy farmers in the market of the returns from the sale of all milk in all uses since producers whose milk is being priced under the order do not share in the Class I sales of producer-handlers.

Milk in the Rio Grande Valley and Certain Other Marketing Areas, Proposed Rule 56 Fed. Reg. 42240, 42248, c.1 (August 27, 1991). The USDA has relied upon the hard line qualifications for producer-handlers to protect against the potential inequities of their operation outside of the pooling system.

With respect to producer-handlers there has always been an important, additional proviso – that the potential for market disruption was minimized by requiring that producer-handlers be self-sufficient in their operations:

> The potential for producer-handler activity in a regulated market to be disruptive is *minimized to the extent that they are required to be self-*

> *sufficient in their operations by order provisions*. Generally, producer-handlers do not have a demonstrated advantage in a market in their capacity as either handlers or producers as long as they are solely responsible for their production and processing facilities and assume essentially the entire burden of balancing their production with their fluid milk needs.

Id. (emphasis supplied). The clear rationale for requiring self-sufficiency by exempt producer-handlers is the elimination (or at least minimization) of a producer-handler being able to use the regulated market to balance its Class I needs. Otherwise a producer-handler could simply buy outside milk when it needed it and reduce or eliminate such sales when it did not. If an FMMO does not require a producer-handler to be self-sufficient, it permits the producer-handler to reap all of the benefits of the pool (access to milk supplies when needed) without having to share in the burdens (minimum prices paid for milk by handlers and distribution of Class I proceeds among all producers). The ability to use the market to balance supplies without contributing to the pool would undercut the entire regulatory program. *Id.* The PDs lack this critical regulatory limitation governing producer-handlers, and that by itself is sufficient reason to reject the proposed special treatment that would result in non-uniform prices paid by handlers and to dairy farmers:

> The producer-handlers contend that unlimited purchases from pool plants would result in an increase in Class I sales that would benefit all producers and would also reduce the need for producer-handlers to increase their production to cover all anticipated needs which could intensify market surplus disposal problems. . .
>
> It is difficult to conclude how benefits could accrue to all producers by providing for unlimited purchases from pool plants if there is a reluctance on the part of such pool plants to furnish supplies of milk to producer-handlers. The two conclusions appear to be contradictory. . . . As previously stated, unlimited purchases from pool plants result in producer-handlers being able to transfer a portion of the cost of balancing their milk supplies to other producers who supply the market. A significant proportion of the risk of total operations should be borne by producer-handlers in order to be exempt from pricing and pooling provisions in view of the production characteristics of the market and the substantial amount of producer-handler activity in the market.

Id. at 42249.

These CSO Class 1 handlers fail another key condition of the FMMO producer-handler definition – they are too large to meet the three million pound cap on milk route distribution. After two rulemaking proceedings, USDA has concluded that once a producer-handler has Class I route disposition of more than three million pounds per month, it necessarily will have a competitive impact on the regulated market and undermine the uniform price requirements of the FMMOs. Accordingly, this cap constitutes a hard threshold beyond which producer-handler status will be denied.

> As already discussed above, producer-handler exemptions from the pooling and pricing provisions of the orders are based upon the premise that the burden of surplus disposal of their milk production is borne by them alone. Consequently, they have not shared the additional value of their production that arose from Class I sales with pooled dairy farmers. In this regard, to the extent that producer-handlers are no longer bearing the burden of surplus disposal, specifically disposal of milk production in some form other than Class I, gives rise to considering regulatory measures that would tend to provide price equity among producers and handlers that is eroded when producer-handlers are permitted to retain the entire additional value of milk accruing from Class I sales.
>
> The record supports finding that producer-handlers with more than 3 million pounds of route disposition per month in both the Pacific Northwest and the Arizona-Las Vegas marketing areas are the primary source of disruption to the orderly marketing of milk. This disorder is evidenced by significantly inequitable minimum prices that handlers pay and reduced blend prices that dairy farmers receive under the terms of each area's marketing order. Accordingly, producer-handler status under the Pacific Northwest and the Arizona-Las Vegas orders should end when a producer-handler exceeds 3 million pounds per month of in-area Class I route disposition.

Milk in the Pacific Northwest and Arizona-Las Vegas Marketing Area, 70 Fed. Reg. 74166, 74185-74186 (December 14, 2005); *see, also, Milk in the Northeast and Other Marketing Areas,* 75 Fed. Reg. 10122, 10151 c.3 – 10152 c.1 (March 4, 2010) ("National Producer-Handler Rulemaking).

In the National Producer-Handler Rulemaking, USDA expressly rejected the idea of a "soft-cap" where a producer-handler could be exempt on its first three million pounds of route distribution, but then fully regulated on the remainder:

> Soft-caps exempt some Class I disposition while subjecting any additional disposition to pooling and pricing. This would cause inequitable treatment across similarly situated handlers where handlers with own-farm milk could ''smooth'' the price advantage gained on the volumes of exempt fluid milk products across any additional Class I sales. In turn, this would also allow handlers with own-farm milk to undercut prices offered by those handlers without own-farm milk strictly as a consequence of regulation.

Id. at 10149, c. 1.

The exempt quota that the PDs seek to retain is a soft-cap equal to their equivalent volume far in excess of the three million soft-cap rejected by USDA in 2010. It has the identical type of negative economic impact on the producer-settlement fund and other regulated players as the rejected soft-cap in 2010. In fact, the primary difference is that the PD's impact in this case would be *much greater* than that considered in 2010, since the PD's seek an exemption for well over the three million pound soft cap considered in that proceeding. USDA's rejection of continued exemption for large producer-handlers and refusal to permit a soft-cap is instructive when reviewing the producer-distributor effort in this proceeding.

Perhaps most troubling of all, the PDs seek a special exemption that would apply only to them. No new entities could apply for or obtain this PD status. Tr. 6832: 4 – 12 (Testimony of Mr. Gonsalves). This form of "grandfathering" regulation whereby entities achieve preferred regulatory status on the basis of historical (and indeed non-FMMO) status has been rejected by USDA. USDA expressly rejected this type of new category of handlers in the National Producer-Handler Rulemaking. "Grandfathering clauses, as proposed, would create inequity between persons who are currently producer-handlers and other entities who may in the future seek to supply milk as producer-handlers." *Id.* at 10149, c. 2.

No justification exists for USDA to abandon its long-standing, well and fully litigated rejection of soft-cap producer-distributor exemptions. In fact, such a decision may undercut all of USDA's prior pronouncements on producer-distributor caps, leading to renewed challenges to those provisions. The proposed PD exemption should be rejected by USDA for the same rationales as relied upon in the 2006 and 2010 proceedings.

C. PD's Exempt-Quota Would Constitute Disorderly Marketing and Must be Rejected.

1. The PDs competitive advantage is the difference between the Class 1 and the quota price.

In the two prior producer-handler proceedings, USDA determined that the advantage that a producer-handler has over fully regulated handlers is equal to the difference between the FMMO Class I price and the traditional FMMO blend "not paid into the producer-settlement fund." 70 Fed. Reg. at 74186, c.1-2; *see, also,* 75 Fed. Reg. at 10148, c.1. Further USDA concluded: "[t]he exemption from payment to the producer-settlement fund renders the order unable to set uniform prices to producers." 75 Fed. Reg. at 10146, c.2.

USDA should make the same finding here except that the advantage under the CSO is the difference between the Class 1 price and the quota price not paid into the producer-settlement fund. Multiple CSO Class 1 handlers testified to this regulated price difference: "The PH, producer-handler, pricing advantage depends on how high the regulated Class 1 price that you have to pay is, compared to the quota price on that milk for which the exempt PD does not need to report." Tr. 5520: 12 – 23 (Testimony of Mr. Britt); Ex. 121; Tr. 6364: 10 – 13 and 6367:21 – 24 (Testimony of Mr. Williams); Ex. 139; for calculation of this advantage *see* Ex. 140.

The PDs allege that this advantage does not exist as they purport to pay their related dairy farms the equivalent to the regulated price for their milk. But this argument misses the point for two reasons: (1) as stated by USDA in 2010 in the National Producer-Handler Rulemaking, this "renders the order unable to set uniform prices to producers" (even as to quota and overbase); and (2) the regulated handlers in competing for milk supplies have paid a significant amount into the producer-settlement fund from which requirement the PDs are exempt. At a minimum, the

PD either benefits on the handler side by paying the regulated blend price for milk and retaining the funds it otherwise would have to contribute to the producer settlement fund or on the producer side by paying the entirety of the Class I value of the milk (rather than the lower blend price). But the larger point is that the regulated CSO Class 1 handlers can only effectively compete for milk supplies with PDs by equalizing payments to their own dairy farmers with the alleged payments made by the PDs to their related dairy farms; the only way that the fully regulated Class 1 handler can accomplish this is by paying an additional amount over and above the minimum regulated price. Thus, regardless of how the PD internally distributes its fund, it still leaves them in a competitively advantaged position over their fully regulated counterparts.

This conclusion on the record is consistent with USDA's conclusion in 2010 that California's system of quota exemption resulted in inequities that it could not incorporate into the FMMOs:

> This decision has considered the testimony regarding the use of similar soft-cap limits for producer-handlers under California's milk marketing regulatory plan. California's milk marketing regulatory system is similar to that of the Federal order system. The soft-cap limits there led to inequity among similarly situated handlers. According to the record, other fully regulated handlers with similar Class I disposition, but without own-farm milk production, were placed at a competitive disadvantage relative to those handlers with own-farm production.

Id. at 10149, c. 1. The PDs have the burden of demonstrating the need for an exemption from regulation. The Dairy Institute recognizes, as it must, that in this Order promulgation proceeding, all regulatory provisions must be independently justified based upon this hearing record. Thus, USDA's conclusion from 2010 is not conclusive; but the factual underpinning the legal conclusion remains the same, as does the law.

In light of the AMAA uniform price requirements, USDA cannot legally support this non-uniform treatment of both Class I handlers and dairy farmers.

2. Fully regulated Class 1 handlers presented evidence of PDs competitive harm.

The evidence presented at the hearing revealed the real and demonstrable disruption from the PDs. While the failure to operate a fully integrated farm and plant operation by itself suffices to require rejection of exempt quota (as discussed in Part 1 above), the PDs also fail to meet the requirement that the exemption not disrupt the market.

The witness for Clover-Stornetta described how the PDs (located hundreds of miles south of the San Francisco Bay Area which is the home of Clover-Stornetta) are able to use that advantage to take business away from Clover-Stornetta in their home market. Tr. 5520 – 5522 (Testimony of Mr. Britt).[50] The witness for Farmdale Creamery also spoke about their experience in competing against PDs. While he does not have access to the books and records of the PDs to prove their activity, the pattern of action is clear and consistent with the kind of activities that USDA found to undercut the Order's successful regulation in prior proceedings:

> We then would lose that customer to the Producer-Handler because their end-product is significantly cheaper. It then becomes quite a lot of effort to retrieve the customer. We frequently do get the customer back once pricing gets normalized, as it inevitably would. In the meantime, the Producer-Handler could shift its "small volume" production focus to another customer.

Tr. 4725: 4 – 17 (Testimony of Mr. Hofferber). Farmdale's testimony is precisely what USDA meant in 2010 when it concluded that "handlers with own-farm milk could 'smooth' the price advantage gained on the volumes of exempt fluid milk products across any additional Class I sales." 76 Fed. Reg. at 10149, c.1.

Finally, Dean Foods Company provided a detailed and clear example of PDs successfully bidding on and taking business away from Dean Foods including stores in both Northern and Southern California. In this case, the PDs' processing facilities were in much more distant locations in the Central Valley of California than Dean Foods' (13.8 miles versus 241 miles for

[50] This was accomplished even though Clover-Stornetta has a well-known consumer brand supported by its North Coast Excellence Certified program for milk quality and participation in the American Humane Society's animal welfare program. Tr. 5318:5319 (Testimony of Mr. Britt).

Southern California and 21.1 miles versus 154 miles for Northern California). Tr. 6374 – 6375 (Testimony of Mr. Williams). The only justification for the PD to be able to offer competitive pricing after taking into account the increased transportation costs is that the PD used its exempt quota price advantage. Tr. 6376:4 – 6378: 13 (Testimony of Mr. Williams), Ex. 141. This Dean Foods witness is responsible for the California plant operations profits and losses and was directly involved in the transactions about which he testified:

> However, despite the cost advantage built into the RFP to those producing plants that were located closer to the retailer's stores, the more distant producing plants were awarded the business. This result cannot credibly be explained by claiming that the Producer Handler plants have more efficient plant operations that enable them to overcome the materially higher distribution costs they incur for the business. First, because raw milk represents a substantial majority (over 70%) of the total costs of processing and packaging a gallon of milk, any cost advantage in those areas of operations that a Producer Handler may have would have a minimal impact on the overall bid price, and would not be nearly sufficient to offset the substantial disadvantage in its distribution costs. Second, based on my industry knowledge and familiarity with Dean Foods' processing costs throughout its more than 60 plant network, I know there is very little variability between operations in costs associated with long production runs of gallon and half-gallon private label white milk, which made up a substantial part of the RFP at issue. Therefore, the only reasonable conclusion is that the more distant Producer Handler plants were able to bid competitively with their competitors who are closer to the retailer's stores because Producer Handlers pay substantially less for the raw milk they purchase, and they use that substantial advantage to overcome a materially higher distribution cost.

Tr. 6376:4 – 6378: 13 (Testimony of Mr. Williams), Ex. 141.

Just as in the earlier producer-handler rulemaking proceedings, the PDs predictably trotted out assertions that business changed hands regularly or claimed that they provided better customer service. Tr. 6953:13 – 18 (Testimony of Mr. Shehadey); Tr. 7309 – 7310 (Testimony of Mr. Otis); Tr. 7573: 12 – 19 (Testimony of Mr. DeGroot). But these claims ring hollow for highly competitive Class I milk, the price of which is determined per the RFP in question based upon criteria that eliminated all other factors. Moreover, as the PDs themselves pointed out, they are not able to benefit from the CSO's transportation credits and allowances system, Tr. 7045:17 – 20 (Testimony of Mr. Shehadey), so by definition they were paying to transport the packaged milk from the Central Valley to San Francisco and Los Angeles. The only logical conclusion is that the benefit of not having to pay the producer-settlement fund the difference between the Class 1 and the quota price permitted them to take their regulatory advantage and make these kinds of transactions lawfully.[51]

3. Producer-Distributors have grown their business at the expense of fully regulated Class I handlers.

Consistent with testimony from prior proceedings regarding the impact of these kinds of exemptions from regulation, the hard numbers back up the Dairy Institute's argument that PD's have a regulatory advantage via exempt quota. Exhibit 155, relying on CDFA exhibits and the testimony of the PDs, shows the growth of PDs in both real and relative terms as compared to the Class 1 fluid market in California. As with the rest of the United States, fluid milk sales in California have been on an unfortunate and precipitous decline. Exhibit 155 shows that over six and a half years (to August 2015) that decline was 23.96%. During the same time period, PDs Class 1 volume grew slightly, but certainly did not decrease. As a result, while Class 1 sales are falling, the Class 1 market share for PDs has *grown* by 3.41%. These numbers show that the PDs' impact on the Class market is significant, and increasing. The 333.0% growth of total PD California Class 1 sales from 1985 to 2015 is also notable.

The Quota Provision provides no basis for USDA to permanently enshrine this dual non-uniform price exemption at the expense of Class I handlers and regulated producers.

D. Any California FMMO Definition of Producer-Handlers Should Rely on Arizona and Pacific Northwest Provisions.

The Cooperative Order and the Dairy Institute Proposal also differ with respect to the definition of a producer-handler. The Cooperative Order relies on language found in a number

[51] As the PDs also pointed out, they must not sell milk below cost under California law. Tr. 7572: 15 – 16 (Testimony of Mr. DeGroot). Given that raw milk represents 70% of the cost of finished product, the fact that processing costs can only vary so significantly as testified by Dean Foods, and the fact that the PDs had to pay to transport their packaged milk to Northern and Southern California, the only logical conclusion is that the PDs are able to and do use the regulatory advantage to obtain Class 1 business under the CSO.

of FMMOs, but not the two physically located nearest to California (i.e., the Arizona and Pacific Northwest Orders). The differences are largely, if not wholly, based upon the fact that the west's generally larger dairy farms and use of the producer-handler exemption by relatively larger entities created creative opportunities to meet the producer-handler self-sufficiency requirements. For instance, a requirement that all the cows be under the care and management of the producer-handler does not by itself constrain the temporary leasing of cows or a farm. Abuses of the general producer-language led to USDA hearings in what are now the Arizona and Pacific Northwest orders. USDA then adopted the producer-handler language found in 7 U.S.C. §§ 1124.10 and 1131.10. *Milk in the Pacific Northwest and Arizona-Las Vegas Marketing Areas*, 70 Fed. Reg. 74166, 74188 c.2 (December 14, 2005); *Milk in the Puget Sound Marketing Area*, 31 Fed. Reg. 7062, 7065 (May 13, 1966) merged with other orders to form the Pacific Northwest Order, *Milk in the Oregon-Washington and Puget Sound-Inland Empire Marketing Areas,* 53 Fed. Reg. 49154, 49169 c.2 – 49170 c.1 (December 6, 1988).

In order to avoid those kinds of creative activities that undermine the purpose of the producer-handler exemption in a California FMMO, we urge adoption of §1151.10 as proposed by the Dairy Institute in Proposal 2.

E. Rockview's Proposal 4 Must Also Be Rejected.

Similarly, and in apparent response to the trade barriers created by the Cooperative Order, Rockview Farms, in Proposal 4, seeks a special pooling provision for milk received by California Class I handlers from out-of-state milk which would in essence continue the treatment of out-of-state milk under the CSO post-*Hillside, supra.* This would be accomplished by adopting a unique pool accounting mechanism (requiring payment of the plant blend price and providing a corresponding credit against the producer settlement fund obligation) applied to all out-of-state milk received at California Class I plants. That treatment would also result in non-uniform prices paid by Class I handlers to dairy farmers and permit the purchasers of such milk to avoid payments to the producer-settlement fund, unlike their fully regulated Class I competitors. And naturally it would be yet another exemption from the uniform price requirements of the AMAA.

Proposal 4's unique accounting treatment for out-of-area milk is parallel to that for partially regulated plants under 7 C.F.R. §1000.76(b) (the so-called "Wichita Option"). However, the Wichita Option does not support such proposals. A virtually identical proposal was advanced as to the regulatory treatment of own-farm milk in the National Producer-Handler hearing and expressly rejected by USDA in no uncertain terms equally applicable here:

> This would essentially create a unique exemption based upon the origin of the milk supplies received by a given handler. As proposed, NAJ's [National All Jersey] modification is grounded in a justification based upon the source of a milk supply. It would not be appropriate to have *differentiated regulatory treatment of milk supplies on the basis of origin.*

Id. at 10149, c.3 (emphasis supplied). Rockview's basis of origin is location-based rather than own-farm milk. USDA's logic however must apply to location, too. Rockview's Proposal 4 must be rejected.

X. DISCUSSION OF SPECIFIC POOLING AND PRICING ORDER PROVISIONS

A. Cooperative Diversion Limits – Proposal 1 - §1051.13(d)

If USDA adopts the Cooperative Order, the Dairy Institute opposes the ability of cooperative handlers under §9(c) to divert milk based upon "milk receipts reported" rather than the language applied to all other industry players – "milk received from dairy farmers." §§1051.13(d)(2) and (3). Similarly, the Cooperative Order provides that qualifying producer milk must be "received," not "reported" under §§1051.13(a) and (b). Permitting diversions to be based upon what milk is "reported" could permit a 9(c) handler to report milk as being received by it (a true statement in the most general terms) even when that milk is actually received at a distant location (e.g., in Idaho). As the provision is written (which may not be the intent of the Cooperatives), it appears that using the word reported could result in the following: a handler "reports" 100 million pounds of milk, with 50 million of those 100 million pounds diverted to Idaho. Of the 50 million pounds diverted to Idaho, 25 million pounds (50% of diversions) are delivered to 7(a) or 7(b) plants, and another 25 million pounds "reported" by the 9(c) handler are received in Idaho and not treated as diverted by the reporting handler. Thus, the handler "reports" 100 million pounds of milk, but only 25 million pounds are actually received within the marketing area and 25 million pounds will not be properly treated as diverted. Such a scenario cannot be acceptable under any FMMO. In conjunction with the Cooperative Order's unique provision, discussed below in Part F, which does not adjust producer pay prices for producer location, the value of the distant milk could draw even more money out of the pool than under a traditional FMMO.

It is impossible to conclude how this provision calculating diversions based upon reporting can possibly be consistent with the need to bring forth an adequate supply of milk to meet fluid market needs. At the hearing, the Dairy Institute sought, but did not receive, clarification as to the actual intent of this language. Tr. 3006-3007 (Testimony of Mr. Hollon). As with all issues, we reserve the right to comment further on this issue in our Reply Brief based on information, if any, that we learn from the Cooperative's Opening Brief.

B. Churchill County – Unique Automatic Pool Status – Cooperative Order - §1051.7(c)(1)

For the unique benefit of DFA, the Cooperative Order includes a provision providing for the automatic pooling of a nonfat dry milk plant located in Churchill County, NV. §1051.7(c)(1). This provision has no basis in any existing regulation or statute, neither the CSO nor any FMMO. The flaws in this provision are myriad and compelling. USDA must reject it entirely.

The Dairy Institute of course has no problem with a plant qualifying under the California FMMO under a performance-based pooling provision like 7(d) (although the Dairy Institute does not accept the actual standard proposed by the Cooperatives). But an automatic pool plant provision of this type was expressly rejected by USDA in the Northeast because it undermines the ability to bring forth an adequate supply of milk for fluid use and undermines prices paid to other dairy farmers. *See* Section VI, supra; 70 Fed. Reg. at 4943 c.3 – 4944 c.1. As the language is presently drafted once one pound of milk is received from a dairy farmer in Churchill County, that plant is a pool plant and then can receive unlimited supplies of milk from Utah, Idaho or Oregon. The diversion rules discussed in Part A above would permit significant diversions of milk to Idaho. And not one drop of milk connected or reported by that plant would ever have any requirement to serve the fluid needs in California. There is no justification for this proposal under the Declared Policy of the AMAA to bring forth an adequate supply of milk for fluid use as discussed in Section V.

Adoption of the Churchill County provision effectively expands the marketing area outside California to one county in Nevada (the regulatory result of an automatic pool status is the same as the mandatory pooling for California plants). This is certainly inconsistent with the spirit and arguably a violation of the letter of 7 U.S.C. §608c(11)(d) – "no *county* or other political subdivision of the State of Nevada shall be within the marketing area definition of any order issued under this section."

Finally, adoption of the provision would result in non-uniform payments to dairy farmers. As discussed above in Section VIII, dairy farmers like Charles Turner located in Nevada but shipping into California would receive the so-called non-quota blend price under the Cooperative Order or a traditional FMMO blend under the Dairy Institute Proposal. But DFA for its farmers in Churchill County would receive prices *better* than either of these prices because DFA also ships milk in Nevada to a Class I facility in Reno, NV. Tr. 2866:11 – 2867:15 (Testimony of Mr. Hollon). There is nothing in the Cooperative Order that limits the producer milk definition or otherwise adjusts for the financial treatment for Churchill County pool milk when milk of the same producer is also received at an unregulated (likely partially regulated on a California FMMO pursuant to Section 76) Reno plant. The Cooperatives did not propose a traditional "producer for other markets" provision. *See, e.g.,* 7 C.F.R. §1124.12(a)(5). This is yet another characteristic of the Cooperative Order not found in the traditional FMMOs.

Exhibit 67, page 2 demonstrates that under an FMMO and under either the Cooperative Order or Dairy Institute's treatment of out-of-state milk, producers whose milk is received both at the Reno Class I facility and the Churchill County will generate a blend price value for milk that is *always* higher than the $15.08 overbase or $15.51 FMMO blend price.[52] USDA cannot adopt the Churchill County provision when it would clearly result in a violation of the AMAA's requirement of uniform pricing paid to producers.

C. ESL Shrinkage

As to the treatment of shrink for extended shelf life (ESL) fluid milk products, the Dairy Institute incorporates by reference the Brief of HP Hood LLC filed in this Hearing Docket. The proposal will do no more than assure that ESL processors, like conventional milk processors, are only charged the Class I price for milk "intended to be used" as a beverage, and is "disposed of in the form of fluid milk products." 7 C.F.R. §1000.15(a) and § 1000.40(a)(1). The Dairy Institute disputes the relevance or significance of the criticism during examination by the Cooperatives' counsel that the ESL proposal belongs in a National Hearing and not as a rifle shot in this proceeding. Tr. 3971:7 – 24 (Testimony of Mr. Suever). This is an order promulgation hearing and USDA is writing on a blank slate for California. There is no presumption that any provision of the Cooperative Order is valid and all provisions must be proven. The ESL proposal is just as valid and has equal standing with the Cooperative Order treatment of shrink at this stage of the proceeding.

It was also the Cooperatives who (presumably for political and industry reasons) chose not to seek a National Hearing as part of this matter when a National Hearing could have addressed a myriad of other issues (e.g., the outdated price formulas for Class III and IV). The Dairy Institute maintains that USDA is free to, and really ought to, hold a national hearing and reopen this proceeding as necessary in order to consider any of the Cooperatives' concerns.

[52] The fact that Exhibit 67 was never entered into evidence is irrelevant since it relies on other record evidence and then runs simple math calculations based upon on that record data. Moreover, the result is intuitively obvious. Any dairy farmer who ships both to Reno and Churchill County will receive the Class I benefit in the plant blend on the Reno plant and the California overbase or FMMO blend on the remainder of its milk. Any Class I value at Reno adds value to that producer that cannot be obtained by any other pool producer who must always share all Class I proceeds with all other pool dairy farmers.

D. Two Factor v. Three Factor Class I Pricing

As to the issue of two v. three factor Class I pricing, the Dairy Institute incorporates by reference the Brief of Dean Foods Company filed in this Docket. The Dairy Institute agrees that the use of only two factor pricing, when combined with California's separate fluid milk standards requirements, will almost certainly result in non-uniform prices paid by handlers for milk. This result would violate the AMAA's uniform price requirement discussed above.

E. Calculation of Producer Price Differential

As to the use of use and calculation of the Producer Price Differential ("PPD"), the Dairy Institute agrees with the testimony of National All Jersey ("NAJ") and urges USDA to adopt the NAJ amended proposal. Tr. 3671 – 3722 (Testimony of Mr. Metzger); Ex. 82. The Dairy Institute reserves the right to comment further on this issue in our Reply Brief based on information, if any, that we learn from the Opening Briefs.

F. Producer Location Differentials

The Dairy Institute opposes the Cooperatives' proposal to pay producers under the Order a price not adjusted for location, a feature in all other FMMOs presently. This refusal to adjust for location is yet another unjustified deviation from the characteristics of the ten FMMOs. In addition to the problems that will likely arise under diversions discussed in Part A above, this provision will not encourage milk to move from where it is produced to where it is needed – the fluid milk market. In fact combined with mandatory pooling, no dairy farmer would want her milk to move from Fresno to Los Angeles. As discussed above in Section VII, Part H., "the first and foremost consideration must be to provide the economic incentive to transport milk from the production areas to the Class I distribution area." 41 Fed. Reg. at 12161. Producer location adjustments must be equal to handler adjustments in order to successfully move the milk to Class I. For this reason, and all the reasons discussed in the sections dealing with the purposes of the AMAA, performance-based pooling standards, and Class I pricing, we urge USDA to reject the Cooperatives' proposal on producer location adjustments.

G. Transportation Credits

The Dairy Institute tentatively accepts and agrees with the Cooperatives' proposed language for transportation credits, subject to rates being adjusted for applicable location differentials. We reserve the right to comment further on this issue in our Reply Brief based on information, if any, that we learn from the Cooperative's Opening Brief.

XI. CONCLUSION

In order for USDA to adopt the Cooperative Order, it must completely eschew, abandon or significantly alter all of the following principles embedded in the AMAA and justified in the characteristics of the existing ten FMMOs:

1) FMMOs are not intended to be price enhancing;

2) FMMOs are intended to bring forth an adequate supply of milk for fluid use;

3) Federal intervention in un-regulated or under-regulated milk markets is based upon actual and substantial evidence of failure to achieve classified and uniform pricing based upon Class I market failure;

4) Uniform prices shall apply to all prices paid by handlers and to producers;

5) No FMMO shall create a trade barrier, broadly defined as prohibiting or in any manner limiting, in the case of cheese, the marketing of that milk or cheese in the marketing area;

6) Performance-based pooling standards are the only viable means of assuring an adequate supply of milk for fluid use and properly defining which dairy farmers can share in the benefits of the FMMO's uniform price;

7) Pooling must be voluntary in order to accomplish the goals of assuring an adequate supply of milk for fluid use and ensuring fair prices to dairy farmers who actually do or can serve the fluid market, for without voluntary pooling, performance-based pooling standards are moot;

8) Regulated minimum prices must be set based upon current economic conditions in the marketing area subject to regulation;

9) Regulated minimum prices for milk used to produce cheese, nonfat dry milk, and butter must be set at market clearing levels that recognize location value;

10) Due recognition must be given to the differences in production and marketing of milk and milk products in the marketing area to be regulated;

11) No order shall be applicable to any producer in his capacity as a producer;

12) No county of the State of Nevada shall be included in any marketing area.

If supply and demand dictate lower prices for milk in California, resulting in lower producer returns, USDA cannot solve this problem by raising regulated prices and shifting the California producers' issues to others throughout the FMMO system. Indeed, the preliminary economic impact analysis prepared by AMS establishes that there will be significant and widespread effects on the prices received by dairy farmers throughout the FMMO system outside California if the Cooperative Order is adopted and the California dairy farmers also continue to receive unabated a quota price for their milk.

A review of the testimony from November 6, 2015 (Tr. 6495 – 6572, Testimony of Mr. Doornenbal) regarding the history of the California Milk Marketing Order system and quota reveals the Frankenstein-like birth of this history-based system. The Federal Milk Marketing Order system should not be forced, via the Quota Provision, to incorporate California's flaws and doomed to repeat the errors of California's past. USDA should conclude that no disorderly marketing conditions exist in California or, if such conditions are found, reject the Cooperatives' Order and adopt the Dairy Institute of California's Proposal.

DATED this 31st day of March, 2016.

DAVIS WRIGHT TREMAINE LLP

By ______________________________
Charles M. English, Jr.
Email: chipenglish@dwt.com

Ashley L. Vulin
Email: ashleyvulin@dwt.com

Attorneys for Dairy Institute of California

ATTACHMENT 1

Public Law 89-321

AN ACT

November 3, 1965
[H. R. 9811]

To maintain farm income, to stabilize prices and assure adequate supplies of agricultural commodities, to reduce surpluses, lower Government costs and promote foreign trade, to afford greater economic opportunity in rural areas, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Food and Agriculture Act of 1965". Food and Agriculture Act of 1965.

TITLE I—DAIRY

SEC. 101. The Agricultural Adjustment Act, as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended, is further amended by striking in subparagraph (B) of subsection 8c(5) all of clause (d) and inserting in lieu thereof a new clause (d) to read as follows: 49 Stat. 753. 7 USC 608c.

"(d) a further adjustment, equitably to apportion the total value of the milk purchased by any handler, or by all handlers, among producers and associations of producers, on the basis of their marketings of milk, which may be adjusted to reflect sales of such milk by any handler or by all handlers in any use classification or classifications, during a representative period of time which need not be limited to one year. In the event a producer holding a base allocated under this clause (d) shall reduce his marketings, such reduction shall not adversely affect his history of production and marketing for the determination of future bases. Allocations to producers under this clause (d) may be transferable under an order on such terms and conditions as may be prescribed if the Secretary of Agriculture determines that transferability will be in the best interest of the public, existing producers, and prospective new producers. Any increase in class one base resulting from enlarged or increased consumption and any producer class one bases forfeited or surrendered shall first be made available to new producers and to the alleviation of hardship and inequity among producers. In the case of any producer who during any accounting period delivers a portion of his milk to persons not fully regulated by the order, provision may be made for reducing the allocation of, or payments to be received by, any such producer under this clause (d) to compensate for any marketings of milk to such other persons for such period or periods as necessary to insure equitable participation in marketings among all producers";

and by adding at the end of said subparagraph (B) the following: "Notwithstanding the provisions of section 8c(12) and the last sentence of section 8c(19) of this Act, order provisions under (d) above shall not become effective in any marketing order unless separately approved by producers in a referendum in which each individual producer shall have one vote and may be terminated separately whenever the Secretary makes a determination with respect to such provisions as is provided for the termination of an order in subparagraph 8c(16)(B). Disapproval or termination of such order provisions shall not be considered disapproval of the order or of other terms of the order." 75 Stat. 305.

SEC. 102. Such Act is further amended (a) by adding to subsection 8c(5) the following new paragraph: "(H) Marketing orders applicable to milk and its products may be limited in application to milk used for manufacturing."; and (b) by amending subsection 8c(18) by adding after the words "marketing area" wherever they occur the 62 Stat. 1258.

Attachment 1_A
Page 1 of 2

words "or, in the case of orders applying only to manufacturing milk, the production area".

Termination.

SEC. 103. The provisions of this title shall not be effective after December 31, 1969.

Producer handlers of milk, legal status.

48 Stat. 31; 50 Stat. 246. 7 USC 601 notes, 674 note.

SEC. 104. The legal status 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 as it was prior thereto.

TITLE II—WOOL

Price supports.

SEC. 201. The National Wool Act of 1954, as amended, is amended, as follows:

68 Stat. 910; 75 Stat. 306. 7 USC 1782.

(1) By deleting from section 703 "March 31, 1966" and inserting in lieu thereof "December 31, 1969".

(2) By changing the period at the end of the third sentence of section 703 to a colon and inserting the following:

"*Provided further*, That the support price for shorn wool for the 1966 and each subsequent marketing year shall be determined by multiplying 62 cents by the ratio of (i) the average of the parity index (the index of prices paid by farmers, including commodities and services, interest, taxes, and farm wage rates, as defined in section 301 (a)(1)(C) of the Agricultural Adjustment Act of 1938, as amended) for the three calendar years immediately preceding the calendar year in which such price support is determined and announced to (ii) the average parity index for the three calendar years 1958, 1959, and 1960, and rounding the resulting amount to the nearest full cent."

62 Stat. 1250. 7 USC 1301.

(3) By deleting the fourth sentence of section 703.

TITLE III—FEED GRAINS

72 Stat. 994. 7 USC 1441 note.

SEC. 301. Section 105 of the Agricultural Act of 1949, as amended, is amended by adding the following new subsection (e):

"(e) For the 1966 through 1969 crops of feed grains, the Secretary shall require, as a condition of eligibility for price support on the crop of any feed grain which is included in any acreage diversion program formulated under section 16(i) of the Soil Conservation and Domestic Allotment Act, as amended, that the producer shall participate in the diversion program to the extent prescribed by the Secretary, and, if no diversion program is in effect for any crop, he may require as a condition of eligibility for price support on such crop of feed grains that the producer shall not exceed his feed grain base: *Provided*, That the acreage on any farm which is diverted from the production of feed grains pursuant to a contract hereafter entered into under the Cropland Adjustment Program shall be deemed to be acreage diverted from the production of feed grains for purposes of meeting the foregoing requirements for eligibility for price support: *Provided further*, That the Secretary may provide that no producer of malting barley shall be required as a condition of eligibility for price support for barley to participate in the acreage diversion program for feed grains if such producer has previously produced a malting variety of barley, plants barley only of an acceptable malting variety for harvest, does not knowingly devote an acreage on the farm to barley in excess of 110 per centum of the average acreage devoted on the farm to barley in 1959 and 1960, does not knowingly devote an acreage on the farm to corn and grain sorghums in excess of the acreage devoted on the farm to corn and grain sorghums in 1959 and 1960, and does not devote any acreage devoted to the production of oats and rye in 1959 and 1960

Post, p. 1190.

Post, p. 1206.

Attachment 1_A
Page 2 of 2

Public Law 91-523

November 25, 1970
[S. 902]

AN ACT

To amend section 1162 of title 18, United States Code, relating to State jurisdiction over offenses committed by or against Indians in the Indian country.

Indians. Jurisdiction in Alaska.
67 Stat. 588; 72 Stat. 545.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (a) of section 1162 of title 18, United States Code, is amended by deleting the following:

"Alaska .... All Indian country within the Territory"

and inserting in lieu thereof the following:

"Alaska .... All Indian country within the State, except that on Annette Islands, the Metlakatla Indian community may exercise jurisdiction over offenses committed by Indians in the same manner in which such jurisdiction may be exercised by Indian tribes in Indian country over which State jurisdiction has not been extended."

62 Stat. 757; 63 Stat. 94.

SEC. 2. Subsection (c) of section 1162 of title 18, United States Code, is amended to read as follows: "(c) The provisions of sections 1152 and 1153 of this chapter shall not be applicable within the areas of Indian country listed in subsection (a) of this section as areas over which the several States have exclusive jurisdiction."

Approved November 25, 1970.

Public Law 91-524

November 30, 1970
[H. R. 18546]

AN ACT

To establish improved programs for the benefit of producers and consumers of dairy products, wool, wheat, feed grains, cotton, and other commodities, to extend the Agricultural Trade Development and Assistance Act of 1954, as amended, and for other purposes.

Agricultural Act of 1970.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Agricultural Act of 1970".

TITLE I—PAYMENT LIMITATION

SEC. 101. Notwithstanding any other provision of law—

Post, pp. 1362, 1368, 1371.

(1) The total amount of payments which a person shall be entitled to receive under each of the annual programs established by titles IV, V, and VI of this Act for the 1971, 1972, or 1973 crop of the commodity shall not exceed $55,000.

"Payments."

(2) The term "payments" as used in this section includes price-support payments, set-aside payments, diversion payments, public

access payments, and marketing certificates, but does not include loans or purchases.

(3) If the Secretary determines that the total amount of payments which will be earned by any person under the program in effect for any crop will be reduced under this section, the set-aside acreage for the farm or farms on which such person will be sharing in payments earned under such program shall be reduced to such extent and in such manner as the Secretary determines will be fair and reasonable in relation to the amount of the payment reduction. Set-aside acreage, reduction.

(4) The Secretary shall issue regulations defining the term "person" and prescribing such rules as he determines necessary to assure a fair and reasonable application of such limitation: *Provided*, That the provisions of this Act which limit payments to any person shall not be applicable to lands owned by States, political subdivisions, or agencies thereof, so long as such lands are farmed primarily in the direct furtherance of a public function, as determined by the Secretary. Regulations.

TITLE II—DAIRY

DAIRY BASE PLANS

SEC. 201. (a) The Agricultural Adjustment Act, as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended, is further amended by striking in subparagraph (B) of subsection 8c(5) all that part of said subparagraph (B) which follows the comma at the end of clause (c) and inserting in lieu thereof the following: "(d) a further adjustment to encourage seasonal adjustments in the production of milk through equitable apportionment of the total value of the milk purchased by any handler, or by all handlers, among producers on the basis of their marketings of milk during a representative period of time, which need not be limited to one year; (e) a provision providing for the accumulation and disbursement of a fund to encourage seasonal adjustments in the production of milk may be included in an order; and (f) a further adjustment, equitably to apportion the total value of milk purchased by all handlers among producers on the basis of their marketings of milk, which may be adjusted to reflect the utilization of producer milk by all handlers in any use classification or classifications, during a 79 Stat. 1187. 7 USC 608c.

representative period of one to three years, which will be automatically updated each year. In the event a producer holding a base allocated under this clause (f) shall reduce his marketings, such reduction shall not adversely affect his history of production and marketing for the determination of future bases, or future updating of bases, except that an order may provide that, if a producer reduces his marketings below his base allocation in any one or more use classifications designated in the order, the amount of any such reduction shall be taken into account in determining future bases, or future updating of bases. Bases allocated to producers under this clause (f) may be transferable under an order on such terms and conditions, including those which will prevent bases taking on an unreasonable value, as are prescribed in the order by the Secretary of Agriculture. Provisions shall be made in the order for the allocation of bases under this clause (f)—

"(i) for the alleviation of hardship and inequity among producers; and

"(ii) for providing bases for dairy farmers not delivering milk as producers under the order upon becoming producers under the order who did not produce milk during any part of the representative period and these new producers shall within ninety days after the first regular delivery of milk at the price for the lowest use classification specified in such order be allocated a base which the Secretary determines proper after considering supply and demand conditions, the development of orderly and efficient marketing conditions and to the respective interests of producers under the order, all other dairy farmers and the consuming public. Producer bases so allocated shall for a period of not more than three years be reduced by not more than 20 per centum; and

"(iii) dairy farmers not delivering milk as producers under the order upon becoming producers under the order by reason of a plant to which they are making deliveries becoming a pool plant under the order, by amendment or otherwise, shall be provided bases with respect to milk delivered under the order based on their past deliveries of milk on the some basis as other producers under the order; and

"(iv) such order may include such additional provisions as the Secretary deems appropriate in regard to the reentry of producers who have previously discontinued their dairy farm enterprise or transferred bases authorized under this clause (f); and

"(v) notwithstanding any other provision of this Act, dairy farmers not delivering milk as producers under the order, upon becoming producers under the order, shall within ninety days be provided with respect to milk delivered under the order, allocations based on their past deliveries of milk during the representative period from the production facilities from which they are delivering milk under the order on the same basis as producers under the order on the effective date of order provisions authorized under this clause (f): *Provided*, That bases shall be allocated only to a producer marketing milk from the production facilities from which he marketed milk during the represensative period, except that in no event shall such allocation of base exceed the amount of milk actually delivered under such order.

The assignment of other source milk to various use classes shall be made without regard to whether an order contains provisions authorized under this clause (f). In the case of any producer who during any accounting period delivers a portion of his milk to persons not fully regulated by the order, provision shall be made for reducing the allocation of, or payment to be received by, any such producer under this clause (f) to compensate for any marketings of milk to such other persons for such period or periods as necessary to insure equitable participation in marketings among all producers. Notwithstanding the provisions of section 8c(12) and the last sentence of section 8c(19) of this Act, order provisions under this clause (f) shall not be effective in any marketing order unless separately approved by producers in a referendum in which each individual producer shall have one vote and may be terminated separately whenever the Secretary makes a determination with respect to such provisions as is provided for the termination of an order in subparagraph 8c(16)(B). Disapproval or termination of such order provisions shall not be considered disapproval of the order or of other terms of the order." 49 Stat. 759; 75 Stat. 305. 7 USC 608c.

(b) The legal status 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 as it was prior thereto. 48 Stat. 31; 50 Stat. 246. 7 USC 601 note.

(c) Nothing in subsection (a) of this section 201 shall be construed as invalidating any class I base plan provisions of any marketing order previously issued by the Secretary of Agriculture pursuant to authority contained in the Food and Agriculture Act of 1965 (79 Stat. 1187), but such provisions are expressly ratified, legalized, and confirmed and may be extended through and including December 31, 1971. 7 USC 608c note.

(d) It is not intended that existing law be in any way altered, rescinded, or amended with respect to section 8c(5)(G) of the Agricultural Adjustment Act, as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended, and such section 8c(5)(G) is fully reaffirmed. 49 Stat. 755.

(e) The provisions of this section shall not be effective after December 31, 1973 except with respect to orders providing for Class I base plans issued prior to such date, but in no event shall any order so issued extend or be effective beyond December 31, 1976. Termination provisions.

SUSPENSION OF BUTTERFAT SUPPORT PROGRAM

SEC. 202. Effective only with respect to the period beginning April 1, 1971, and ending March 31, 1974— Price supports.

(a) The first sentence of section 201 of the Agricultural Act of 1949, as amended (7 U.S.C. 1446), is amended by striking the words "milk, butterfat, and the products of milk and butterfat" and inserting in lieu thereof the words "and milk". Designated nonbasic commodities. 63 Stat. 1052.

(b) Paragraph (c) of section 201 of the Agricultural Act of 1949, as amended (7 U.S.C. 1446(c)), is amended to read as follows: Milk and butterfat.

"(c) The price of milk shall be supported at such level not in excess of 90 per centum nor less than 75 per centum of the parity price therefor as the Secretary determines necessary in order to assure an adequate supply. Such price support shall be provided through purchases of milk and the products of milk." 68 Stat. 899; 70 Stat. 86; 74 Stat. 1054.

TRANSFER OF DAIRY PRODUCTS TO THE MILITARY AND TO VETERANS HOSPITALS

SEC. 203. Section 202 of the Agricultural Act of 1949, as amended (7 U.S.C. 1446a), is amended by changing "December 31, 1970" to read "December 31, 1973" both places it appears therein. 81 Stat. 464.

DAIRY INDEMNITY PROGRAM

SEC. 204. (a) Section 3 of the Act of August 13, 1968 (Public Law 90-484; 82 Stat. 750), is amended by striking out the word "June 30, 1970.", and inserting in lieu thereof the word "June 30, 1973.". 7 USC 450l.

*Public Law 99-198
99th Congress

An Act

Dec. 23, 1985
[H.R. 2100]

To extend and revise agricultural price support and related programs, to provide for agricultural export, resource conservation, farm credit, and agricultural research and related programs, to continue food assistance to low-income persons, to ensure consumers an abundance of food and fiber at reasonable prices, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Food Security Act of 1985.
Farms and farming.
Agriculture and agricultural commodities.
7 USC 1281 note.

SHORT TITLE

SECTION 1. This Act may be cited as the "Food Security Act of 1985".

TABLE OF CONTENTS

SEC. 2. The table of contents is as follows:

*Note: The printed text of Public Law 99-198 is a reprint of the hand enrollment, signed by the President on December 23, 1985.

"(b) If the Secretary terminates the order, the Institute shall be dissolved 180 days after the termination of the order.

"(c) If the Institute is dissolved for any reason, the moneys remaining in the Fund shall be disposed of as shall be agreed to by the board and the Secretary.

"ADDITIONAL AUTHORITY

Prohibition. 7 USC 4538.

"SEC. 137. (a) No provision of this subtitle shall be construed to preempt or supersede any other program relating to milk or dairy products research organized and operated under the laws of the United States or any State.

Ante, p. 1369.

"(b) The provisions of this subtitle applicable to the order issued under section 132(b) shall be applicable to any amendment to the order.".

Subtitle C—Milk Marketing Orders

MINIMUM ADJUSTMENTS TO PRICES FOR FLUID MILK UNDER MARKETING ORDERS

7 USC 674.

SEC. 131. (a) Section 8c(5)(A) of the Agricultural Adjustment Act (7 U.S.C. 608c(5)(A)), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, is amended by adding at the end the following: "Throughout the 2-year period beginning on the effective date of this sentence (and subsequent to such 2-year period unless modified by amendment to the order involved), the minimum aggregate amount of the adjustments, under clauses (1) and (2) of the preceding sentence, to prices for milk of the highest use classification under orders that are in effect under this section on the date of the enactment of the Food Security Act of 1985 shall be as follows:

Ante, p. 1354.

"Marketing Area Subject to Order	Minimum Aggregate Dollar Amount of Such Adjustments Per Hundredweight of Milk Having 3.5 Percent Milkfat
New England	$3.24
New York-New Jersey	3.14
Middle Atlantic	3.03
Georgia	3.08
Alabama-West Florida	3.08
Upper Florida	3.58
Tampa Bay	3.88
Southeastern Florida	4.18
Michigan Upper Peninsula	1.35
Southern Michigan	1.75
Eastern Ohio-Western Pennsylvania	1.95
Ohio Valley	2.04
Indiana	2.00
Chicago Regional	1.40
Central Illinois	1.61
Southern Illinois	1.92
Louisville-Lexington-Evansville	2.11
Upper Midwest	1.20
Eastern South Dakota	1.50
Black Hills, South Dakota	2.05
Iowa	1.55
Nebraska-Western Iowa	1.75
Greater Kansas City	1.92
Tennessee Valley	2.77
Nashville, Tennessee	2.52
Paducah, Kentucky	2.39
Memphis, Tennessee	2.77
Central Arkansas	2.77

Fort Smith, Arkansas	2.77
Southwest Plains	2.77
Texas Panhandle	2.49
Lubbock-Plainview, Texas	2.49
Texas	3.28
Greater Louisiana	3.28
New Orleans-Mississippi	3.85
Eastern Colorado	2.73
Western Colorado	2.00
Southwestern Idaho-Eastern Oregon	1.50
Great Basin	1.90
Lake Mead	1.60
Central Arizona	2.52
Rio Grande Valley	2.35
Puget Sound-Inland	1.85
Oregon-Washington	1.95

Effective at the beginning of such two-year period, the minimum prices for milk of the highest use classification shall be adjusted for the locations at which delivery of such milk is made to such handlers.".

(b) The amendment made by this section shall take effect on the first day of the first month beginning more than 120 days after the date of the enactment of this Act.

Effective date. 7 USC 608c note.

ADJUSTMENTS FOR SEASONAL PRODUCTION; HEARINGS ON AMENDMENTS; DETERMINATION OF MILK PRICES

SEC. 132. Section 101(b) of the Agriculture and Food Act of 1981 (7 U.S.C. 608c note) is amended by striking out "1985" and inserting in lieu thereof "1990".

MARKETWIDE SERVICE PAYMENTS

SEC. 133. Effective January 1, 1986, section 8c(5) of the Agricultural Adjustment Act (7 U.S.C. 608c(5)), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, is amended by adding at the end thereof the following:

Effective date. *Ante*, p. 1372. 7 USC 674.

"(J) Providing for the payment, from the total sums payable by all handlers for milk (irrespective of the use classification of such milk) and before computing uniform prices under paragraph (A) and making adjustments in payments under paragraph (C), to handlers that are cooperative marketing associations described in paragraph (F) and to handlers with respect to which adjustments in payments are made under paragraph (C), for services of marketwide benefit, including but not limited to—

"(i) providing facilities to furnish additional supplies of milk needed by handlers and to handle and dispose of milk supplies in excess of quantities needed by handlers;

"(ii) handling on specific days quantities of milk that exceed the quantities needed by handlers; and

"(iii) transporting milk from one location to another for the purpose of fulfilling requirements for milk of a higher use classification or for providing a market outlet for milk of any use classification.".

STATUS OF PRODUCER HANDLERS

SEC. 134. The legal status of producer handlers of milk under the Agricultural Adjustment Act (7 U.S.C. 601 et seq.), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937,

7 USC 674.

shall be the same after the amendments made by this title take effect as it was before the effective date of such amendments.

Subtitle D—National Commission on Dairy Policy

FINDINGS AND DECLARATION OF POLICY

7 USC 1446 note.

SEC. 141. (a) Congress finds that—

(1) the Federal program established to support the price of milk marketed by producers in the United States was created to provide price and income protection for milk producers as well as to assure consumers of an adequate supply of milk and dairy products at reasonable prices;

(2) the milk production industry in the United States is composed primarily of small- and medium-sized family farm operations;

(3) consumers in the United States benefit financially from a milk price support program that prohibits large fluctuations in the price and supply of milk and dairy products;

(4) consumers in the United States also benefit financially from the current structure of the domestic milk production industry; and

(5) the Office of Technology Assessment, in its report entitled "Technology, Public Policy, and the Changing Structure of American Agriculture", found that larger milk production operations already enjoy a major advantage in the production of milk and that, under current Federal policy, the development and use of new technologies will permit a continued trend toward fewer and larger milk production operations throughout the country.

(b) It is hereby declared to be the policy of Congress to respond to the development of new technologies in the domestic milk production industry by reviewing the present milk price support program and its alternatives, and by adopting such policies as are needed to prevent significant surplus production in the future while ensuring that the current small- and medium-sized family farm structure of such industry will be preserved for new generations of producers and consumers alike.

ESTABLISHMENT OF COMMISSION

7 USC 1446 note.

SEC. 142. (a) There is hereby established a National Commission on Dairy Policy, which shall study and make recommendations concerning the future operation of the Federal program established to support the price of milk marketed by producers in the United States.

(b) The Commission shall be composed of eighteen members who are engaged in the commercial production of milk in the United States, to be appointed by the Secretary of Agriculture. Not fewer than twelve members shall be appointed from nominations submitted to the Secretary by the following Members of Congress, after consultation with the other Members of Congress who sit on the specified committee of the respective House of Congress:

(1) The Chairman of the Committee on Agriculture of the House of Representatives.

(2) The ranking minority member of the Committee on Agriculture of the House of Representatives.

Public Law 106–78
106th Congress

An Act

Making appropriations for Agriculture, Rural Development, Food and Drug Administration, and Related Agencies programs for the fiscal year ending September 30, 2000, and for other purposes.

Oct. 22, 1999
[H.R. 1906]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the following sums are appropriated, out of any money in the Treasury not otherwise appropriated, for Agriculture, Rural Development, Food and Drug Administration, and Related Agencies programs for the fiscal year ending September 30, 2000, and for other purposes, namely:

Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2000.

TITLE I

AGRICULTURAL PROGRAMS

PRODUCTION, PROCESSING, AND MARKETING

OFFICE OF THE SECRETARY

(INCLUDING TRANSFERS OF FUNDS)

For necessary expenses of the Office of the Secretary of Agriculture, and not to exceed $75,000 for employment under 5 U.S.C. 3109, $15,436,000, of which, $12,600,000, to remain available until expended, shall be available only for the development and implementation of a common computing environment: *Provided*, That not to exceed $11,000 of this amount, along with any unobligated balances of representation funds in the Foreign Agricultural Service, shall be available for official reception and representation expenses, not otherwise provided for, as determined by the Secretary: *Provided further*, That the funds made available for the development and implementation of a common computing environment shall only be available upon approval of the Committees on Appropriations and Agriculture of the House of Representatives and the Senate of a plan for the development and implementation of a common computing environment: *Provided further*, That none of the funds appropriated or otherwise made available by this Act may be used to pay the salaries and expenses of personnel of the Department of Agriculture to carry out section 793(c)(1)(C) of Public Law 104–127: *Provided further*, That none of the funds made available by this Act may be used to enforce section 793(d) of Public Law 104–127.

(1) GRANT AUTHORITY.—The Secretary of Agriculture may make competitive grants (or grants without regard to any requirement for competition) to Native Hawaiian serving institutions for the purpose of promoting and strengthening the ability of Native Hawaiian serving institutions to carry out education, applied research, and related community development programs.

(2) USE OF GRANT FUNDS.—Grants made under this section shall be used—

(A) to support the activities of consortia of Native Hawaiian serving institutions to enhance educational equity for under represented students;

(B) to strengthen institutional educational capacities, including libraries, curriculum, faculty, scientific instrumentation, instruction delivery systems, and student recruitment and retention, in order to respond to identified State, regional, national, or international educational needs in the food and agriculture sciences;

(C) to attract and support undergraduate and graduate students from under represented groups in order to prepare them for careers related to the food, agricultural, and natural resource systems of the United States, beginning with the mentoring of students at the high school level and continuing with the provision of financial support for students through their attainment of a doctoral degree; and

(D) to facilitate cooperative initiatives between two or more Native Hawaiian serving institutions, or between Native Hawaiian serving institutions and units of State government or the private sector, to maximize the development and use of resources, such as faculty, facilities, and equipment, to improve food and agricultural sciences teaching programs.

(3) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated to make grants under this subsection $10,000,000 for each of fiscal years 2001 through 2006.

SEC. 760. Effective October 1, 1999, section 8c(11) of the Agricultural Adjustment Act (7 U.S.C. 608c(11)), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, is amended by adding at the end the following: "The price of milk paid by a handler at a plant operating in Clark County, Nevada shall not be subject to any order issued under this section.". Effective date.

SEC. 761. Notwithstanding any other provision of law, the City of Olean, New York, shall be eligible for grants and loans administered by the Rural Utilities Service. New York.

SEC. 762. Notwithstanding any other provision of law, the Municipality of Carolina, Puerto Rico shall be eligible for grants and loans administered by the Rural Utilities Service. Puerto Rico.

SEC. 763. Section 1232(a) of the Food Security Act of 1985 (16 U.S.C. 3832(a)) is amended—

(1) in paragraph (9), by adding "and" after the semicolon at the end;

(2) in paragraph (10), by striking "; and" and inserting a period; and

(3) by striking paragraph (11).

SEC. 764. None of the funds made available by this or any other Act shall be used to implement Notice CRP–338, issued by the Farm Service Agency on March 10, 1999, nor shall funds be

Attachment 1_D
Page 2 of 2

PUBLIC LAW 109–215—APR. 11, 2006

MILK REGULATORY EQUITY ACT OF 2005

Public Law 109–215
109th Congress

An Act

Apr. 11, 2006
[S. 2120]

To ensure regulatory equity between and among all dairy farmers and handlers for sales of packaged fluid milk in federally regulated milk marketing areas and into certain non-federally regulated milk marketing areas from federally regulated areas, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Milk Regulatory Equity Act of 2005.
7 USC 601 note.

SECTION 1. SHORT TITLE.

This Act may be cited as the "Milk Regulatory Equity Act of 2005".

SEC. 2. MILK REGULATORY EQUITY.

(a) MINIMUM MILK PRICES FOR HANDLERS; EXEMPTION.—Section 8c(5) of the Agricultural Adjustment Act (7 U.S.C. 608c(5)), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, is amended by adding at the end the following new subparagraphs:

"(M) MINIMUM MILK PRICES FOR HANDLERS.—

"(i) APPLICATION OF MINIMUM PRICE REQUIREMENTS.—Notwithstanding any other provision of this section, a milk handler described in clause (ii) shall be subject to all of the minimum and uniform price requirements of a Federal milk marketing order issued pursuant to this section applicable to the county in which the plant of the handler is located, at Federal order class prices, if the handler has packaged fluid milk product route dispositions, or sales of packaged fluid milk products to other plants, in a marketing area located in a State that requires handlers to pay minimum prices for raw milk purchases.

Applicability.

"(ii) COVERED MILK HANDLERS.—Except as provided in clause (iv), clause (i) applies to a handler of Class I milk products (including a producer-handler or producer operating as a handler) that—

"(I) operates a plant that is located within the boundaries of a Federal order milk marketing area (as those boundaries are in effect as of the date of the enactment of this subparagraph);

"(II) has packaged fluid milk product route dispositions, or sales of packaged fluid milk products to other plants, in a milk marketing area located in a State that requires handlers to pay minimum prices for raw milk purchases; and

"(III) is not otherwise obligated by a Federal milk marketing order, or a regulated milk pricing plan operated by a State, to pay minimum class prices for the raw milk that is used for such dispositions or sales.

"(iii) OBLIGATION TO PAY MINIMUM CLASS PRICES.—For purposes of clause (ii)(III), the Secretary may not consider a handler of Class I milk products to be obligated by a Federal milk marketing order to pay minimum class prices for raw milk unless the handler operates the plant as a fully regulated fluid milk distributing plant under a Federal milk marketing order.

"(iv) CERTAIN HANDLERS EXEMPTED.—Clause (i) does not apply to—

"(I) a handler (otherwise described in clause (ii)) that operates a nonpool plant (as defined in section 1000.8(e) of title 7, Code of Federal Regulations, as in effect on the date of the enactment of this subparagraph);

"(II) a producer-handler (otherwise described in clause (ii)) for any month during which the producer-handler has route dispositions, and sales to other plants, of packaged fluid milk products equaling less than 3,000,000 pounds of milk; or

"(III) a handler (otherwise described in clause (ii)) for any month during which—

"(aa) less than 25 percent of the total quantity of fluid milk products physically received at the plant of the handler (excluding concentrated milk received from another plant by agreement for other than Class I use) is disposed of as route disposition or is transferred in the form of packaged fluid milk products to other plants; or

"(bb) less than 25 percent in aggregate of the route disposition or transfers are in a marketing area or areas located in one or more States that require handlers to pay minimum prices for raw milk purchases.

"(N) EXEMPTION FOR CERTAIN MILK HANDLERS.—Notwithstanding any other provision of this section, no handler with distribution of Class I milk products in the marketing area described in Order No. 131 shall be exempt during any month from any minimum price requirement established by the Secretary under this subsection if the total distribution of Class I products during the preceding month of any such handler's own farm production exceeds 3,000,000 pounds.

"(O) RULE OF CONSTRUCTION REGARDING PRODUCER-HANDLERS.—Subparagraphs (M) and (N) shall not be construed as affecting, expanding, or contracting the treatment of producer-handlers under this subsection except as provided in such subparagraphs.".

(b) EXCLUSION OF NEVADA FROM FEDERAL MILK MARKETING ORDERS.—Section 8c(11) of the Agriculture Adjustment Act (7 U.S.C. 608c(11)), reenacted with amendments by the Agriculture Marketing Agreement Act of 1937, is amended—

(1) in subparagraph (C), by striking the last sentence; and

(2) by adding at the end the following new subparagraph:

"(D) In the case of milk and its products, no county or other political subdivision of the State of Nevada shall be within the marketing area definition of any order issued under this section.".

7 USC 608c note.

(c) RECORDS AND FACILITY REQUIREMENTS.—Notwithstanding any other provision of this section, or the amendments made by this section, a milk handler (including a producer-handler or a producer operating as a handler) that is subject to regulation under this section or an amendment made by this section shall comply with the requirements of section 1000.27 of title 7, Code of Federal Regulations, or a successor regulation, relating to handler responsibility for records or facilities.

7 USC 608c note.

(d) EFFECTIVE DATE AND IMPLEMENTATION.—The amendments made by this section take effect on the first day of the first month beginning more than 15 days after the date of the enactment of this Act. To accomplish the expedited implementation of these amendments, effective on the date of the enactment of this Act, the Secretary of Agriculture shall include in the pool distributing plant provisions of each Federal milk marketing order issued under subparagraph (B) of section 8c(5) of the Agriculture Adjustment Act (7 U.S.C. 608c(5)), reenacted with amendments by the Agriculture Marketing Agreement Act of 1937, a provision that a handler described in subparagraph (M) of such section, as added by subsection (a) of this section, will be fully regulated by the order in which the handler's distributing plant is located. These amendments shall not be subject to a referendum under section 8c(19) of such Act (7 U.S.C. 608c(19)).

Approved April 11, 2006.

LEGISLATIVE HISTORY—S. 2120:

CONGRESSIONAL RECORD:
Vol. 151 (2005): Dec. 16, considered and passed Senate.
Vol. 152 (2006): March 28, considered and passed House.

○

Public Law 110–246
110th Congress

An Act

To provide for the continuation of agricultural and other programs of the Department of Agriculture through fiscal year 2012, and for other purposes.

June 18, 2008
[H.R. 6124]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Food, Conservation, and Energy Act of 2008.
7 USC 8701 note.

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Food, Conservation, and Energy Act of 2008".

(b) TABLE OF CONTENTS.—The table of contents of this Act is as follows:

SEC. 1503. DAIRY EXPORT INCENTIVE PROGRAM.

(a) EXTENSION.—Section 153(a) of the Food Security Act of 1985 (15 U.S.C. 713a–14(a)) is amended by striking "2007" and inserting "2012".

(b) COMPLIANCE WITH TRADE AGREEMENTS.—Section 153 of the Food Security Act of 1985 (15 U.S.C. 713a–14) is amended—

(1) in subsection (c), by striking paragraph (3) and inserting the following:

"(3) the maximum volume of dairy product exports allowable consistent with the obligations of the United States under the Uruguay Round Agreements approved under section 101 of the Uruguay Round Agreements Act (19 U.S.C. 3511) is exported under the program each year (minus the volume sold under section 1163 of this Act during that year), except to the extent that the export of such a volume under the program would, in the judgment of the Secretary, exceed the limitations on the value permitted under subsection (f); and"; and.

(2) in subsection (f), by striking paragraph (1) and inserting the following:

"(1) FUNDS AND COMMODITIES.—Except as provided in paragraph (2), the Commodity Credit Corporation shall in each year use money and commodities for the program under this section in the maximum amount consistent with the obligations of the United States under the Uruguay Round Agreements approved under section 101 of the Uruguay Round Agreements Act (19 U.S.C. 3511), minus the amount expended under section 1163 of this Act during that year.".

SEC. 1504. REVISION OF FEDERAL MARKETING ORDER AMENDMENT PROCEDURES.

Section 8c of the Agricultural Adjustment Act (7 U.S.C. 608c), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, is amended by striking subsection (17) and inserting the following:

"(17) PROVISIONS APPLICABLE TO AMENDMENTS.—

"(A) APPLICABILITY TO AMENDMENTS.—The provisions of this section and section 8d applicable to orders shall be applicable to amendments to orders.

"(B) SUPPLEMENTAL RULES OF PRACTICE.—

"(i) IN GENERAL.—Not later than 60 days after the date of enactment of this subparagraph, the Secretary shall issue, using informal rulemaking, supplemental rules of practice to define guidelines and timeframes for the rulemaking process relating to amendments to orders. Deadline.

"(ii) ISSUES.—At a minimum, the supplemental rules of practice shall establish—

"(I) proposal submission requirements;

"(II) pre-hearing information session specifications;

"(III) written testimony and data request requirements;

"(IV) public participation timeframes; and

"(V) electronic document submission standards.

"(iii) EFFECTIVE DATE.—The supplemental rules of practice shall take effect not later than 120 days after

Attachment 1_F
Page 3 of 5

the date of enactment of this subparagraph, as determined by the Secretary.

Deadlines.

"(C) HEARING TIMEFRAMES.—

"(i) IN GENERAL.—Not more than 30 days after the receipt of a proposal for an amendment hearing regarding a milk marketing order, the Secretary shall—

Notice.

"(I) issue a notice providing an action plan and expected timeframes for completion of the hearing not more than 120 days after the date of the issuance of the notice;

"(II)(aa) issue a request for additional information to be used by the Secretary in making a determination regarding the proposal; and

"(bb) if the additional information is not provided to the Secretary within the timeframe requested by the Secretary, issue a denial of the request; or

"(III) issue a denial of the request.

"(ii) REQUIREMENT.—A post-hearing brief may be filed under this paragraph not later than 60 days after the date of an amendment hearing regarding a milk marketing order.

"(iii) RECOMMENDED DECISIONS.—A recommended decision on a proposed amendment to an order shall be issued not later than 90 days after the deadline for the submission of post-hearing briefs.

"(iv) FINAL DECISIONS.—A final decision on a proposed amendment to an order shall be issued not later than 60 days after the deadline for submission of comments and exceptions to the recommended decision issued under clause (iii).

"(D) INDUSTRY ASSESSMENTS.—If the Secretary determines it is necessary to improve or expedite rulemaking under this subsection, the Secretary may impose an assessment on the affected industry to supplement appropriated funds for the procurement of service providers, such as court reporters.

"(E) USE OF INFORMAL RULEMAKING.—The Secretary may use rulemaking under section 553 of title 5, United States Code, to amend orders, other than provisions of orders that directly affect milk prices.

"(F) AVOIDING DUPLICATION.—The Secretary shall not be required to hold a hearing on any amendment proposed to be made to a milk marketing order in response to an application for a hearing on the proposed amendment if—

Deadline.

"(i) the application requesting the hearing is received by the Secretary not later than 90 days after the date on which the Secretary has announced the decision on a previously proposed amendment to that order; and

"(ii) the 2 proposed amendments are essentially the same, as determined by the Secretary.

"(G) MONTHLY FEED AND FUEL COSTS FOR MAKE ALLOWANCES.—As part of any hearing to adjust make allowances under marketing orders commencing prior to September 30, 2012, the Secretary shall—

"(i) determine the average monthly prices of feed and fuel incurred by dairy producers in the relevant marketing area;

"(ii) consider the most recent monthly feed and fuel price data available; and

"(iii) consider those prices in determining whether or not to adjust make allowances.".

SEC. 1505. DAIRY INDEMNITY PROGRAM.

Section 3 of Public Law 90–484 (7 U.S.C. 450l) is amended by striking "2007" and inserting "2012".

SEC. 1506. MILK INCOME LOSS CONTRACT PROGRAM. 7 USC 8773.

(a) DEFINITIONS.—In this section:

(1) CLASS I MILK.—The term "Class I milk" means milk (including milk components) classified as Class I milk under a Federal milk marketing order.

(2) ELIGIBLE PRODUCTION.—The term "eligible production" means milk produced by a producer in a participating State.

(3) FEDERAL MILK MARKETING ORDER.—The term "Federal milk marketing order" means an order issued under section 8c of the Agricultural Adjustment Act (7 U.S.C. 608c), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937.

(4) PARTICIPATING STATE.—The term "participating State" means each State.

(5) PRODUCER.—The term "producer" means an individual or entity that directly or indirectly (as determined by the Secretary)—

(A) shares in the risk of producing milk; and

(B) makes contributions (including land, labor, management, equipment, or capital) to the dairy farming operation of the individual or entity that are at least commensurate with the share of the individual or entity of the proceeds of the operation.

Contracts.

(b) PAYMENTS.—The Secretary shall offer to enter into contracts with producers on a dairy farm located in a participating State under which the producers receive payments on eligible production.

(c) AMOUNT.—Payments to a producer under this section shall be calculated by multiplying (as determined by the Secretary)—

(1) the payment quantity for the producer during the applicable month established under subsection (e);

(2) the amount equal to—

(A) $16.94 per hundredweight, as adjusted under subsection (d); less

(B) the Class I milk price per hundredweight in Boston under the applicable Federal milk marketing order; by

(3)(A) for the period beginning October 1, 2007, and ending September 30, 2008, 34 percent;

(B) for the period beginning October 1, 2008, and ending August 31, 2012, 45 percent; and

(C) for the period beginning September 1, 2012, and thereafter, 34 percent.

(d) PAYMENT RATE ADJUSTMENT FOR FEED PRICES.—

Time period.

(1) INITIAL ADJUSTMENT AUTHORITY.—During the period beginning on January 1, 2008, and ending on August 31, 2012, if the National Average Dairy Feed Ration Cost for a month during that period is greater than $7.35 per hundredweight,

Attachment 1_F
Page 5 of 5