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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

PROPOSED FINDINGS OF FACT AND REQUEST FOR OFFICIAL NOTICE

SUBMITTED BY

DAIRY INSTITUTE OF CALIFORNIA

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March 31, 2016

I. PROPOSED FINDINGS OF FACT

This proceeding “is governed by the provisions of Sections 556 and 557 of Title 5 of the United States Code.” 80 Fed. Reg. 47210 c.1 (Aug. 6, 2015). Pursuant to 5 U.S.C. § 557(c), the Dairy Institute requests that the Secretary examine each proposed finding of fact contained herein and rule specifically and individually on them as required by § 557(c). *

II. SUMMARY OF CRITICAL FACTS¹

- A. California produces 20% of the country’s milk supply.
- B. California producers currently produce an adequate supply of milk for fluid use.
- C. Raw milk supplies and manufactured milk products regularly are moving in and out of the state of California without market disruption.
- D. In all current FMMOs, a dairy farmer may only receive a uniform regulated price if he is willing to serve the fluid milk market by meeting performance-based pooling standards.
- E. In the current FMMOs, specific market situations may incentivize dairy farmers and the handlers to whom they ship milk to maximize their returns by electing non-pool status.
- F. In the current FMMOs, specific financial incentives exist for handlers to elect to not pool eligible milk when the handler acts rationally to maximize its profits.
- G. In the current markets under existing FMMOs, many handlers have elected to not pool significant volumes of milk otherwise eligible to be pooled.
- H. A cooperative that must pool all of its milk can blend losses internally with other revenue including increased revenue from the sale of producer milk at higher regulated minimum levels. A private manufacturing company who must pool all of its milk does not have the option to reblend such losses.
- I. California FMMO prices should reflect the current marketing conditions in California.
- J. A market-clearing price is where the supply and demand curves intersect.
- K. Prices that are minimum prices should be set below market-clearing levels to ensure they do not rise above market-clearing prices.

¹ With the exception of Critical Fact A, each of these Critical Facts corresponds with the same number in the Complete Proposed Findings of Fact.

- L. Prices that are above market-clearing levels will disrupt the market and result in disorderly marketing conditions.
- M. Milk production levels in California have been on a significant upward trajectory for the last couple of decades.
- N. California producers' increased production was not driven by increased manufacturing demand.
- O. Increased prices will lead to increased production.
- P. Manufacturing demand for raw milk in California has been largely met by current supplies.
- Q. California's increased milk production has outpaced the increase in local demand for manufactured milk products.
- R. A large percentage of California's manufacturers are cheese plants that manufacture a large percentage of California's milk production. Proprietary companies own the vast percentage of the cheese plants and manufacture most of the cheese in California.
- S. California's fluid milk processing fulfills local demand for Class I products. California's production of manufactured products significantly exceeds California's demand for these products.
- T. California's manufactured cheese products must be marketed nationally, primarily on the East Coast, and internationally.
- U. Any California FMMO will increase California fluid milk production.
- V. A California FMMO will result in decreased prices for producers in other FMMOs.
- W. An increase in California milk prices will result in a decrease in processing capacity in California.
- X. An acceptable level of price difference exists between California prices and FMMO prices.
- Y. Increased manufacturing costs due to increased milk prices will disrupt sales of manufactured dairy products.
- Z. If prices do not reflect real-life supply and demand, the market will react negatively.
- AA. Cooperatives can reblend losses from their manufacturing operations with profits from higher milk prices.

- BB. The cooperatives did not introduce evidence on a number of topics related to their proposed prices.
- CC. A number of production and marketing characteristics make the California dairy market unique from other order areas. Quota, however, is a function of California law and is not a production or marketing characteristic.
- DD. Manufactured milk products, especially cheese, have different values depending on where the product is produced and where it has to be sold.
- EE. Raw milk supply must clear locally, manufactured milk products clear nationally.
- FF. Producer-handlers under FMMOs have to meet different standards than producer-distributors (“PDs”) under California law.
- GG. Fluid milk processors have lost business to Producer-Distributors as the result of California’s exempt quota.
- HH. Specific California FMMO provisions must comply with the AMAA.

III. COMPLETE PROPOSED FINDINGS OF FACT

A. Federal Milk Marketing Order Regulations

1) 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).

2) 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. §§608(c)(11) and (18).

3) The AMAA 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.

B. California producers currently produce an adequate supply of milk for fluid use.

4) California currently has a 12-13% Class I utilization. *See* 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.

5) California presently has 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).

C. Raw milk supplies and manufactured milk products regularly are moving in and out of the state of California without market disruption.

6) California Hispanic Cheese can be found in Pennsylvania and Cabot cheese from Vermont can be found in Fresno. *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).

7) Cooperatives have downsized, sold or closed cheese-making operations in California. Ex. 98, at 11 (Testimony of Mr. de Jong).

8) Proprietary Class III investments are being made outside California. Tr.4392:9–21 (Testimony of Mr. de Jong).

9) The Cooperative witnesses 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 (Testimony of Mr. 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.

10) 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 I prices.

11) No witness appeared to claim that there were market disruptions in Nevada whether from California or other areas not subject to federal regulation.

12) CDFA credits processors (whether Class I or otherwise) at the plant blend for out-of-state milk sales to California Class I plants. Payment at the plant blend means that the plant may avoid the producer-settlement fund payment, but still pays the full use value for that milk to out-of-state handlers. The milk is not unpriced. Tr. 4081: 23 – 4082:4 (Testimony of Mr. Turner); Tr. 7600:20 – 21 (Testimony of Mr. DeGroot).

13) 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.

D. In all current FMMOs, a dairy farmer may only receive a uniform regulated price if he is willing to serve the fluid milk market by meeting performance-based pooling standards.

14) In every one of the current 10 FMMOs, if a dairy farmer is unwilling to serve the fluid market when needed, then he is not entitled to that uniform price. 7 C.F.R. 1---.7 and .13

15) 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* 7 C.F.R. §§ 1---.7 and .13; *County Line Cheese Co., supra.*

E. In the current FMMOs, specific market situations may incentivize dairy farmers and the handlers to whom they ship milk to maximize their returns by electing non-pool status.

16) 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).

F. In the current FMMOs, specific financial incentives exist for handlers to elect to not pool eligible milk when the handler acts rationally to maximize its profits.

17) 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 party transactions and premiums “will take care of supply in the Class I markets”); Ex. 58, at 13 (Testimony of Mr. Christ).

18) 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)).

19) All California cheese plant milk would be priced and pooled under the Cooperative Order at classified prices based upon the non-updated FMMO formulas. *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).

20) Unlike their FMMO competitors who can and do avoid minimum regulated prices by de-pooling milk or receiving nonpool milk for instance 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).

21) The ability of manufacturers of cheese, butter and nonfat dry milk that may be otherwise regulated by an FMMO to avoid paying regulated minimums is a financial advantage. Tr. 2529:23 – 25 (Testimony of Mr. Christ).

22) The ability of manufacturers of cheese, butter and nonfat dry milk that may be otherwise regulated by an FMMO to retain monies that would otherwise be paid to the producer-settlement fund is a financial advantage. Tr. 2497:25 – 2498:4 and 2529: 13 – 25 (Testimony of Mr. Christ).

23) The ability to retain monies otherwise payable to the producer-settlement fund reduces the entities' cost of milk for making products. Tr. 2498:22 – 2499:24 (Testimony of Mr. Christ), Tr. 3754:18 – 22 (Testimony of Mr. Metzger).

24) USDA does not and cannot audit and thus, truly know, the prices paid for milk that is not pooled. Tr. 602: 12 – 20 (Testimony of Mr. Schaefer).

G. In the current markets under existing FMMOs, many handlers have elected to not pool significant volumes of milk otherwise eligible to be pooled.

25) Significant volumes of eligible milk are not pooled on today's FMMOs. *See* USDA Data Request, 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).

26) 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.”).

27) The ability to leverage eligible milk not pooled or purchases of milk below class prices in the existing FMMOs, provides a financial benefit to businesses operating with that system. Ex. 98: 15 – 17 (Testimony of Mr. de Jong); Tr. 2529: 13 – 25 (Testimony of Mr. Christ).

28) 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).

29) There have been 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).

30) 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).

31) 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).

32) Hilmar has purchased billions of pounds of other milk under Class III prices in the 12 months preceding the hearing. Ex. 98, at 15 (Testimony of Mr. de Jong).

33) The results of overproduction that led to HP Hood enforcing their volume caps 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.

34) Hilmar Cheese Company has de-pooled milk under the Southwest Marketing Area. Ex. 98, at 16 (Testimony of Mr. de Jong).

35) 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).

36) 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. *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).

H. A cooperative that must pool all of its milk can blend losses internally with other revenue including increased revenue from the sale of producer milk at higher regulated minimum levels. A private manufacturing company who must pool all of its milk does not have the option to reblend such losses.

37) 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).

38) The cooperatives can internally balance losses with any increased 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.”)

I. California FMMO prices should reflect the current marketing conditions in California.

39) A California FMMO would result in 20% of the nation’s dairy being incorporated into the FMMO system.

40) CDI argued 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).

41) National All Jersey testified that prices should be up-to-date. Tr. 3752:4 – 7 (Testimony of Mr. Metzger).

J. A market-clearing price is where the supply and demand curves intersect.

42) 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.

K. Prices that are minimum prices should be set below market-clearing levels to ensure they do not rise above market-clearing prices.

43) 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).

44) The importance of setting market clearing prices is heightened when the regulated minimum prices are mandatory rather than elected voluntarily as under the ten FMMOs.

45) 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).

46) CDI stated 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.).

L. Prices that are above market-clearing levels will disrupt the market and result in disorderly marketing conditions.

47) Prices at overly-high levels would disrupt the market. 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.

48) Ignoring 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.

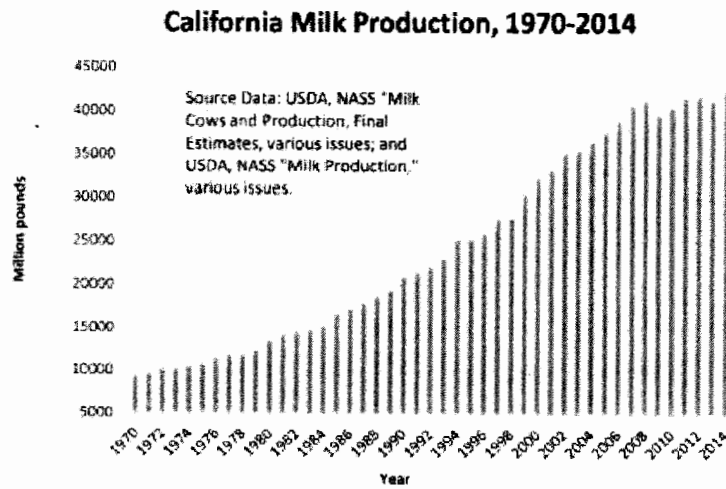
49) Ignoring the changes in markets and market conditions both in California and nationally since 1996 would also limit, in a way, the ability to market in California.

50) Markets are driven from the top down, not the bottom up. The ultimate consumer determines how much milk is worth to them, and then suppliers and producers respond accordingly, not vice versa.

M. Milk production levels in California have been on a significant upward trajectory for the last couple of decades.

51) Milk production in California has been on an upward trajectory for the last couple of decades. In fact, California producers more than tripled their milk production since 1980 through 2014. Ex. 91, at 4. “[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 milk production increases over the last 45 years:

Figure 3.

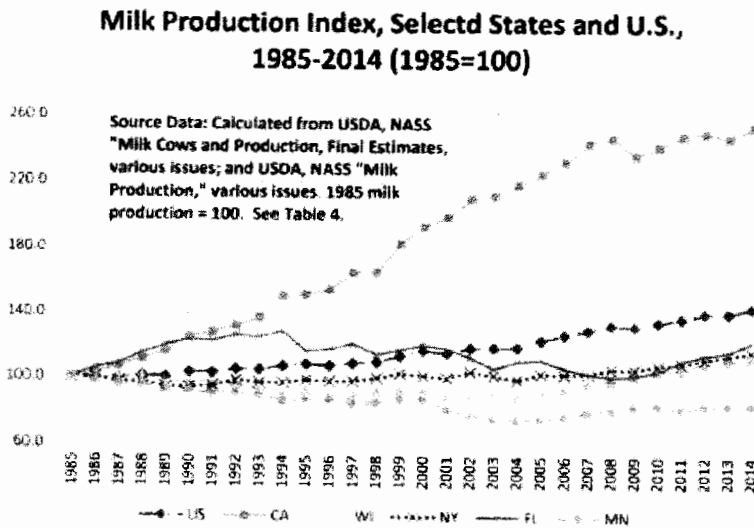


Source: See Table 3.

Ex. 80, at 7 (Exhibits to Testimony of Dr. Schiek).

52) This growth in California was unparalleled in other dairy states.

Figure 4



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

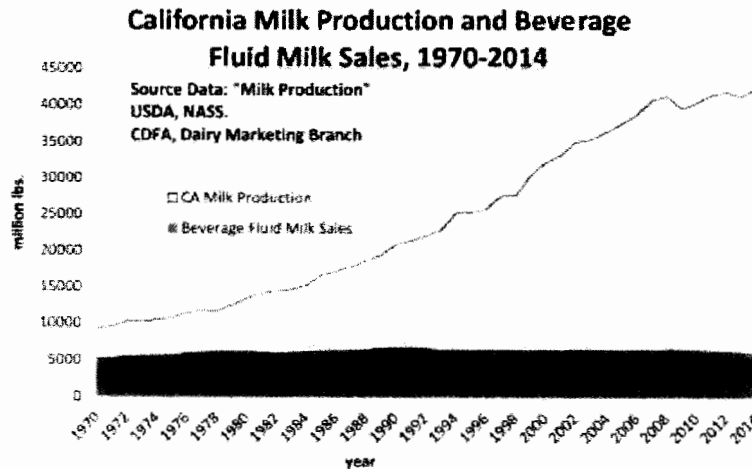
53) A multitude of forces were driving increased production in California, even in light of the regulatory prices. California has the largest cow-per-herd average of any state in the

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.

N. California producers’ increased production was not driven by increased manufacturing demand.

54) The increase in production was not demand driven, but a result of increasing efficiencies and a drive towards profits. Class I sales have stalled and had no correlation with the 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).

55) 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 historically left the market oversaturated.

O. Increased prices will lead to increased production.

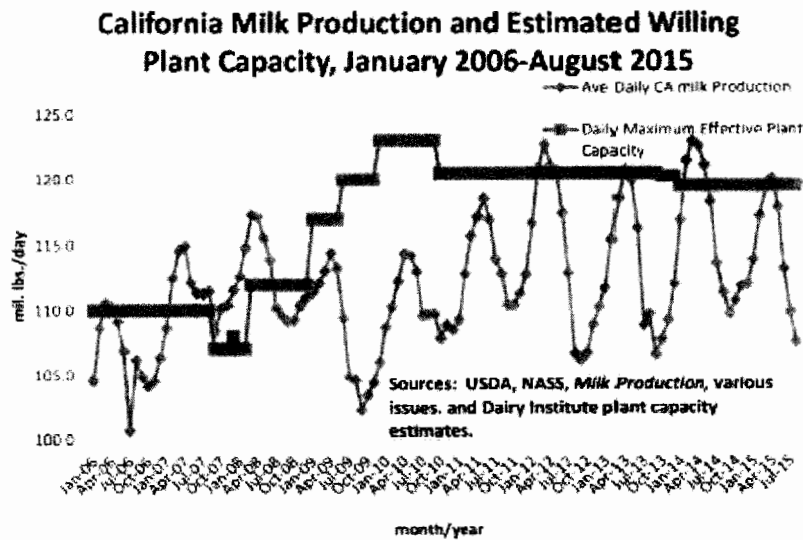
56) “If local prices were not adequate to cover [a high cost production area], you would experience a declining milk production industry. In an area where milk production costs are below available prices, you might expect expanding milk production.” Tr. 2553: 10 – 12 (Testimony of Mr. Christ).

57) If the price for a good increases, production and sale of that good will also increase. Ex. 116, at 4 – 5 (Testimony of Ms. Taylor); Tr. 5302: 1 – 8 (Testimony of Ms. Taylor).

P. Manufacturing demand for raw milk in California has been largely met by current supplies.

58) 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, at 3) for all classes from January 2006 until August 2015.

Figure 2



Source: See Table 1.

Ex. 80, at 2.

59) As shown by the chart, producers largely have met 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 (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.*

60) “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). 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 added).

61) Manufacturers testified at the hearing that production had largely met their manufacturing demand needs. Producers easily fulfill Class 1 needs in California. Ex. 91, at 6 (Testimony of Mr. Dryer).

62) 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. 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. Ex. 97, at 3. Tr.4351:1–4352:3 (Testimony of Mr. Newell). An overvalued mandatory minimum in the form of whey factor values led to this result. Ex. 97, at 4.

63) The Cooperatives have sought to address the problem of excess milk production by enforcing caps on production in the form of base plans. *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). The state does not mandate these base plans and the Cooperatives can terminate them at any time. Tr. 975: 4 – 20 (Testimony of Mr. Kasbergen).

64) 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).

65) One farmer testified that he has never had the base plan enforced for his milk. Tr. 1012: 16 – Tr. 1013: 20 (Testimony of Mr. Fernandes).

66) The Cooperatives have decreased manufacturing capacity in California in recent years. 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 Land O’Lakes (“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 supply in light of the strained capacity. Ex. 79, at 28 (Testimony of Dr. Schiek) and Ex. 39 (Article on LOL Supplemental Base Reduction).

67) Nationally the dairy industry has struggled 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).

Q. California's increased milk production has outpaced the increase in local demand for manufactured milk products.

68) California produces 20% of the country's milk supply. *See* 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.

69) 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).

70) In the 19 years from 1995 to 2014, the California population had increased by 23% and the western states by 34%. Milk production has far outpaced local demand in the region. *Id.*

71) 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.*

R. A large percentage of California's manufacturers are cheese plants that manufacture a large percentage of California's milk production. Proprietary companies own the vast percentage of the cheese plants and manufacture most of the cheese in California.

72) 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.

73) 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.

74) 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).

75) California also has significant Hispanic cheese manufacturing. *Id.*

76) California manufacturers also make other products, including butter, nonfat dry milk (“NFDM”), ice cream, sour cream, buttermilk, cottage cheese, and yogurt. *Id.*

77) 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).

S. California’s fluid milk processing fulfills local demand for Class I products. California’s production of manufactured products significantly exceeds California’s demand for these products.

78) California has sufficient population and demand for most fluid milk finished products to be efficiently 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 moves 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.

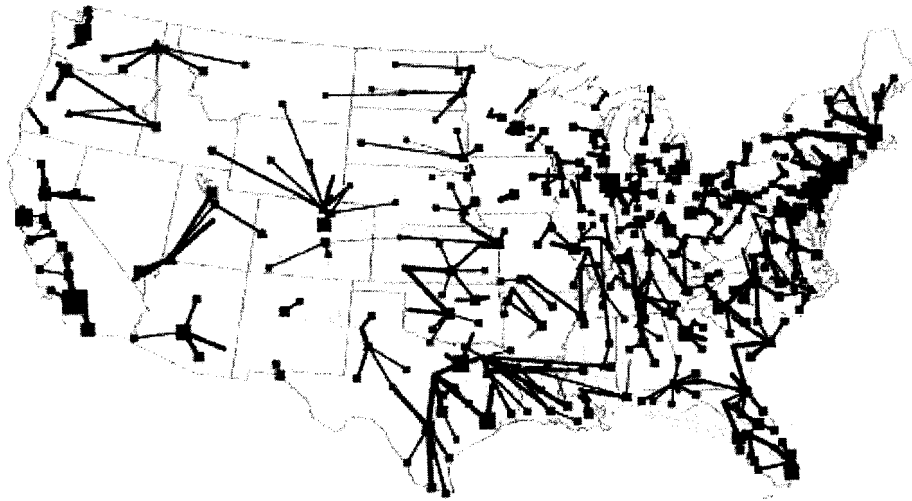


Figure 1. Least-Cost Fluid Milk Processing Locations and Flows,
USDSS Primal Solution, March 2014.

Ex. 133 at 4.

T. California's manufactured cheese products must be marketed nationally, primarily on the East Coast, and internationally.

79) 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 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, discussing the sale of Cabot Cheese from Vermont in California (testimony of Mr. Moore and Mr. de Cardenas). 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.

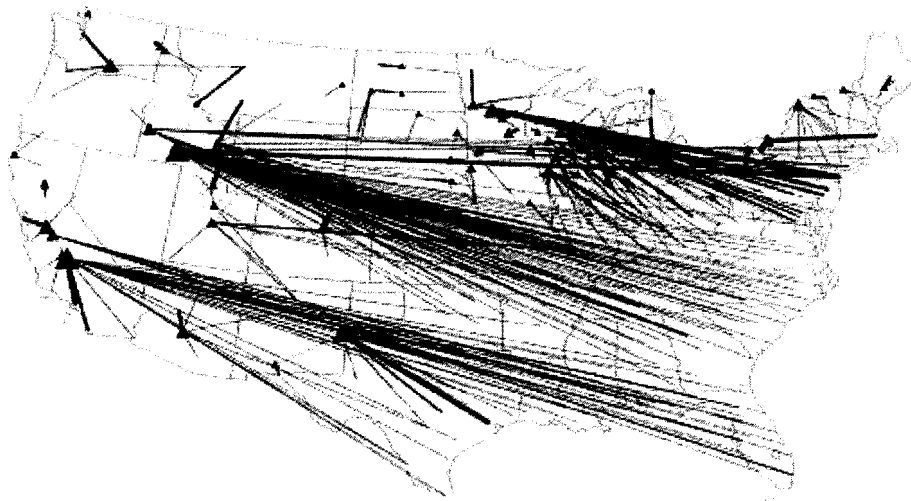


Figure 2. Least-Cost American Cheese Processing Locations and Flows, USDSS Primal Solution, March 2014.

Ex. 133 at 4.

80) 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.

U. Any California FMMO will increase California fluid milk production.

81) Increased prices indicate to farmers that manufacturers need more milk and it is worth your while to produce it.

82) Manufacturers in California are seldom in need of more milk.

83) 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	0.37	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
HI AK 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).

84) California production will grow, on average, 6 million pounds per year under the Dairy Institute Proposal 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	0.06	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
HI AK 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).

V. A California FMMO will result in decreased prices for producers in other FMMOs.

85) The economic model prepared by 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).

W. An increase in California milk prices will result in a decrease in processing capacity in California.

86) 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 8–9 (Testimony of Mr. de Jong), Ex. 107, at 11 (“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].”).

87) California’s manufacturers cannot afford the increase in prices in the Cooperative Order.

88) An over-valued minimum milk price will be especially felt by cheesemakers, a devastating result for California’s cheese-heavy manufacturing class.

89) Additionally, California’s manufacturing growth has mostly been bulk commodities plants which command lower margins than other specialty plants. Ex. 91, at 15.

90) “[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.

91) Hispanic cheese makers cannot survive an increase in milk prices. Ex. 105 (Testimony of Mr. Maldonado). Caci que 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.

92) 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. Ex. 119, at 3 (Testimony of Mr. Vandenberg).

93) The high whey prices in California in the 2000's 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).

94) 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. This increase represents a 10% increase in the cheese's gross value. Ex. 91, at 6.

95) Class III and IV prices impact all classes. Changes made to Class III and Class IV prices are compounded in Class I prices.

X. An acceptable level of price difference exists between California prices and FMMO prices.

96) "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 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).

97) Present capacity will moved or be reduced if the Cooperative Order is adopted. Ex. 98, at 8 (Testimony of Mr. de Jong, and Ex. 116, at 3 (Testimony of Sue Taylor).

98) New cheese capacity is already being built or planned is building outside of California in response to uncertainties created by the CSO and the potential for an FMMO with mandatory pooling.

Y. Increased manufacturing costs due to increased milk prices will disrupt sales of manufactured dairy products.

99) Demand for fluid milk products is elastic. *See* Tr. 4374:11 – 25 (Testimony of Mr. Newell).

100) The industry is already seeing consumers move to alternative beverages like fruit punch when milk gets too expensive. See Tr. 4374:11 – 25 (Testimony of Mr. Newell).

101) 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. This is especially true for California, which has a large percentage of butter and powdered milk. Ex. 98, at 13.

102) The loss of manufacturing capacity due to overvalued minimum prices leaves farmers without a purchaser for their milk. Ex. 98, at 8 (Testimony of Mr. de Jong). It also results in a 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).

Z. If prices do not reflect real-life supply and demand, the market will react negatively.

103) If prices do not reflect real-life market and demand, 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).

104) 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.

105) Normally a corresponding decrease in price accompanies a run-up in production unmet by demand (as demonstrated by simple supply and demand laws). If a minimum price prevents the price from dropping to respond to this market effect, then the only option is for demand to drop.

106) Premiums complement minimum prices set below market clearing levels so that manufacturers purchase milk at its actual value.

107) 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 (Testimony of Mr. de Jong).

108) If prices are not higher than a certain level, then it can only be concluded that the demand that raises premiums over the minimum price does not currently exist. To put it plainly, the milk is not worth more than the minimum price being paid. Ex. 98, at 10 (Testimony of Mr. de Jong).

109) 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).

110) 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).

111) Setting regulated minimum prices too high prevents milk from moving to its highest and best use. *Id.* (Ex. 116, at 3–4) (Testimony of Ms. Taylor); Tr. 5858: 13 – 16 (Testimony of Mr. Vetne) (Marketplace premiums play the important role of drawing milk to its highest and best use.).

AA. Cooperatives can reblend losses from their manufacturing operations with profits from higher milk prices.

112) If the manufacturing price of milk is overvalued, Cooperatives 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).

113) Cooperative manufacturing facilities are able to counterbalance their losses on the manufacturing side with the higher profits on the producer side. Ex. 133, at 9 (Dr. Stephenson Study).

114) The cooperatives control the vast majority of manufacturing in the PNW and Arizona. Ex. 133, at 9 (Testimony of Dr. Stephenson).

115) 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.*

BB. The Cooperatives did not introduce evidence on a number of topics related to their proposed prices.

116) Cooperatives did not know if the cost conversion that serves as the 70 cent Price II differential had changed since the mid-1990's (when it was set). Tr. 1364: 6 – 15 (Testimony of Mr. Hollon). Nor did cooperatives study that conversion for this proceeding. *Id.*

117) 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).

118) The Cooperatives acknowledge that Class I sales have fallen and that Class I processors face increasingly challenging markets, but have not done any study as to the effect of their proposal on these problems.

119) 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).

120) 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).

121) The Cooperatives have provided no 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).

CC. A number of production and marketing characteristics make the California dairy market unique from other order areas. Quota, however, is a function of California law and is not a production or marketing characteristic.

122) USDA did not include data gathered about receipts and distribution of fluid milk products by all known distributing plants in their Federal Order Reform pricing analysis. 64 Fed. Reg. 16044, c.2.

123) Milk and cheese production in the Pacific Northwest 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 III Producer Milk in 2014 in California). Similarly, at the of Federal Order Reform time not a lot of milk or milk products needed to move east from that location. Tr. 5124:12 – 15 (Testimony of Mr. Vetne), Ex. 112, at 58.

124) The national dairy industry has seen changes since 1993, and 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*, preceding paragraphs discussing the California market.

DD. Manufactured milk products, especially cheese, have different values depending on where the product is produced and where it has to be sold.

125) 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 model 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. 5973:6–25 (Testimony of Dr. Stephenson).

126) 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.

127) 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.²



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

² 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).

Ex. 133 at 4.

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

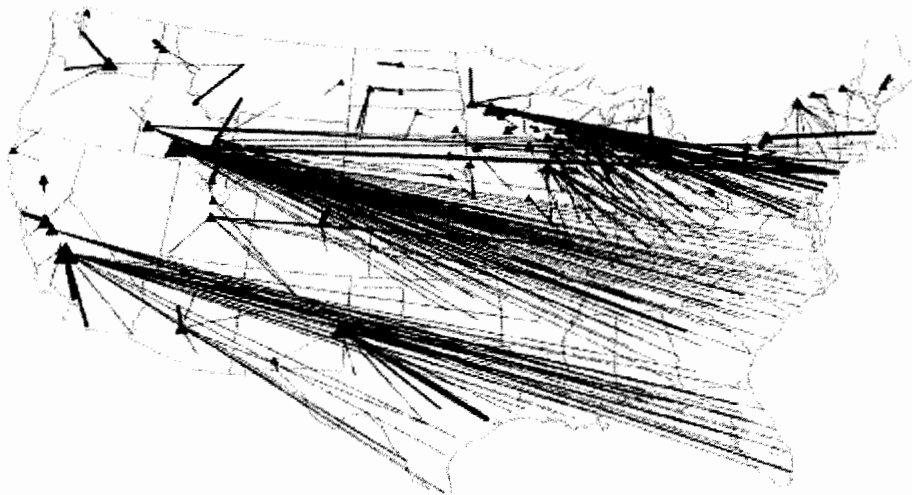


Figure 2. Least-Cost American Cheese Processing Locations and Flows.
USDSS Primal Solution, March 2014.

Ex. 133 at 4.

129) 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 the real world as to efficient markets.

130) 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).

131) 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.

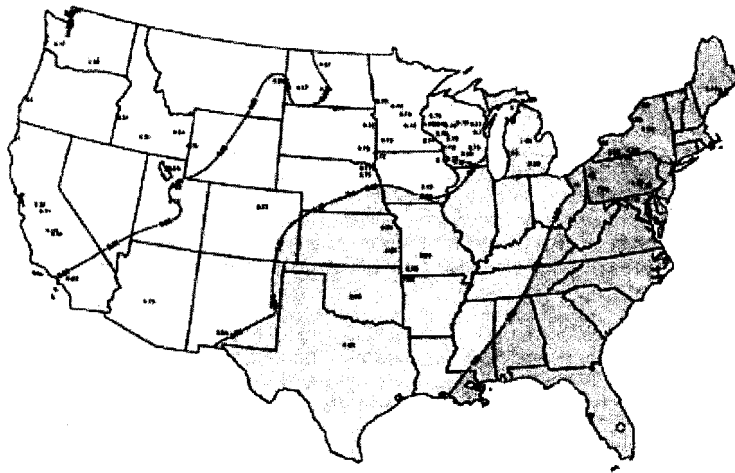


Figure 3. USDSS Model-Generated Cheese Differentials, May 1995.

132) 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.

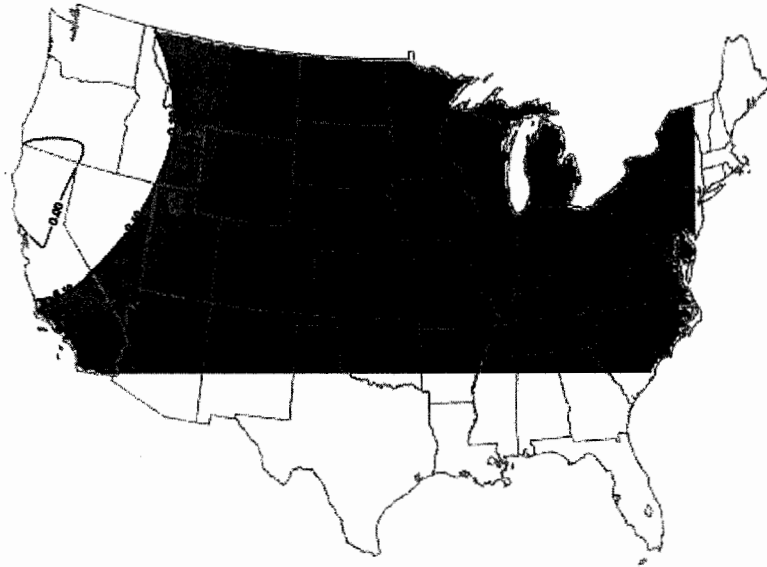


Figure 4. USDSS Model-Generated Cheese Difference in Marginal Value of Milk at Cheese Plants² from Low Value-Point, March 2014.

Ex. 133, at 7.

133) 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, 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.

134) USDA cannot and should not force the California minimum market-clear 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.

EE. Raw milk supply must clear locally, manufactured milk products clear nationally.

135) The USDA model 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).

136) While markets for dairy products clear nationally, milk markets have to clear locally. Tr. 4155: 23 – 24 (Testimony of Dr. Schiek).

137) 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. An analysis that fails to incorporate this fundamental principle cannot be the basis for an FMMO pricing scheme.

138) The measure for Dairy Market News prices for delivered products in less than carload mixed lots is entirely different from what NDPSR, the CME, or CDFEA measures. Tr. 5666:4 – 18 (Testimony of Dr. Schiek).

139) Northwest manufacturers faced 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.*

140) Almost all U.S. milk is Grade A. Milk produced in California that meets Grade A standards can elect Grade B status. Tr. 4552:23 – 4554:23 (Testimony of Mr. de Jong).

FF. Producer-handlers under FMMOs have to meet different standards than producer-distributors (“PDs”) under California law.

141) At the hearing, both examiners and witness would routinely refer alternatively to PDs, P-Hs, producer-distributors, and producer handlers. However, these terms are not interchangeable. PDs only refer to CSO producer-distributors with example 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 existing FMMOs. *See all 7 C.F.R. §1---.10.*

142) PDs operate both dairy farms and processing plants. Tr. 6820: 5 – 7 (Testimony of Mr. Gonsalves); Tr. 6948: 13 – 18 (Testimony of Mr. Shehadey).

143) 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).

144) The PDs also operate large volume Class I plants. Tr. 6948: 13 – 18 (Testimony of Mr. Shehadey).

145) At least three of the PD's have more than three million pounds milk route distribution. Tr. 6422: 3 – 19 (Testimony of Mr. Blaufuss).

146) The four PD's would not qualify as producer-handlers under a traditional FMMO because they buy significant amounts of milk outside their own system. Tr. 6383: 15 – 24 (Testimony of Mr. Blaufuss).

147) The two most significant factual distinctions between PDs and “producer-handlers” under traditional FMMOs are: (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).

148) No new entities could apply for or obtain this PD status. Tr. 6832: 4 – 12 (Testimony of Mr. Gonsalves). New entities can become Producer-Handlers under FMMOs if they meet the criteria. *See all 7 C.F.R. §1---.10.*

149) Under the CSO, large Class 1 handlers with historical 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. 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. 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. These 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).

150) When exempt quota was issued and when subsequently purchased, exempt quota’s price was the same as regular quota. Tr. 8130, lines 2-13 (Testimony of Mr. Lund).

151) PDs retain the money that is the difference between the regulated Class 1 price and the quota price for milk. Tr. 6364:10 – 13 (Testimony of Mr. Blaufuss).

GG. Fluid milk processors have lost business to Producer-Distributors as the result of California’s exempt quota.

152) Clover-Stornetta has lost business to PDs in the San Francisco Bay Area (which is the home of Clover-Stornetta). Tr. 5520 – 5522 (Testimony of Mr. Britt).

153) 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. 5517:23 – 5518:5 (Testimony of Mr. Britt). Farmdale Creamery has lost business to PDs because the PDs could offer a lower priced end product. Tr. 4725: 4 – 17 (Testimony of Mr. Hofferber). Dean Foods Company has lost business to PDs. 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 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.

154) Class I milk sales are highly competitive. For packaged fluid milk, raw milk represents 70% of the cost of finished product. Tr. 6376:4 – 6378: 13 (Testimony of Mr. Williams), Ex. 141.

155) PDs are not able to benefit from the CSO's transportation credits and allowances system. Tr. 7045:17 – 20 (Testimony of Mr. Shehadey).

156) PDs also pointed out, they must not sell milk below cost under California law. Tr. 7572: 15 – 16 (Testimony of Mr. DeGroot).

157) 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%.

158) 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 1 market is significant, and increasing. The 333.0% growth of total PD California Class 1 sales from 1985 to 2015 is also notable. Ex. 154 and Ex. 155 (based on Ex. 153 (Testimony of Mr. Shehadey)).

HH. Specific California FMMO provisions must comply with the AMAA.

159) Under the Cooperative Order, the following would be permitted: 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 50 million pounds will not be properly treated as diverted.

160) Under the Cooperative Order, the following would be permitted: 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 Cooperative Order's diversion rules 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.

161) Under the Cooperative Order, the following would be permitted: 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. 2893 – 2903 (Testimony of Mr. Hollon).

162) Under the Cooperative Order, the following would be permitted: 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.

163) Under the Cooperative Order, 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.

164) Given California's separate statute requiring fortification of certain milk under California's Fluid Milk Standards, use of traditional two factor Class I pricing would result in non-uniform prices paid by handlers. Three-factor Class I pricing complies with the AMAA uniform price requirements and would raise dairy farmer prices.

165) The Dairy Institute hereby incorporates by reference the Proposed Findings of Fact submitted on behalf of Hilmar.

IV. OFFICIAL NOTICE

Pursuant to 7 C.F.R. 900.8(d)(5), “Official notice may be taken of such matters as are judicially noticed by the courts of the United States and of any other matter of technical, scientific, or commercial fact of established character.” The Dairy Institute Proposes the below list of matters, information, and/or documents which should be officially noticed by USDA.³

The USDA may adopt the Dairy Institute’s requested official notice documents as they are matters which are “judicially noticed by the courts of the United States.” A court may take judicial notice of a fact “not subject to reasonable dispute” because it can be determined “from sources whose accuracy cannot reasonably be questioned” or is “generally known within the trial court’s territorial jurisdiction.” Fed. R. Evid. 201(b). Courts may take judicial notice of information contained in government websites or documents. *See, e.g., Daniels-Hall v. Nat’l Educ. Ass’n*, 629 F.3d 992, 998-99 (9th Cir. 2010) (taking judicial notice of information displayed on educational union website); *Sinaloa Lake Owners Ass’n v. City of Simi Valley*, 882 F.2d 1398, 1403 n.2 (9th Cir. 1989) (“We take judicial notice of these figures, contained in the reports of a public body, pursuant to Fed. R. Evid. 201(b)(2).”), *overruled on other grounds by Armendariz v. Penman*, 75 F.3d 1311 (9th Cir. 1996); *Gustavson v. Mars, Inc.*, No. 13-CV-04537, 2014 WL 2604774, at *3 n.1 (N.D. Cal. June 10, 2014) (judicially noticing an FDA letter, FDA press release, and FDA Warning Letter that were “readily available on a government agency website”). Courts also may take notice of official reports and scholarly texts. *Cty. of Santa Cruz, Cal. v. Ashcroft*, 279 F. Supp. 2d 1192, 1211 n. 21 (N.D. Cal. 2003) *on reconsideration on other grounds*, 314 F. Supp. 2d 1000 (N.D. Cal. 2004) (finding appropriate for judicial notice documents that “appear in scholarly texts” and an official report of the Ohio State Medical Committee on Cannabis Indica); *Cent. Delta Water Agency v. U.S. Fish &*

³ Much discussion was had at the hearing regarding whether or not the officially noticed documents needed to be printed and submitted in full. This issue was never fully resolved. The Dairy Institute, in an effort to be environmentally conscious, has decided not to submit full copies of each judicially-noticed items. Instead, the Dairy Institute has included either a direct website link or instructions for accessing the exact document it references. Additionally, the Dairy Institute agrees to provide such copies to any party which wishes to have them and who notices the Dairy Institute as such through its counsel of record.

Wildlife Serv., 653 F. Supp. 2d 1066, 1079 (E.D. Cal. 2009) (granting request for judicial notice of NEPA and CEQA treatises “as generally recognized scholarly source material”).

Additionally, pursuant to 44 U.S.C. § 1507, “[t]he contents of the Federal Register shall be judicially noticed.” *Bruton v. Gerber Products Co.*, 961 F. Supp. 2d 1062, 1075 n. 1 (N.D. Cal. 2013) (taking judicial notice of an excerpt from an FDA rule, 58 Fed.Reg. 2302, 2407 (Jan. 6, 1993), and an excerpt of the FDA’s revisions to the Supplemental Nutrition Program for Women, Infants and Children, 72 Fed.Reg. 68966 (Dec. 6, 2007)).

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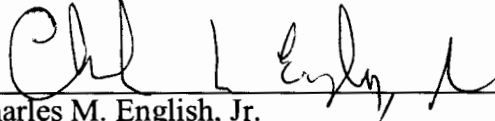
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ATTACHMENT 1



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December 2, 2015

TO: Pool Handlers
FROM: Erik F. Rasmussen, Market Administrator 
SUBJECT: Request for Temporary Holiday Dumped Milk Policy

Pool handlers in the Northeast, Mideast and Central Federal Orders have requested a relaxation of the pooling requirements for dumped milk during the holiday period due to anticipated surplus supply conditions.

The Market Administrators of Federal Orders 1, 32, and 33 have agreed to the following temporary policy for the pooling of milk dumped at farm or other non-plant locations due to present surplus milk conditions:

Temporary plant delivery exception for the time period of December 15, 2015 through January 18, 2016, for Orders 1 and 33, and the time period of December 20, 2015 through January 4, 2016 for Order 32.

Producers that take advantage of this temporary policy must have been a pool producer for all of their production for the months of November and December 2015, and January 2016.

The milk must be picked up at the farm, measured and sampled for payment. The tanker test will be a weighted average of the producer tests.

Notification should be given to the Market Administrator's office by the next business day, or as soon as practicable, when the milk is dumped. At pool time we need the producers on the load, the tests, location of the dump and the nearest plant to that location.

Erik F. Rasmussen
Market Administrator