UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

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

POST-HEARING REPLY BRIEF SUBMITTED ON BEHALF OF

DEAN FOODS COMPANY

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INTRODUCTION

According to the brief submitted on behalf of California Dairies, Inc., Dairy Farmers of America, Inc. and Land O'Lakes, Inc. (collectively, "the Cooperatives" or "the Coops"), California is unique and its quota is unique, so the Department should do what it takes to accommodate California's special interests, even if that means adopting a new California FMMO Federal Milk Marketing Order that ignores Federal Milk Marketing Order ("FMMO") precedent under the authorizing statute for milk marketing orders (7 U.S.C. § 608c) ("AMAA"). With respect to the mandatory pooling framework in Proposal 1, the Coops rely heavily on the 2014 Farm Bill provision[1] and only refer to select provisions in the AMAA and select precedent (which are not actually analogous to mandatory pooling at all),[2] instead characterizing those opposing Proposal 1 as myopic for suggesting that FMMO precedent should guide the Department. (Cooperatives Opening Brief, dated March 31, 2016, p. 95; hereafter "Coop. Opening Br."). But, as discussed herein, canons of statutory construction require that the Department consider all of the provisions in the AMAA before implementing any proposal in service to the Farm Bill provision authorizing that the Department recognize quota. The Farm Bill did not abrogate the terms of the AMAA and so the guidance and precedent of FMMOs still must guide the Department. As discussed below, the Coop proposal does not differ in any significant way from a pooling scheme that was roundly rejected by the Department in 1990 for

[1] The provision provides "Upon the petition and approval of California dairy producers in the manner provided in section 608c of this title, the Secretary shall designate the State of California as a separate Federal milk marketing order. The order covering California shall have the right to reblend and distribute order receipts to recognize quota value." 7 U.S.C. § 7253.

[2] Testimony cited in the Coop brief about early orders accommodating all milk eligible to serve the market and dairy farmer for other markets provisions and tighter pooling requirements post-reform (Coop Opening Br. 95-96), are not examples, or even de facto examples, of the Coop pooling proposal which rather than *accommodating all milk regardless of use*, would *pool all milk regardless of choice*, hence the more appropriate term for the Coop pooling scheme is "mandatory" pooling.

creating, not ameliorating, disorderly marketing conditions. Finally, the Coop brief failed to answer how its proposed handling of Class I pricing comports with the AMAA requirement to utilize current and location-specific information. For these reasons, as well as those articulated in Dean Foods' Opening Brief, the Coops have failed to carry their burden of justifying their proposed federal milk marketing order for California.

ARGUMENT

A. Notwithstanding the Farm Bill, a California Federal Order Must Comport With All of the Requirements of the AMAA

The Coops have failed to demonstrate that their proposal for a California federal milk marketing order will comport with all provisions of the AMAA applicable to milk marketing orders. Although the Coops pay lip service to the AMAA by arguing that section 608c(5)(B) is broad enough to permit mandatory pooling[3] and that mandatory pooling is just another way of preventing opportunistic depooling,[4] these arguments ignore other important provisions and precedents of the AMAA, in service to their expansive reading of the Farm Bill. But, the Farm Bill did not abrogate the AMAA or its precedents and what may be adopted as a result of the Farm Bill is circumscribed by all of the provisions of the AMAA and all of its precedent.

Accepted canons of statutory construction require the conclusion that the Farm Bill Provision did not amend or suspend the purpose behind marketing orders, which include among

[3] The Coops argue that the "AMAA neither specifies what milk can be included in the pool nor limits the mandatory pooling to Class I" and goes on to assert that the "AMAA expressly authorizes mandatory pooling of 'all milk so delivered...irrespective of the uses made of such milk....'" (Coop. Opening Br. pp. 94-95).

[4] The Coops offer examples of pooling rules, such as the dairy farmer for other markets provision in the Northeast, to argue that the Department has effectively had mandatory pooling before. (Coop. Opening Br. p. 95). However, making it harder to re-pool in order to discourage opportunistic depooling is not the same as the pooling scheme included in the Coop Proposal 1 which, save very minor exceptions, takes away the choice to ever depool. The Coops' examples also fail to justify the absence of performance requirements in their proposed pooling scheme.

them the need to maintain orderly marketing conditions and to ensure a sufficient supply of fluid milk. 7 U.S.C. §§ 602, 608c(4), (18); *see infra*. Part B.

Even where, for instance, Congress actually revises or consolidates laws, it is not inferred that Congress intended to change the effect of the existing provisions unless Congress' intent is clearly manifested. *Newton v. F.A.A.,* 457 F.3d 1133, 1143 (10th Cir. 2006). Here, as discussed by the Dairy Institute, the Farm Bill provision does not have the benchmarks of an amendment (Dairy Institute Opening Brief, dated March 31, 2016, p. 12) and a plain reading of the Farm Bill provision reveals it is vacant of language, let alone language with a clear intent, that would suggest it is intended to trump the requirements of the AMAA. *See* footnote 1.

As a corollary, courts presume that Congress is knowledgeable about existing law pertinent to the legislation it enacts. *United States v. Hunter*, 101 F.3d 82, 85 (9th Cir. 1996). As a result, if Congress intended to abrogate the AMAA's objectives for a California FMMO, Congress needed to say so and did not.

The Coops seem to agree that the AMAA constrains what can be done to implement the Farm Bill provision regarding quota by virtue of its reference to section 608c(5)(B), but their proposal ignores important precedent arising out of other provisions of the AMAA.

For instance, the major defense of the mandatory pooling proposal is that the reblending authority under section 608c(5)(B) is broad enough to allow for mandatory pooling and mandatory pooling is an extension of the Department's efforts at various times to clamp down on excessive opportunistic pooling and depooling. (Coop. Opening Br. pp. 95-96). Notably, however, that provision does not specifically mention mandatory pooling and could just as easily be read as authority to allow more milk into a pool than is necessary to serve the Class I market.

To the extent there is any doubt about what section 608c(5)(B) authorizes, canons of statutory construction require a review of the provision in the context of the whole statute. The provision must be read in context with a view towards its place in the overall statutory framework - the Supreme Court noted, "[o]ur duty, after all, is 'to construe statutes, not isolated provisions.' (internal citation omitted)." *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015). Thus, in determining whether section 608c(5)(B) gives the Department the authority to adopt mandatory pooling without performance requirements or, more likely, gives the Department discretion to include more milk than is necessary to serve the Class I market and to determine whether performance requirements are needed in order to bring about orderly marketing conditions, the other provisions of the AMAA become important.

Thus, the meaning of section 608c(5)(B) must be placed in the context of section 608c(13), among others, which requires a narrower construction of the pooling provision. Section 608c(13) provides that producers shall not be subject to the requirements of a marketing order. *See* 7 U.S.C. § 608c(13)(b) ("No order issued under this chapter shall be applicable to any producer in his capacity as a producer."). Erecting a pooling scheme that leaves California producers without any outlets for their milk other than those subject to pooling is tantamount to regulating producers.

In addition, the scope of the pooling provision must be read in light of 7 U.S.C. § 608c(4), which provides that the Department must adopt an order that tends to effectuate the declared policy of the AMAA. The policy of the AMAA is declared in 7 U.S.C. § 602 and is further developed in section 608c(18). These provisions have been interpreted by USDA and the

courts to provide that the Department's duty with respect to milk marketing orders is to maintain orderly marketing conditions that bring forth an adequate supply of fluid milk.[5]

In 1969, the U.S. Supreme Court explained that the purpose of a federal milk marketing order is to ameliorate cutthroat competition geared toward fluid milk sales, which tend to depress prices and destabilize markets. *Zuber v. Allen*, 396 US 168, 172-174 (1969). The USDA has repeatedly reminded the industry that section 608c(18) requires that the Department adopt order provisions that bring forth an adequate supply of fluid milk. The Dairy Institute outlined these decisions in its opening brief and they are incorporated herein by reference. (Dairy Institute Opening Br., Part V).

Accordingly, even *assuming arguendo* that the Department has authority to implement mandatory pooling and/or pooling without performance requirements, that discretion is no doubt circumscribed by the mandates in the AMAA and the lessons of more than seven decades.

B. The Proposal to Implement Mandatory Pooling Without Performance Requirements and Only a Call Provision Will Create Rather than Ameliorate Disorderly Marketing Conditions in Violation of the AMAA

Many of the lessons learned over the more than seven decades of federal milk marketing orders, were articulated in the very decision that rejected the Call provision that Coop witness Dennis Schad referenced during the last week of the hearing, ostensibly as support for the Coop proposal to have mandatory pooling with a Call provision but no performance standards. (Schad, Vol. XXXVIII, Tr. 7730:19-7731:2). Mr. Schad is technically correct that Order 2 once had a Call provision with no performance requirements,[6] but is wrong if he intended to imply that the

[5] One of the policies of the Act, parity pricing, is modified with respect to milk by section 608c(18), which requires prices to be reasonable in light of supply and demand among other considerations. *United States v. Mills*, 315 F.2d 828, 833 (4th Cir. 1963).

[6] Mr. Schad admitted on cross examination that the other two Call provisions that he mentioned – current Order 124 and pre-reform Order 68 – were actually accompanied by minimum performance standards in the form of shipping percentages. (Schad, Vol. XXXVIII, Tr. 7732-7733). Thus, the Order 2 Call provision is the only one referenced

Order 2 Call provision is an example that can justify mandatory pooling and no performance standards.

Quite the contrary, the Department rejected the Order 2 arrangement in 1990 concluding that it is neither equitable nor orderly to allow milk that is able to avoid serving the Class I market to be pooled. After finding that the presence of a Call provision without minimum performance standards meant that some handlers were able to avoid supplying the Class I market while still sharing in the proceeds of the Class I market as a result of being pooled without performance requirements on Order 2, the Department decided to impose mandatory performance standards noting:

> A situation in which some handlers and producers are able to withhold their milk from the fluid market for their own, more profitable, uses and still expect to share fully in the benefits of the order's blend price, enhanced above the manufacturing milk price by the higher-valued fluid uses, ***is neither equitable nor orderly***.

Milk in the New England, New York-New Jersey and Middle Atlantic Marketing Areas, 55 Fed. Reg. 50934, 50953, c.3 (December 11, 1990). Explaining that inequity among handlers and inequity among those serving the Class I market were among the considerations that led to the finding that a singular Call provision without minimum performance standards created disorderly marketing conditions, the Department noted:

> Distributing plant operators who must pay excessive handling or give up charges to obtain supplemental milk to operate their plants are competitively disadvantaged relative to other distributing plant operators who are able to obtain adequate milk supplies, often from their own manufacturing operations at reasonable and customary prices.

55 Fed Reg at 50951, c2. The Department noted there was also inequity among those handlers not serving the Class I market and those handlers who ship milk to fluid plants. Those shipping must incur costs of unused manufacturing capacity and transportation costs not covered by the

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by Mr. Schad that bears analysis as a potential analog to the Call provision that the Coops now offer to quiet concerns that their mandatory pooling will be unable to assure fluid milk plants necessary supplies.

order, while others saved those costs while still sharing in the value of the Class I market. 55 Fed. Reg. at 50951, c.2.[7] Indeed, discussing and rejecting a proposal to compensate suppliers for all of their direct costs for serving the fluid market, the Department observed that it is costly and that cost to the extent not defrayed by the order, is essentially the cost of admission to the pool, which the Department concluded was a sufficient offset. 55 Fed. Reg. at 50955, c.1.

The record of this proceeding demonstrates that the marketing conditions – recognized by the Department as disorderly in Order 2 in 1990 - will necessarily exist if mandatory pooling is adopted with a singular Call provision, and no minimum performance requirements.

By its very nature mandatory pooling will mean that virtually all of the facilities in California, with very minor exceptions (Coop. Opening Br. p. 118), will share in the pool proceeds, but none will be obligated to regularly serve the Class I market. The system of transportation subsidies will not fully address transportation costs in the aggregate. (Hollon, Vol. XVII, Tr. 3392). And although the system is designed to get close to covering transportation costs to the fluid market at the individual level, the Coop witness explained bias is in favor of undercompensating for transportation. (Id.). This, in addition to the fact that transportation costs do not compensate for the opportunity cost of giving up milk to the fluid market means performance standards are the only regulatory measure to draw milk to the fluid market. Without performance standards, fluid plants will be forced to pay significant premiums and give up charges on top of already hefty Class I prices, that subsidize the very entities with whom they must compete for a milk supply. This is a net negative for a segment of the industry that is

[7] As part of FMMO reform the Department reinforced these conclusions when it rejected a proposal to permit automatic pool status for as little as four months after an entity qualified for pool status noting "[t]he provisions adopted in each order should ensure that the Class I needs of the markets are met." *Milk in New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders*, 64 Fed. Reg. 16026, 16167, c.2 (April 2, 1999).

already struggling to compete with numerous alternative beverage products. (Dairy Institute Opening Br. p. 118). As such, distributing plants not located near or associated with manufacturing facilities or sufficient numbers of producers will have insult added to the injury of subsidizing competitors by being forced to pay additional premiums and give up charges to supplement their milk supply. Indeed, there was agreement that in the absence of performance requirements, additional premiums would be required to move milk to the fluid plants. (Blaufuss, Vol. XXVII, Tr. 5481:19-22; Christ, Vol. XII, Tr. 2535:8-25 and 2536:1-2).

However, USDA has recognized that excessive premiums and give up charges, when paid to attract fluid milk, contribute to handler inequity and non-uniform pricing and contribute to disorderly marketing conditions. 55 Fed. Reg. at 50951, c.1-2 , 50953, c.3; *see also Milk in New England and Other Marketing Areas*, 64 Fed. Reg. 16026, 16109, c.3. ("prices need to provide equity to handlers with regard to raw product costs").

There are no material differences in the circumstances that will arise under the Coop proposal and those that caused the Department in 1990 to reject a Call provision as insufficient to maintain orderly marketing conditions. Moreover, in 1990, the Department also found that initiating a Call is a costly procedure that should only be used on an irregular basis, thus necessitating regular minimum performance criteria, noting:

> The procedure for issuing a "call", while effective for assuring that temporary needs for additional shipments are met, should not take the place of basic shipping requirements. The procedure for issuing a "call" requires the market administrator to hold meetings, usually on an urgent basis, involving all of the handlers in the market to determine the desirable utilization of all milk shipments. The use of this procedure on other than an irregular basis is unnecessarily burdensome and expensive. Adoption of minimal shipping requirements and the resulting relationships expected to form between suppliers and fluid processors should result in more order marketing conditions.

55 Fed. Reg. at 50953, c.1. Thus, the Coop proposal for mandatory pooling, without regular minimum performance requirements, is not saved by the proposed Call provision introduced by Mr. Schad.

In short, the mandatory pooling aspect of the Coop proposal will create the kind of disorderly marketing conditions that USDA has identified as unacceptable under the AMAA.

C. The Coops' Proposal for Class I Prices Lacks the Support Required Under the AMAA

As the Dairy Institute explains, the AMAA requires current and regionally specific evidence to support the adoption of minimum prices. (Dairy Institute Opening Br. VII, A)(incorporated herein reference). In addition to the concerns raised in Dean's opening brief (Dean Opening Br. pp. 8-10), there are still other problems with the Coops' Class I pricing proposal that their brief did not answer.

Dr. Stephenson explained that the USDSS model that was used to establish FMMO reform Class I differentials requires periodic updating by its nature. (Stephenson, Vol. XXX, Tr. 5955) The Coop proposal fails in this respect. (See Dean Opening Br. pp. 8-10). The Coop proposal also makes the insurmountable mistake of relying on Class I differentials for California that were extrapolated from a study that *did not reflect actual economic and marketing conditions in California* according to USDA, which noted during federal order reform:

> 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 added); see also Dairy Institute Reply Brief, dated May 16, 2016, p. 6.

CONCLUSION

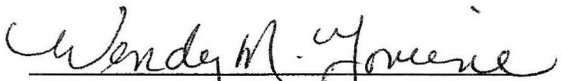
As demonstrated herein, the Coops' belittling of the opposition as myopic for focusing the Department on FMMO precedent is not well founded. Certainly with respect to Class I issues, a deeper look at the precedents, including the 1990 precedent, shows that by ignoring FMMO principles, such as those outlined in 1990 and carried forward in FMMO reform, the Coop proposal portends disorder and serious issues for the fluid milk sector.

Dean continues to believe that federal order for California is neither advisable nor justified on this record. The lengths the Department would have to go to implement the Coops' ideal of quota, are beyond the lengths authorized by Congress.

If the Department adopts a federal order applicable to California, Dean urges adoption of the Dairy Institute proposed performance requirements, but vigorously opposes adopting Class I pricing without commissioning the appropriate studies, including fully vetted elasticity of demand studies that perform elasticity studies on a product specific basis and in greater detail than anything on this record, and up-to-date price surface studies that actually include data from California. Given the continued decline in fluid milk sales and the record evidence that fluid milk demand is price sensitive, the Department has a duty to reject provisions that will place additional and/or cumulative burdens on the fluid milk sector.

Dated: May 16, 2016

Respectfully submitted,



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