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May 13, 2016

**VIA UPS (TRACKING: 1Z 965 W53 01 6670 0633)
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Brenda Seegars, Acting Hearing Clerk
U.S. Department of Agriculture
Stop 9203 South Building Room 1031
1400 Independence Ave SW
Washington, DC 20250-9203

**Re: Brief and Proposed Findings of Fact and Conclusions of Law
Milk in California; (AO) Docket No. 15-0071**

Dear Ms. Seegars:

Enclosed please find the Reply Brief Filed on Behalf of Ponderosa Dairy.

Very truly yours,

A handwritten signature in black ink that reads "Nicole Hancock".
Nicole C. Hancock

NCH/kra
Enclosures

DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

In the Matter of Milk in California;
Notice of Hearing on a Proposal to
Establish a Federal Milk Marketing
Order

7 CFR Part 1051
Docket No.: AO-15-0071;
AMS-DA-14-0095

**REPLY ON BEHALF OF
PONDEROSA DAIRY**

I. INTRODUCTION

The briefs and amended proposals of the interested parties highlight the statutory constraint that prevents the implementation of the California FMMOs envisioned by Proposals 1 and 2, unless Proposal 4, introduced by Ponderosa Dairy (“Ponderosa”), is incorporated. The brief of California Dairies, Inc., Dairy Farmers of America, Inc., and Land O’Lakes, Inc. (collectively, the “Cooperatives”) argues that payment of an “out-of-state producer (‘OOS’) adjustment rate” will ensure OOS producers do not unlawfully subsidize quota payments under amended Proposal 1. Beyond the fact that Section 1051.61(a.2) under amended Proposal 1 does not make clear even how the OOS adjustment rate will be calculated,¹ a fair reading of what the Cooperatives may have intended reveals that the Cooperatives’ amended proposal does not cure the discriminatory trade barrier highlighted in Ponderosa’s opening brief. Because the OOS

¹ Amended Proposal 1 incorporating provisions and calculations for a purported OOS adjustment rate apparently recognize that the original form of Proposal 1 was improper for the reasons discussed in Ponderosa’s opening brief. Of concern, the provisions and calculations concerning an OOS adjustment rate were never introduced, discussed, or analyzed during the hearing. *See* 5 U.S.C. § 553(b).

adjustment rate is apparently calculated using all pooled milk, quota holders essentially get an added premium on top of their quota premium, resulting in the net effect of OOS producers subsidizing quota. Despite this, OOS producers can never benefit from owning quota (the historical assignment of free quota, and nearly 50 years of ability to acquire quota), including its guaranteed fixed stream of income and book value. Even with this proposed compromised fix, OOS producers will continue to be disadvantaged simply because they are on the outside of the state border. OOS producers will never be able to participate in the premium payments from the California pool, a benefit flowing only to those who reside within the state boundary. This disparate impact is strikingly similar to the facts that gave rise to the Commerce Clause violation the Supreme Court struck down in *Hillside Dairy*, and the disparate impact in this instance cannot be remedied by forcing the OOS producers to participate in a pool that inherently discriminates against OOS producers.

As these examples and the discussion below reveal, Proposal 4 must be incorporated into any California FMMO to prevent an impermissible economic trade barrier proscribed by 7 U.S.C. § 608c(5)(G).

II. PROPOSAL 1 (AS AMENDED) RESULTS IN A TRADE BARRIER AND IMPERMISSIBLE DISCRIMINATION

A. Out-Of-State Producers Do Not Cause Disorder

The Cooperatives' brief states: "As will be demonstrated *infra*, these OOS producers, taking advantage of the California system, find themselves in a better position than California producers." (Cooperatives' Br. at 41.) However, the Cooperatives fail to support this statement with any evidence introduced during the lengthy hearing. Indeed, Ted DeGroot of Ponderosa testified that the plant blend that Ponderosa receives is less than the Class 1 price. (Hearing Tr. 7596:10-7596:11.) The fact that it sells milk into California reveals Ponderosa is not demanding

more money for its milk under the present California State Order System (“CSOS”) or faring better than California farmers. Moreover, the Cooperatives’ brief fails to consider the benefits that producers in California receive under the CSOS (e.g., the opportunity to own quota), which OOS producers are categorically barred from receiving. There was no evidence offered at the hearing to suggest that OOS producers create any disorder in the California market.

B. Amended Proposal 1 Still Results In A Trade Barrier

The Cooperatives submitted an amended Proposal 1 with its opening brief. The amended Proposal 1 allows OOS producers to participate in transportation benefits, and it attempts to create a second pool that purports to neutralize the payment to OOS producers through reblending without the quota premiums removed. The amendment does not resolve the impermissible trade barrier. The issue remains: there is a benefit (quota) afforded to in-state producers to which OOS producers cannot participate. In other words, there is an economic upside not available to OOS producers, justified only because they reside on the other side of the California state border. The amended Proposal 1 attempts to make the California FMMO more complicated (and still fails under the application of applicable precedent), rather than preserve the rights of quota interest holders established since the inception of the CSOS.

The Cooperatives amended its Proposal 1:

Proponents have modified Proposal No. 1 to provide for the payment of a blend price adjustment to these producers so that their total receipts are undiminished by quota payments. This is accomplished through payment of an “out of state” (“OOS”) adjuster; see Section 1051.61(a)(2) at Appendix Exhibits 2 and 3, which pays to out-of-state producers an adjustment equal to the amount by which non-quota blend is reduced by the quota premium payments.

(Cooperatives’ Br. at 147-48.)

Section 1051.61(a.2) in Proposal 1 is amended as follows:

(1) Divide the value of the quota premium for the month for producers at handlers included in these computations by the hundredweight computed in .61(d) and rounded to the second decimal. This rate will be known as the out-of-state producer (“OOS”) adjustment rate.

(2) Multiply the hundred weight of OOS producer milk reported at included handlers by the rate computed in .61(a.2.i.)

It is not clear what “producers at handlers” means (perhaps a typographical error), nor is the reference to “the hundredweight computed in .61(d)” clear. Section .61(d) requires the division of an amount determined under the preceding subsections (a)-(c). Equally unclear is the phrase “reported at included handlers by the rate computed in .61(a.2.i.)” The problem of having this proposal arrive after the hearing is that no one has the opportunity to explore the meaning or impact of this suggested change.

Assuming the computation is to add back to the pool the value of quota and pay to OOS producers an amount that would not deduct premium quota payments, it still would not resolve the resulting trade barrier for OOS producers. It would remain true that in-state producers have the ability to participate in a quota program in which none of the OOS producers could participate. In other words, the OOS producers could never own quota, never receive premium quota payments, never have the financial advantage of owning the quota asset, and never have the ability to trade quota as a marketable asset. The pool, one way or the other, would be reduced by the quota payments, and even if that were neutralized for the OOS producers, it would come out of the in-state non-quota-holder blend price. This effort to neutralize the pool for OOS producers, while likely a good faith effort, was nearly the exact scenario in *Hillside Dairy, Inc. v. Kawamura*, 317 F. Supp. 2d 1194, 1198-99 (E.D. Cal. 2004).

After remand from the Supreme Court on the grounds that the prohibitions of the Commerce Clause were applicable to the California regulations at issue, *Hillside Dairy Inc. v.*

Lyons, 539 U.S. 59 (2003), the District Court found that it was a violation of the Commerce Clause to disallow OOS producers from participating in the financial benefits of the pool but then subject them to pricing from the pool reflecting a diluted blend price. *Hillside Dairy, Inc.*, 317 F. Supp. 2d at 1198-99. There, California processors purchasing OOS milk were required to pay into the pool the difference between the gross pool obligation and the lesser of plant blend or modified quota.

In effect, this meant that OOS producers were subsidizing California's quota program and were receiving at best the modified quota price, which the court found did not encompass all of the benefits of quota. Thus, the court concluded that, "[s]ince the 1997 amendment to § 900 requires OOS raw milk producers to pay for benefits received exclusively by California dairy businesses, it is similar to the milk pricing order in *West Lynn*," and the regulation was discriminatory. *Id.* at 1198.

Despite the *Hillside Dairy* precedent, Congress did not exempt a California FMMO from the prohibition on economic trade barriers under 7 U.S.C. § 608c(5)(G), and the lawfulness of Proposals 1 and 2 must be considered within the confines of this well-established precedent. In this case, even with the amended proposal from the Cooperative, there are pool benefits (namely quota) that OOS producers cannot realize. Requiring OOS producers to participate in a pool with benefits not available to the OOS producer results in a Commerce Clause violation, as well as operates as a trade barrier. Therefore, the amended proposal is not sufficient to cure OOS producers' concerns.

C. The Resulting Trade Barrier Of Proposal 1

7 U.S.C. § 608c(5)(G) provides that "[n]o marketing agreement or order applicable to milk and its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of any milk or product thereof produced in any

production area in the United States.” The Cooperatives attempt to rely on *Sunnyhill Farms Dairy Co. v. Hardin*, 442 F.2d 1124, 1131 (8th Cir. 1971) for the proposition that the trade barrier at issue is permissible. (Cooperatives’ Br. at 43.) *Sunnyhill* is unavailing.

In *Sunnyhill*, the Eighth Circuit upheld a 15 cent location differential authorized by 7 U.S.C. § 608c(5)(A). 442 F.2d at 1129-31. Notably, the processor challenging the differential did not contest the Secretary’s findings of fact that such a differential was necessary to avoid serious disruption of milk to certain regions of the marketing area. *Id.* at 1129-30.

Here, by contrast, there is no statutory authorization that allows for the discriminatory treatment and resulting trade barrier to OOS milk. Such disparate treatment is based solely upon the fact that producers fall outside the borders of the State of California. Moreover, as is discussed above and in Ponderosa’s opening brief, there is no evidence to suggest that the provisions advanced by the Cooperatives are necessary to remedy any existing disorder. (*Compare* Exhibit 5, Table B2, *with* Exhibit 5, Table B34 (revealing negligible economic impact to California farmers if Proposal 4 is adopted).)

Attempting to limit the applicability of *Lehigh Valley Cooperative Farmers, Inc. v. United States*, 370 U.S. 76, 97 (1962), the Cooperatives claim that *Lehigh* endorses “a payment equal to the difference between the Class I price and the blend price” to “achieve competitive parity between pool milk and non-pool milk.” (Cooperatives’ Br. at 44.) However, *Lehigh* made clear that “as regards milk the word ‘prohibit’ refers not merely to absolute or physical quota restrictions, but also encompasses economic trade barriers of the kind effected by the subsidy called for by this ‘compensatory payment’ provision.” *Lehigh*, 370 U.S. at 97. The original and amended versions of Proposal 1 continue to require that OOS producers subsidize quota payments in a manner similar to that which was held unlawful by the *Lehigh* court.

III. PROPONENT OF PROPOSAL 2 (THE DAIRY INSTITUTE) APPEARS TO SUPPORT PROPOSAL 4

Apparently because the Dairy Institute recognizes that the Cooperative's Proposal 1 "would violate 608c(5)(G) and make second class citizens of any out-of-area producer who wants to market in a California FMMO" (Dairy Institute's Br. at 131) and that "no justification exists for such discrimination other than that the out-of-area producers do not live in California" (Dairy Institute's Br. at 132), its brief provides that "the Dairy Institute's Proposal establishes what it has found to be the only mechanism by which quota may continue to operate within a Federal Order without resulting in unlawful trade barriers—that out-of-area farmers receive a plant blend and are not forced to participate in the quota pool" (Dairy Institute's Br. at 130-131).

To the extent the Dairy Institute diverges from this concept, it is notable that the two pool system it originally proposed results in an unlawful trade barrier similarly barred by 7 U.S.C. § 608c(5)(G). Because under such a plan OOS processors are permanently precluded from participating in quota and its many economic benefits, yet forced to subsidize the costs of such benefits (including administration costs), OOS processors would be effectively precluded from selling milk into California because of the resulting artificially low prices exacerbated by their subsidy of quota. Moreover, because OOS producers were never given the opportunity to obtain free quota allocations at various times under the CSOS based upon historical Class 1 sales and, later, increased consumption, the historical treatment of OOS producers under the CSOS must be preserved in any California FMMO to avoid violating by 7 U.S.C. § 608c(5)(G).

IV. CONCLUSION

Based upon the foregoing, Ponderosa respectfully urges the Secretary to incorporate the substance of Proposal 4 in any California FMMO in order to allow OOS producers to receive the plant blend price and avoid any discriminatory treatment to OOS producers.

May 13, 2016

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 13, 2016, I served a copy of the foregoing **REPLY ON BEHALF OF PONDEROSA DAIRY** on the following, in the matter indicated below:

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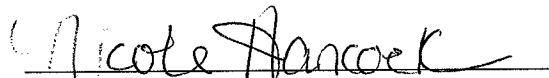
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