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BEFORE THE SECRETARY OF AGRICULTURE RECEIVED

Re: Proposal to Establish a Federal Milk
Marketing Order for California

Docket No. AO-15-0071;
AMS-DA-14-0095

Hearing in Fresno, California,
September – November 2015

POST-HEARING BRIEF OF TRIHOPE DAIRY FARMS

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I. INTRODUCTION.

Trihope Dairy Farms respectfully requests that the Secretary of Agriculture (“Secretary”) deny the issuance of a California Federal Milk Marketing Order (“FMMO”). The California FMMO is not being requested because “disorderly marketing conditions” exist in California. Instead, this is a thinly disguised demand for price supports for California milk producers. The promulgation of a California FMMO would severely and adversely impact the prices received by, and the economic viability of, milk producers in the rest of the nation, and particularly in the southeast. Moreover, the requested California FMMO raises serious questions of the appropriate role of Federal regulation versus State regulation. California has an extensive and comprehensive system of milk marketing regulations that has been in place for decades. California producers have advocated for and been supported by that regulatory system in the past. California producers have chosen to remain apart from the FMMO system until now. The sole reason for this recent change of heart is that California producers now believe that switching to a FMMO will result in a higher price for their milk. This is a wholly inadequate reason to impose a California Order on milk producers in the rest of the FMMO system. Finally, the implementation of a California FMMO which incorporates and maintains the California “quota” system *ad infinitum* is both illegal and unconstitutional.

On February 3, 2014, California Dairies, Inc., Dairy Farmers of America, Inc. and Land O'Lakes, Inc. (collectively the "Cooperatives") requested pursuant to 7 C.F.R. § 900.3 that the Secretary of Agriculture hold hearings with the goal of the promulgation of a Federal Milk Marketing Order for the State of California. The stated basis for the FMMO request was alleged "disorderly marketing conditions" in California. The primary "disorderly marketing condition" alleged was the difference between the FMMO price for Class III milk and the California price for the roughly equivalent class 4b milk. *See* February 3, 2015 letter from Marvin Beshore to Anne Alonzo of the Agriculture Marketing Service ("AMS"), at p. 6. Hearings were held in September, October and November of 2015, with numerous witnesses called, a significant number of statements taken, and 194 exhibits introduced into evidence.

The FMMO proposed by the Cooperatives would cover the entire State of California, keep the current "quota" system of preferential payments to certain California producers in place, require mandatory milk pooling, and otherwise retain much of the current regulatory system administered by the California Department of Food and Agriculture ("CDFA"). The Cooperatives proposal was viewed by certain milk processor interests headed by the Dairy Institute of California as unnecessarily raising the processors' raw material costs, with resulting higher retail prices and/or lower margins rendering the processors

uncompetitive. The Dairy Institute offered an alternative proposal (the “Institutes Proposal”), if such an Order were deemed needed. The California Producer Handlers Association (“CPHA”) and certain Nevada dairy interests also saw the Cooperatives proposals as disadvantageous, with the result that they proposed other alternative plans (the CPHA and the Ponderosa Dairy Proposals).¹ Most of the hearing time on the various proposals was taken up with evidence which related to the competing interests of the Cooperatives, the Institutes, and the CPHA and Ponderosa, in what one might call the “Cheese Wars.” However, there are other interested parties who do not share the parochial interests of California producers and handlers; namely, the milk producers who are participants in other milk marketing regions in the United States and who will be adversely effected by any proposed California FMMO.

Representatives of several of these non-California parties testified at the hearing, such as Calvin Covington, a former CEO of Southeast Milk, Inc., who represented southeast based dairy cooperatives in Virginia and Florida; Richard Sparrow, a dairy farmer in Kentucky who spoke on behalf of the Kentucky Dairy Development Counsel and the Tennessee Dairy Producers Association; Everett

¹ For example, the CPHA proposed that if the USDA elects to recommend the establishment of a FMMO for the State of California which includes the preservation of the California “quota system as part of that California FMMO,” that the Producer-Handler quota exemption in California also be maintained.

Williams who presented testimony on behalf of Georgia Milk Producers, Inc. and Walter E. Whitcomb, the Commissioner of the Maine Department of Agriculture, Conservation and Forestry, who presented a northeast perspective. This brief addresses those concerns, though the prism of a milk producer in the southeast region, Trihope Dairy Farms (“Trihope”), and one of its owners, Michael Sumners.

Trihope maintains that the hearing record evidences that the proposal for a California FMMO does not arise out of disorderly marketing conditions in California. Rather, it is motivated by the desire of California producers to enhance their revenues. The proponents of the requested addition of California to the FMMO system have not carried their burden of proof.² The hearing record does not demonstrate the presence of disorderly market conditions, but instead is the continuation of an ongoing dispute over the wisdom of California’s own milk marketing statutes and regulations. Crucially, as determined by the USDA’s own “Preliminary Regulatory Impact Analysis,” Exhibit 5 in the Hearing Record (“PRIA”), the result of the proposed California FMMO will be “lower uniform

² 5 USC § 556(d) (“Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof.”). Since neither the AMAA or the applicable rules of practice provide a specific burden of proof in this proceeding, the burden of proof standard is governed by § 556(d) of the Administrative Procedure Act (“APA”). That burden requires a proponent to present substantial evidence in support of each part of the proposal made to USDA. *Minnesota Milk Producers Ass’n v. Glickman*, 153 F.3d 632, 642 (8th Cir. 1998). Further, “[M]ere speculation is not sufficient to support an agency’s findings.” *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 414 (3d Cir. 1987).

prices, lower milk production, lower all-milk prices, and lower producer revenues across most of the rest of the United States”. This forecast result adversely affects milk producer economic viability, as well as the fluid milk supply, in the southeast region. Since Trihope is directly impacted, it files this Post-Hearing Brief to urge the Secretary to decline any request to permit California to join the FMMO system under the terms of any current proposal.

II. BACKGROUND OF TRIHOPE DAIRY FARMS.

Trihope Dairy is a family owned and operated dairy farm in Henry County, Tennessee, and is a member of Henry County Cooperative. Michael Sumners, one of its owners, has been involved in dairy farming and dairy operations since he worked on his own father’s farm as a child. Mr. Sumners has been operating a dairy as a partner or as an owner for over 35 years. Recently, his daughter, Elizabeth Sumners, has joined Trihope Dairy following her graduation from college. Elizabeth Sumners now represents the third generation of the Sumners family in the dairy business. Along with the other southeast dairymen who provided testimony, the Sumners are concerned that the proposed California FMMO is not necessitated by any disorderly marketing conditions in California, or between California and other regions, and will have adverse consequences on the orderly operations of the milk markets in the southeast United States. Most importantly, the addition of California into the FMMO system with certain

California producers being paid a quota price for their milk, will have a direct and deleterious effect on Trihope and the price that the Sumners receive for the milk which they market in the southeast order. The additional money placed in the pockets of California producers under the terms of the proposed California FMMO will be taken from the producers in the remaining areas of the FMMO system. Such special treatment for one set of producers to the detriment of all others is prohibited.

III. THE AMAA PROHIBITS ANY SPECIAL TREATMENT FOR CALIFORNIA MILK PRODUCERS WHICH WOULD NEGATIVELY IMPACT PRODUCERS IN THE OTHER FEDERAL MILK MARKETING ORDERS.

“First do no harm” is a maxim in medicine that reminds a doctor that given an existing problem, it may be better not to do something, or even do nothing, than to risk causing more harm than good.³ Put another way, it reminds the doctor to carefully consider the collateral effects of a proposed course of action, and not just to focus on the narrow problem which is first presented. The California Cooperatives have offered repetitive testimony of difficulties faced by California milk producers who allegedly are challenged by costs in excess of revenues and who allegedly may need to cease operations, move elsewhere, or transition their

³ This maxim is derived from the *The Physicians Oath*, Hippocrates (460-400 B.C.).

land to non-farming or non-dairy uses if milk prices do not rise. This claim has been made by the Cooperatives despite 2014 being a historically good year for California dairy producers' revenue, and 2015 also being an apparently good year, but not close to 2014. As dairy farmers themselves, the Sumners sympathize with the Cooperative's general concerns about the economic trends that dairy farmers face. They know such problems from firsthand experience. But they also know that such issues as the decrease in demand for dairy products, the struggle to attain revenues in excess of costs, the travails of family farms being sold, and the pain felt when dairy herds are sold off, are not problems unique to California, nor a new phenomenon in the United States. Rather, these are concerns expressed by dairy farmers across the country. California is not even the worst case. Per capita fluid milk consumption in the U.S. has declined from approximately 29 gallons in 1975 to 19 gallons in 2013. (Testimony of Rob Blaufuss at Exhibit 130.) *See* Figure 6 and Table 8 to Exhibit 80 showing that California has experienced less decline in dairy herds than the U.S. generally from 2003 through 2014. *See* also Tables 3 and 4 and Figure 4 to Exhibit 80 describing milk production trends in California as compared to the rest of the United States, and showing no indication that California production is plummeting as compared to the rest of the United States.

If California milk producers are producing too much milk, they cannot solve their economic woes by shifting their problems to other producers throughout the

FMMO system. Indeed, the economic model prepared by the United States Department of Agriculture shows that there will be a negative effect on the prices received by milk producers throughout the federal milk marketing order system if there is a California FMMO and California producers also continue to receive a quota price for their milk. The AMAA prohibits such disparate treatment of milk producers. Indeed, enhancement of the pool price for the California pool is not a basis for making an amendment to or issuing a federal milk marketing order.

Moreover, the current problems faced by California milk producers will not be resolved by higher minimum prices. Instead, California producers face significant challenges to continuing in the milk business, such as the ongoing drought in California and other alternative land uses. These issues are not totally going away in the foreseeable future. Testimony of George Mertens, Exhibit 26 at p. 4. For example, raising milk prices will not prevent California dairy farms from converting their farms to almond or other “nut” production, where the returns on almonds and other nut orchards are multiples of the return on dairy operations. *See* Testimony of Greg Dryer, Exhibit 91 at p. 19. Nor will raising prices help to arrest the decline in the number of California dairy farmers. *See* Testimony of Dr. Eric Erba at pp. 1897-1898 to the effect that while the number of California dairy farmers declined from 2,161 in 1995 to only 1,407 in 2015, milk production actually increased from 24.7 billion lbs. to 41 billion lbs. in approximately the

same time period. Nor is it appropriate, in an effort to alleviate the problem of California milk overproduction with attendant decreasing prices, to further increase California milk production, lower the milk prices in other regions, and thereby export the consequences of California's current economic problems to other regions such as the southeast. The Secretary should not be forced to incorporate California into the Federal Marketing Order System in order to "save" California producers and thereby doom the future of milk producers that reside outside of California.

California has approximately 12% of the U.S. population (Exh. 73 at Table 7A), but produces well over 20% of the country's milk supply. It does this even though the California population is not among the leaders in milk consumption. *See* Table 12 to Exhibit 80 showing that California per capita fluid milk sales have declined from 259.3 gallons in 1970 to 150.1 in 2014. *See also* Figure 7 to Exhibit 80 showing that California beverage milk sales have remained largely static from 1970 through 2014 at just over 5 billion lbs. while fluid milk production over the same period has gone from approximately 10 billion lbs. to approximately 40 billion lbs. California currently produces approximately 42 billion pounds of milk per year. (PRIA, Exh. 5) If the proposal of the California Cooperatives is adopted, that milk production is estimated by the USDA's PRIA to skyrocket to 62 billion pounds per year by 2024 (PRIA, Exh. 5). The Cooperatives leave to the dairy

processors, or perhaps to magic, to demonstrate how that greatly increased production will be cleared. Nor do the Cooperatives demonstrate precisely how the proposed higher revenues will stem the problem of long-term dairy farm decline.

Consistent with California's position as the number 1 milk producer, and number 2 in the overall production of all kinds of cheese in the United States, and the state with the greatest number of dairy cows (*See* Testimony of Elvin Hollon, Exh. 19 at p. 4), the PRIA reaches the obvious conclusion – that a California FMMO would not just impact the California dairy industry but “also have an impact on the milk supply, product demand, product price, and milk allocation through the United States.” (PRIA, Exh. 5 at p. 2.) The PRIA estimates that the forecasted changes in California milk production attendant upon the creation of a California FMMO, and an increase of the California minimum prices to Federal minimum prices; “would likely lead to lower uniform prices, lower milk production, lower all-milk prices and lower producer revenues across most of the rest of the United States.” (PRIA, Exh. 5 at p. 14 (Emphasis added); *See also* Testimony of Amanda Steeneck, September 22, 2015 at pp. 104-105). The PRIA attempts to quantify these changes during the period from 2017 through 2024. It shows an average decrease in prices in the southeast region alone of \$0.25 – 0.26 per hundredweight, combined with flat or decreasing milk production in the

southeast region. This results in substantial losses to milk producers in the southeast. Those losses would be visited upon Trihope and the Sumners.

The testimony of Calvin Covington, for example, was that the dairy producers he represented could expect drops in annual revenue ranging from \$35,000 to \$70,000 per producer. The testimony of Everett Williams is that the average Georgia dairy farm (which is a small farm) would experience lost revenue of about \$19,500 to \$25,000 per year, and on his personal (much larger) farm the range of losses would be from \$123,000 to \$161,000. These are significant amounts to a struggling dairy farmer. Trihope Dairy and the Sumners would also be directly impacted. Trihope Dairy has calculated that changes of the magnitude estimated by the PRIA will result in lost revenue to Trihope Dairy totaling \$313,091.00 during the years 2017 through 2024. The lost revenue to Trihope and the Sumners in this time period increases year over year until it exceeds \$60,000 in 2024. Such significant losses in revenue will force the Sumners to consider whether Trihope Dairy can continue to remain in business, and, if so, what must be done to combat and overcome the regulatory benefit conferred upon the California producers under the terms of the proposed California FMMO. In short, the proposed California FMMO may slowly put Trihope out of business. This problem is not just limited to southeast milk producers.

The testimony of Walter Whitcomb in evaluating the impact of a California FMMO on Maine milk producers, as forecasted by the USDA, and taking into account Maine's already strained dairy support programs, is that "[a]ny reduction in pay prices.....will threaten the viability of our programs and hence the sustainability of our industry." Exhibit 179 at p. 6. As these producers in the southeast and northeast are not mega farms with large cow herds (as are common in California), such losses would be hard to absorb, leading to accelerated declines in dairy herds and dairy producers in the southeast and northeast regions; i.e., the very problem of which the California producers now complain. The contagion which the California producers claim has infected their dairy industry would then be intentionally spread throughout the entire FMMO system. Even if the California producers could somehow be "cured" by joining the FMMO system, it would be at the cost of the viability of the other milk producers throughout the remainder of the country.

In addition to the negative impact on dairy producers in the southeast and elsewhere, an additional and significant negative impact on consumers would also occur. A major objective of the AMAA is to assure that consumers have an adequate and dependable supply of high quality fluid milk. Over the years, as California milk production skyrocketed (from 25 million pounds in 1995 to 42 million pounds in 2014), milk production in the southeast declined from 13.5 to 9.5

billion pounds in the same timeframe. As a consequence of this decline, there is an annual fluid milk deficiency in the southeast in the range of approximately 2.7 – 4.5 billion pounds. (See Testimony of Calvin Covington, Exh. 83, p. 3.) The clear consequence of the proposed California proposal (which the PRIA estimates will result in an increase of California milk production to 62 billion lbs. annually) is a further substantial reduction in the number of southeast dairy herds, with a concomitant reduction in southeast milk production. This will make more difficult the adequate provision to consumers of Class I fluid milk in the southeast United States.

The reality is that California's problem is one of overproduction which has been created by the California producers' efforts to produce more and more milk. Because the increased milk production could not be absorbed in California, the California dairy industry was incentivized to build processing plants and to vastly increase manufactured milk products. See Testimony of Rien Doornenbal at pp. 6514-15. But what worked 30 years ago, will not readily work today. Bubbles cannot expand indefinitely. By definition, bubbles will burst sooner or later. World-wide and U.S. dairy product demand is relatively stagnant. California producers cannot produce their way out of this problem. California processors cannot manufacture and sell sufficient milk products to utilize all the milk that would be produced. The California system needs to find a level where what

producers produce and processors can process and sell are in equilibrium. The Secretary should not be a facilitator of efforts to deny the need for that fundamental adjustment and to export California's problems to milk producers elsewhere in the United States. It is both fundamentally unfair and flatly wrong for California producers to expect to be "bailed out" by the producers in the remainder of the FMMO system.

IV. THE PROPONENTS OF THE CALIFORNIA FEDERAL MILK MARKETING ORDER HAVE NOT MET THEIR BURDEN OF SHOWING DISORDERLY MARKETING CONDITIONS FOR THE PROMULGATION OF A CALIFORNIA FMMO.

The Cooperatives allege that a California FMMO is needed to avoid disorderly marketing. The assertion is made, not in the context of unregulated milk sales, upon which regulatory order is sought to be imposed, but in the context of the California milk market which has been quite thoroughly regulated as to pricing, supply and quality for the last 80 years. The California system has classified minimum pricing and market-wide pooling. California statutes require orderly marketing of milk, and recognize the need to establish producer prices at fair and reasonable levels. *See West's Ann. Cal. Food & Agric. Code ("Food & Agric. C.")* §§ 61802(e) and 61802(h). The California system has undergone numerous changes over the years to adjust to changing times and circumstances; including holding several hearings and making price formula adjustments in recent years in

response to the concerns raised by the proponents of the California FMMO. (*See* Statement of Dr. William Schiek, Exh. 79; testimony of Elvin Hollon pp. 1071-1072). In essence, what the Cooperatives want is not orderly marketing, but a different regulator – a new federal regulator that they hope will give them a better economic deal than the CDFA. *See* Testimony of Rien Doornenbal at p. 6527. However, the AMAA was designed to solve specific problems of unregulated marketing and “unfair” competition, not to assert federal hegemony over milk production and marketing across the entire United States.

The AMAA contains no definition of “disorderly marketing”, nor of “disorderly marketing conditions.” In 7 USC § 602(1), the AMAA charges the Secretary of Agriculture “to establish and maintain such orderly marketing conditions for agricultural commodities in interstate commerce as will establish, as the prices to farmers, parity ...” but in 7 USC § 602(2) it prohibits “the maintenance of prices to farmers above [such parity prices].” Again, in 7 USC § 602(4) the Secretary is directed “to establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in section 608c(2) of this title as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.” This suggests that price differentials are relevant only insofar as prices fall below parity, or create

unreasonable fluctuations in supplies and prices. A mere pricing disparity is not sufficient to establish disorderly marketing absent a showing of lost sales by reason of the pricing disparity. *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 414 (3d Cir. 1987).

Consistent with this, the Secretary has recognized that the AMAA is not intended to be a price support program. On September 17, 2012, the AMS Deputy Administrator for Dairy Programs explained that, “the Federal Milk Marketing Order (FMMO) program is not deemed to be a price or income support program, since it is not authorized to establish minimum prices above the relative market value of the products of milk.” September 17, 2012 letter from Dana Coale to Dori Klein responding to Mr. Klein’s request for a hearing on minimum producer prices, Exhibit B to Statement of John Vetne at Exhibit 112. Nor is the Secretary empowered to set prices based on his assessment of the public interest. As the Court noted in *Schepps Dairy, Inc. v. Bergland*, 628 F.2d 11, 18 (D.C. Cir. 1979): “Decisions of the Supreme Court, and of this court as well, have established beyond peradventure that the Secretary does not have broad authority to set milk prices at levels derived merely from his assessment of the public interest.”

Rather, the Secretary is constrained by the limits of the AMAA. He must objectively examine the “economic conditions which offset market supply for milk and its products in the marketing area to which the contemplated ...order ...

relates” and based on this examination “fix such prices as he feels will reflect such factors, ensure a sufficient quality of pure and wholesome milk, and be in the public interest.” 7 USC § 608C(18) (emphasis added). The prices set for other orders are irrelevant to this analysis. The Secretary must determine whether producer prices are so low as to create disorderly marketing conditions by focusing solely on the California market.

There was no evidence presented at the hearing of unreasonable fluctuations in milk supplies and prices in California. Indeed, the evidence presented was that California regulation has been successful in maintaining a stable and adequate supply of milk and milk products, and for fluid milk in particular. (See Statement of Dr. William Schiek, Exh. 79 and conclusion at p. 19: “The pattern has been that CDFA has made adjustments whenever necessary to deal with changing market conditions and changing dairy price policies in the rest of the country so that milk marketing in California will remain orderly and so that the prices are set at levels that account for and are responsive to market forces originating both inside and outside the state.”).⁴

⁴ An important factor in setting the California prices is that California minimum prices are intended to be market-clearing prices as all processors are required to pay the minimum prices, whereas a Federal minimum price is not so intended because processors can depool and pay less than the minimum price, so that the effective Federal minimum price may on occasion be substantially less than the nominal minimum. Marrying a non-market clearing minimum price to mandatory

The Courts have often said that the AMAA was intended to address the problems posed by (1) a differential pricing structure that permitted a higher return for milk used for beverage purposes over milk used for other purposes, and (2) a cyclical or seasonal production cycle which resulted in a glut of product at certain times of the year. *United States v. Rock Royal Co-op.*, 307 U.S. 533, 550 (1939); *Zuber v. Allen*, 396 U.S. 168, 172-181 (1969); *Smyser v. Block*, 760 F.2d 514 (3d Cir. 1985); *Alto Dairy v. Veneman*, 336 F.3d 560 (7th Cir. 2003). This problem, too, has been resolved by the California regulatory scheme, which has established uniform producer prices, mandatory milk pooling, and producer returns based on uniform prices regardless of to whom or when product is delivered during the year. (See the detailed descriptive and historical depiction of the CDFA regulatory system in the Statement of Dr. William Schiek, at Exh. 79.)

Historically, the USDA has also focused on equity among handlers and producers, within a FMMO region, and upon what is perceived as unfair competition among handlers or producers in a FMMO region, or between FMMO regions where milk sales into a region have perceived inequities. See, for example, *Jones v. Bergland*, 456 F. Supp. 635 (E.D. Pa. 1978); *Edaleen Dairy, LLC v. Johanns*, 467 F.3d 778 (D.C. Cir. 2006). In the case of California producers,

pooling, as proposed for the California Federal Milk Marketing Order, is thus a recipe for creating, and not curing, disorderly marketing conditions.

however, the sales are predominantly made by them in the same market at the same prices. The problem the Cooperatives have alleged is not that out-of-state producers are undercutting them on price, but that California producers are not receiving a sufficiently high uniform product price for milk destined to make cheese based on the CDFA formula as compared to the FMMO price. There is no disorderly marketing or unfair competition. Nor can differences between the FMMO national minimum price for a class and the California class price by itself be conclusive of whether there is disorderly marketing. Actual prices differ in the FMMO systems between regions, and to some extent even within regions to adjust to different circumstances.

In order to evaluate whether a price difference will be predictive of disorder it is necessary to evaluate the consequences of that difference in light of the purposes of the AMAA. The record is bare of solid evidence of adverse consequences to the California marketplace. There are only anecdotes of possible consequences to some individual producers; but there is no evidence that the price differential has negatively affected the orderly supply of fluid milk, especially Class I milk, nor that it has resulted in a substantial decrease in overall milk production, nor that it has led to price wars, seasonal deficiencies or oversupply or even prevented California producers from competing with their colleagues in neighboring states.

Nor can the California producers persuasively argue that the supply of fluid milk to the California consumer is imperiled. California has 12% of the U.S. population, yet produces over 20% of the milk. California Class I production accounts for about 10% of the total California milk production (*See* Testimony of Elvin Hollon at pp. 1457-1458), so that the overwhelming bulk of California milk production now goes into manufactured milk products, and so would the increased production generated by the proposal for higher minimum prices. There is also, under California law, a “call” provision which can divert milk from cheese processors and the like back to fluid uses if there are transitory shortages; a provision that apparently has never needed to be used. Indeed, the testimony of the Cooperative proponents’ witness, Elvin Hollon, shows there is an oversupply of fluid milk. Testimony of Elvin Hollon at pp. 1457-1458.

When the underbrush is cleared away, the Secretary is left with the reality that this is nothing more than a demand by the California milk producers for a higher price for their surplus milk. In particular, they do not want the California Class 4b price, but Federal Class III priced milk used for cheese production. *See* February 3, 2015 Letter of Marvin Beshore at p. 6; Testimony of Rien Doornenbal, at p. 6523; Testimony of Dr. Eric Erba at pp. 1886-1887 admitting that he believed the price differences between FMMO class minimum prices and CDFA minimum prices were acceptable, except for the difference between FMMO Class III and

CDFR Class 4b. Testimony of Dr. Eric Erba at p. 1887. The Cooperatives insist that California's CDFR regulated price is too low to sustain the viability of present California milk production. Left unaddressed in the Cooperatives complaint is whether California's present production is viable, and, as importantly, whether the increased production which would result from the desired higher minimum price would itself lead to disorderly marketing.

As noted, present California production is far in excess of what is required to assure a stable and orderly supply of fluid milk in California. The increased production of the proposed California FMMO Class III milk would be far in excess of what is required for California manufactured milk products. At present prices, which are a cost to them, California processors claim that they currently have to aggressively export dairy products across the nation and overseas. If the Cooperatives' desired increased Class III price were mandated, and the PRIA estimated increased production occurs, the problem of overproduction is greatly exacerbated; a problem that cannot readily be resolved even with substantially greater marketing efforts by the processors. At a time when there is a general decline in demand for dairy products, it cannot be assumed that this increased production will be readily absorbed. Indeed, the unanimous testimony of the California processors has been that they cannot do so. *See*, for example, the Testimony of James DeJong, Exhibit 98, detailing the adverse consequences to

Hilmar Cheese Company, a large California processor, if a California FMMO were to impose Federal minimum Class III prices: “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.” Exhibit 98 at p. 32, *see also*, the Testimony of Jose T. Maldonado, Exhibit 105: “Adoption of any sizeable 4b milk price increase will result in ... the extinction of California’s small/medium size cheese manufacturers.”

Further, because California cheese makers are a long way from the population centers in the eastern United States, the price which California processors can pay for Class III milk, and remain price competitive is significantly lower than the price which processors east of the Mississippi can pay. *See* Exhibit 133, “Testimony on the U.S. Spatial Value of Milk and Whey Practices in Cheese Plants” by Dr. Mark Stephenson. *See also* Exhibit 108, testimony of Gil de Cardenas pointing out that about two-thirds of the difference between the State and Federal Class III/Class 4b pricing is exhausted by shipping costs to Texas alone, and much of the balance is further exhausted by higher California regulatory and other costs, so that California cheese plants need the price differential in order to remain competitive.

In a 2009 CDFA proceeding, Dr. Eric Erba, a witness for the Cooperative proponents in the present proceeding, admitted that higher prices for California Class 4a and 4b milk would be detrimental: “Class 4a and 4b are market-clearing classes of milk and process 75% of the milk in California. The products from these plants compete in national and international markets where price is a dollar consideration for buyers. The California dairy industry is wholly dependent on continued operations 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.” Testimony of Dr. Eric Erba at pp. 1883-1885. *See also*, the Testimony of Greg Dryer, Exh. 91 at pp. 15-16, calculating that the consequence of the requested increase in Class III milk to processors would represent a 10% increase in the cost of California cheese to cheese wholesalers with the result: “it would likely place California cheese plants, especially high volume, low margin plants, in a difficult position to justify their continued operation. Since Class 4b accounts for almost half of the milk in the state, disorderly marketing conditions would inevitably ensue.”

In short, the predictable result of mandating a higher price will be an unabsorbed milk supply which will lead to producer quotas, milk dumping, cheese wars and genuine, not just merely hypothetical, disorderly marketing conditions across California and the United States.

V. RETENTION OF CALIFORNIA “QUOTA” AS PART OF A CALIFORNIA FMMO WOULD BE ILLEGAL AND UNCONSTITUTIONAL.

In 1967-1968, California enacted the Gonsalves Milk Pooling Act to pool Class I milk. The Gonsalves Act represented a compromise between certain producers in Southern California who had location advantages in providing Class I milk, and other producers who did not. The compromise provided for pooling milk, but created a benefit called “quota” allocated to certain producers. These producers have the value of their “quota” allocated to them off the top of the pool before the blended pool price to producers generally is calculated. As a result, holders of “quota” receive a premium price for their milk over the milk delivered by other producers. It is only California producers, and then only certain of them, that are eligible to receive quota. *See* Testimony of Dr. William Schiek, Exh. 79 at pp. 7-9. (Testimony of Dr. Eric Erba, Exhibit 42; Testimony of Lon Hatamiya, Exh. 54.)

The Cooperatives proposal contemplates that this unique California construct of “quota” be retained under the California FMMO and administered by the CDFA. Only existing California holders of quota would receive this benefit under the FMMO. This financial benefit to holders of quota would be paid into the future with no end date. Such a proposal is illegal and unconstitutional.

It is illegal because the AMAA prohibits it. 7 USC § 608(c)(5) states that Orders issued shall contain certain specified terms and conditions “and except as provided in subsection 7 no others.” Among these provisions, set out in 7 USC § 608(c)(5)(B) was the “payment to all producers and associations of producers delivering milk to the same handler of uniform prices for all milk delivered by them,” subject to certain allowed adjustments not here relevant. Clearly, a payment to one producer of a premium price, and not to another, for the same value and quality of milk, violates this provision. *Zuber v. Allen*, 396 U.S. 168, 180-1888 (1969); *see also, Smyser v. Block*, 760 F.2d 514, 520 (3d Cir. 1985) (AMAA specifically limited methods of regulation and Secretary has no authority to fashion additional or incidental mechanisms).

Similarly, 7 USC § 608(c)(5)(G) provides that “no 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.” (Emphasis supplied.) The provision of a premium price to California purchasers (through the quota system) effectively limits the marketing of out-of-state milk in California, by giving revenue advantages to California producers.

The 1996 Farm Bill language which states, of a possible future California FMMO, that “the order covering California shall have the right to reblend and

distribute order receipts to recognize quota value,” does not change this analysis.⁵ First, the Farm Bill did not purport to amend the AMAA, and the quoted language does not necessarily do so, because the Farm Bill language does not authorize the existing California systems of “quota,” or its producers, but merely permits an order to “recognize quota value,” which is a far different formulation than the preferential payment system operated by California and incorporated into the Cooperative’s proposal. Second, even if the Farm Bill were held somehow to amend the AMAA, it has certainly not amended the United States Constitution, nor could it, and the quota preferences are unconstitutional as applied to out-of-state producers.

The United States Supreme Court has held that payments made to in-state producers, which out-of-state producers do not receive, is a discriminatory burden on interstate commerce. In *Lehigh Valley Co-op Farmers, Inc. v. United States*, 370 U.S. 76 (1962), the United States Supreme Court struck down as unconstitutional FMMO order provisions requiring handlers who receive milk from outside an FMMO to make certain “compensatory payments” to the dairy farmers within the FMMO. In *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361 (1964) the Florida Milk Commission issued regulations which in effect

⁵ The 2014 Farm Bill makes no change of substance. Instead, the 2014 Farm Bill adds a sentence to this Section of the 1996 Farm Bill regarding the non-applicability to the Secretary of Section 143(b) of that 1996 Act.

required a milk distributor to take all its Class I milk from Florida purchasers and to take all milk which designated Florida producers could provide. The Supreme Court held that the Florida regulations were invalid and that not even Congress could set up trade barriers. 375 U.S. at 388. In *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), the Supreme Court invalidated a tax rebate paid solely to in-state producers, but not paid to out-of-state suppliers, as violating the Commerce Clause of the United States Constitution. In *Hillside Dairy, Inc. v. Kawamura*, 317 F. Supp. 2d 1194 (E.D. Cal. 2004), this analysis was extended to invalidate a California law which required California processors receiving milk from out-of-state producers to pay into a pool from which only California producers were paid. The calculation and payment of such amounts only to California producers, was held to violate the Commerce Clause.

A California FMMO that allows certain California producers to receive preferential “quota” payments for their milk, and in effect diminishes the payment to out-of-state producers for milk shipped into California will discriminate against out-of-state producers. Discrimination based upon geographical locations outside the FMMO which has the intended effect of subsidizing better milk pool prices for California producers while denying the same benefits to out-of-state producers is the same sort of trade barrier held unconstitutional in *Lehigh, supra*, *West Lynn, supra* and *Hillside, supra*.

The proposed California FMMO would regulate out-of-state milk to a lower of two blend prices and will have the intended effect of capturing more revenue for the California pool. But that revenue will be subsidizing a pool price – quota – that is only available to certain California producers. This amounts to discrimination against milk producers who reside outside of California. Such discrimination is not allowed under the guise of a Federal Milk Marketing Order. Instead, as noted above, discrimination based upon geographical location outside of the marketing area which subsidizes better pool prices for those inside the marketing area while denying the same benefits to the out-of-state producers is an unconstitutional trade barrier.

VI. A PROPOSED CALIFORNIA FMMO IS NOT THE ONLY PRACTICAL MEANS OF REASONABLY ADDRESSING THE INTERESTS OF CALIFORNIA PRODUCERS.

The AMAA further cabins the Secretary’s discretion in promulgating Federal Marketing Orders by 7 USC § 608c(9)(B) which states that if milk handlers do not voluntarily agree to be bound by an agreement, the Secretary, before promulgating an order, must determine that “the issuance of such order is the only practicable means of advancing the interests of the producers of such commodity pursuant to the declared policy...” The record is replete with evidence that some milk producers and most milk handlers are not in agreement with the Cooperative’s proposal (and the producers are not in agreement with the handlers’

proposal). So, the question is whether the AMAA policy of ensuring orderly supplies of milk to consumers and parity prices to producers can, as a practical matter, *only* be advanced by creating a Federal Milk Marketing Order for California. That is plainly not the case.

The hearing record reflects that for over 80 years, California has had a system of regulations that effectively meets the goals of the AMAA and that such regulations are similar to the Federal Order System. The record further reflects that the CDFA has been responsive to concerns of California producers and processors, and that California statutes and regulations have been frequently modified over the years to accommodate the often divergent interests of these groups. *See* Testimony of Dr. William Schiek at Exhibit 79. Because the California system is similar to that of the Federal Orders and because the California system has shown itself to be flexible and adjustable, a conclusion that the promulgation of a Federal Order is the only practicable means of addressing the producers' concerns or meeting AMAA goals must logically rest upon either proof that California dairy producers are somehow discriminated against (which is an absurd contention that has no evidentiary support in the record or in reality) or that the California system is so inherently flawed that it could never come to a workable policy and never be amended by the California legislature to do so. There is likewise no evidence in the record whatsoever to suggest that. Instead, the

evidence is that California has been diligent in seeking to find workable policies. *See* Testimony of Rob Vandenheuvel, Exhibit 50 at p.2 outlining the CDFA hearings on minimum milk price levels from June 2011 through June 2015. There have been 7 CDFA hearings involving the pricing of Class 4b milk in the last 5 years resulting in 7 changes in the Class 4b price in that time. *See* Testimony of Greg Dryer, Exh. 91 at pp. 2-3.

The United States is a federal system, and the dividing lines between matters best left to state control and matters for which federal intervention is deemed appropriate has shifted back and forth over the years and is part of an ongoing political debate. What can be said, however, is that under the AMAA Congress was concerned with establishing order regions that were no larger than necessary to accomplish the AMAA's goals. *See* 7 USC § 608(c)(11)(A) and (B). Thus, absent evidence that milk from outside California is adversely effecting market stability in California and the orderly provision of an adequate supply of milk inside California, and there is no such evidence, there is no necessity, arising from the inability of California to legislate across borders, for federal intervention here. The Secretary can take notice, as well, that financial inability or lack of human resources, in the most popular and wealthy state in the Union, cannot serve as pretexts for federal intervention. In short, there is no evidence in this record that allowing California to resolve disputes between California dairy producers and

California dairy processors is not a practicable means of resolving any genuine problems that the hearing record may have revealed.

Moreover, how is it possible that competitively disadvantaging all other producers in the Federal Milk Marketing system so that California producers can receive a higher price for their milk advances the purposes of the AMAA? At a minimum, the Secretary must explain why alternative proposals for a California FMMO, including those which would limit the time period for the payment of quota to California producers, would be less effective in accomplishing the terms of the AMAA. The statutory requirement mandates a process of rational analysis under the terms of the AMAA. There is nothing rational about continuing to allow California producers to receive a quota price for their milk *ad infinitum*, while at the same time requiring producers throughout the rest of the Federal Milk Marketing Order system, such as Trihope Dairy, to pay for that financial benefit to California producers in the form of lower milk prices. The AMAA cannot be utilized to create a permanent underclass of milk producers solely for the benefit of California quota holders.⁶

⁶ If the Secretary determines that California should be permitted to join the federal system and that California producers should also be allowed to receive a quota price for their milk, then the Secretary must limit the time period for receipt of such quota. One possible solution is to treat quota as a form of “good will” and to allow quota to be paid only over a specified period of time and then “written off.” Effectively, the Secretary would “recognize quota value,” and the California

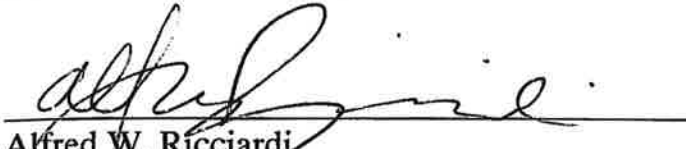
CONCLUSION

For the reasons set out above, as well as otherwise set out in the Hearing Record, Trihope Dairy Farms requests that the Secretary decline to promulgate a California FMMO at this time and under the conditions proposed.

DATED this 31st day of March, 2016.

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producers would then be given a choice of either continuing with the quota system and remaining in a California state order only, or joining the Federal Milk Marketing Order system and permitting their recognized quota payments to “sunset” over a specified time period. While Trihope Dairy is not a direct proponent of such a solution, Trihope Dairy notes that a similar proposal was made during the course of the hearing. Should the Secretary decide to proceed in this manner, Trihope Dairy suggests that a national hearing be convened to take evidence to determine if such a change is warranted. As a part of such a national hearing, there should be evidence taken and an evaluation done by the Secretary of Class III and Class IV pricing in the entire FMMO system.