

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

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 REPLY BRIEF OF TRIHOPE DAIRY FARMS

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I. INTRODUCTION.

The proposal advanced by California Dairies, Inc., Dairy Farmers of America, Inc. and Land O'Lakes, Inc. (collectively the "Cooperatives"), is really a request by the California Producers to issue a California Federal Milk Marketing Order ("FMMO"), to enhance producer prices. The Post-Hearing Brief for the Cooperatives makes this admission, "...it is clear that California, which is responsible for over 20% of the nation's milk production, must be brought under the Federal Milk Marketing Order ("FMMO") system in order to enhance California producer income and maintain orderly market conditions and an orderly supply of milk." (Cooperatives' Post-Hearing Brief, pg. 1.) (Emphasis added.) In other words, the Cooperatives are asking the United States Secretary of Agriculture ("Secretary") to adopt a provision to benefit the California milk producers to the potential detriment of the remaining 80% of the United States milk producers. Trihope Dairy Farms ("Trihope Dairy") is one of the 80%.

While there is a debate regarding whether the hearing record actually evidences "disorderly marketing conditions" in California, there is no doubt that USDA's own "Preliminary Regulatory Impact Analysis", Exhibit "5" in the Hearing Record ("PRIA"), shows that implementation of the proposed California FMMO will "lower uniform prices, lower milk production, lower all-milk prices

and lower producer revenues across most of the rest of the United States.”¹ This forecast result adversely effects milk producer economic viability, as well as the fluid milk supply, in the Southeast region. Indeed, the Southeast is one of the areas of the country most impacted by the Cooperatives’ proposal. The dairy farm sector in the Southeast has been under tremendous chronic stress since the Southeast Order merger and federal order reform in 2000. The region is no longer being able to provide for the fluid demands of the market. As a result, the fluid milk supplies for the Southeast must be imported from locations increasingly remote from the traditional milksheds for the regional marketing area of the Southeast. (*See Post-Hearing Brief on behalf of Maine Dairy Industry Association, Kentucky Dairy Development Counsel, Georgia Milk Producers, Inc., and Tennessee Dairy Producers Association*, pg. 5.) Moreover, and most importantly, the PRIA, as analyzed by Calvin Covington, retired CEO of Southeast Milk Incorporated, shows that the Cooperative proposal would result in an average reduction of producer

¹ The Cooperatives have challenged both the economic analysis and the conclusions reached in the PRIA by the Agricultural Marketing Service (“AMS”) that the Cooperative proposal would result in a reduction in milk revenue to milk producers in other portions of the country. One of the Cooperative proponents, Dairy Farmers of America (“DFA”), has recently filed an opposition to the Organic Trade Association’s (“OTA”) petition for a hearing to amend all federal milk marketing orders to provide for a modified Wichita option for USDA certified organic milk. In a letter to the Secretary dated February 17, 2016, DFA used as one of the reasons for opposing the request for a hearing by the OTA, the USDA / AMS published per farm impact analysis of removing dollars from the Federal Order pools. Specifically, DFA wrote, “[b]ased on the USDA / Dairy Programs’ published per farm impact analysis of removing dollars from the Federal Order pools generated from the sales of organic products, all of these DFA member farms would lose milk revenues if the organic proposal were adopted.” (Letter dated February 17, 2016, from Elvin Hollon, Vice President, Fluid Marketing /Economic Analysis for DFA to the Honorable Tom Vilsack, United States Secretary of Agriculture, attached as Exhibit “A”.) While the context is different, it is apparent that DFA will rely upon the economic analysis done by USDA/AMS if it serves the purposes of the DFA, but DFA will contest any such economic analysis by USDA/AMS when it does not.

blend prices, per hundredweight, of \$0.26 in the Southeast Order. (Exhibit 83 at 2-3.) This lost revenue directly impacts all Southeast milk producers.

Further, the Southeast marketing area is more effected by this loss in revenue than the upper Midwest where 90% of the milk is used to make cheese. The upper Midwest producers have the ability, through the upper Midwest dairy cooperatives and cheese plants, to receive premiums above the minimum federal order Class III price. Those premiums are generally shared with the upper Midwest milk producers. But, in the Southeast, where most of the milk is Class I, a lower Class III price means a lower Class I mover and a lower Class I price paid to Southeast milk producers. Those same producers must also share the Class I differential with producers outside the Southeast. Moreover, if there are any premiums charged, those premiums are generally not shared with member-producers in the Southeast.

In reality, the Secretary is being asked to deliver benefits to the California producers in the form of price enhancements through the efforts of the large Cooperatives who are a concentrated, well organized group within the dairy sector. The PRIA establishes that these price enhancements to California producers advocated by the large Cooperatives will be at the expense of the other milk producers in the remainder of the FMMO system. The latter group is too broadly dispersed to offer effective resistance. The issue for the Secretary is whether it is

both legal and equitable to force 80% of the dairy producing industry to bear the burden of the diagnosed milk price “problem” of the California milk producers. The answer, as a matter of law, and as a matter of fairness, is “no.” Historical problems in the dairy industry have stemmed from overreach rather than inaction. Under the circumstances, the Secretary should exercise his decision making authority here with both prudence and pragmatism.² As set forth below, the Secretary should reject the Cooperatives proposal to promulgate a California Federal Milk Marketing Order that is inconsistent with the foundational principles of the AMAA.

II. THE COOPERATIVES HAVE FAILED TO PROVIDE SUFFICIENT EVIDENCE AND LEGAL AUTHORITY TO SUPPORT THE IMPLEMENTATION OF A CALIFORNIA FMMO.

As noted above, in advance of the California hearing, AMS prepared an economic analysis of the impact on the remaining producers throughout the FMMO system of the promulgation of the Cooperative proposal. While the Cooperative witnesses challenged the methodology and the results of the economic analysis study, they were unable to overturn its conclusion that there would be a deleterious impact on producer prices to milk producers in the remainder of the

² In deciding whether to issue any proposed Order, the Secretary of Agriculture must exercise his discretion, “... in terms consistent with the purpose of the [AMAA] and see that [Orders] are enforced with vigor, fairness, and good judgment ...” (Report to the Secretary of Agriculture by the Federal Milk Order Study Committee, United States Department of Agriculture, April 1962 [hereinafter “*Nourse Report*”], pg. I-19.)

country. Based upon the geographical location of Trihope Dairy as a milk producer in the Southeast, Trihope Dairy would be more negatively impacted than producers in other portions of the country. The modeled evidence of adverse national impacts if the Cooperatives' proposal is adopted is both substantial and well-founded. Since the Department's Analysis and Report are the product of a sophisticated econometric model, the Secretary must consider the impact of any promulgated California Order on the Southeast. In particular, the Department must consider whether promulgation of the California Order would result in further diminution of supply for the Southeast Order. (*See* Post-Hearing Brief on behalf of Maine Dairy Industry Association, Kentucky Dairy Development Counsel, Georgia Milk Producers, Inc., and Tennessee Dairy Producers Association, pg. 9.) Further, the Secretary must be assured that the imposition of a new provision intended to confer a regulatory benefit to one portion of the regulated community, the California milk producers, does not result in unanticipated, material harm to other subjects to the same regulatory program, such as the Southeast milk producers. (*Id.*) The evidence is overwhelming that the Southeast milk producers, such as Trihope Dairy, will be harmed if a California FMMO with quota is adopted. Not only is this wrong as a matter of policy and fairness, it is also violative of the AMAA.

Under the terms of the AMAA, the retention of the California “quota” as part of a California FMMO would be “illegal and unconstitutional” for the reasons outlined in the Post-Hearing Brief of Trihope Dairy. (Post-Hearing Brief, pgs. 24-28.)³ During the course of the hearing, even the Cooperatives acknowledged that the retention of quota in a California FMMO would violate the AMAA:

And what I think we have lost in this process, and this is really a fundamental, it’s a basis for the legal point that I mentioned yesterday, and I would like to emphasize here this morning is, there’s no reconciliation of quota and the uniformity provisions of 608c(5)(B) of the Agricultural Marketing Agreement Act. They are not reconcilable. (Emphasis added.)

(Transcript of Proceedings [“TP”], Vol. XXXV, pg. 7012.)

While the Cooperatives attempt to reconcile the AMAA and the quota provision in their Opening Brief, their initial conclusion at the hearing is correct; it is not reconcilable.⁴ The Cooperatives intend that the California FMMO would capture more revenue for the California pool. But that revenue would subsidize a

³ In addition to all of the other constitutional infirmities, the proposed FMMO for California advanced by the Cooperatives is also violative of the AMAA’s milk price control authority as set forth in *Nebbia v. People of New York*, 291 U.S. 502 (1934), and “*Nebbia’s* judicial progeny.” (Post-Hearing Brief for Hilmar Cheese Company, pgs. 32-36.)

⁴ The Cooperatives acknowledge the potential for inconsistency in their Opening Brief: “If the Secretary finds that the AMAA requirement of “uniform prices” is inconsistent with the Farm Bill’s requirement of reblending and distributing order receipts to recognize quota value, ...” (Post Hearing Brief for California Dairies, Inc., Dairy Farmers of America, Inc. and Land O’Lakes, Inc., pg. 49.) The Cooperatives then attempt to distinguish the AMAA requirement by arguing that the Farm Bill’s language “implicitly modifies, or amends, the older, more generic terms of the AMAA ...” (*Id.*) Such a distinction, however, is not persuasive. The arc of 80 years of history shows that the AMAA requirement of “uniform prices” is completely inconsistent with reblending and distributing order receipts to recognize quota value for the benefit of only certain milk producers who own quota in California. The Secretary must adhere to the core values and statutory language of the AMAA. The only way to impose consistency and stability on the AMAA as a whole is to reject the attempted nullification of the primary purpose of the AMAA by allowing this isolated “exception.”

pool price (quota) that is only available to certain California producers. This amounts to discrimination among milk producers who reside outside of California. In particular, it would discriminate against milk producers in the Southeast. Discrimination under the guise of a Federal Milk Marketing Order is not permitted. Discrimination based upon geographical location outside of the marketing area which subsidizes a better pool price for those inside the marketing area while denying the same benefits to out-of-state producers is an unconstitutional trade barrier. As such, quota payments to certain California producers only cannot be reconciled with the AMAA. Since the Secretary is required to advance the interests of all of the producers in the entire FMMO system, and to ensure that the provisions of the AMAA are followed by all, this is an unsurmountable hurdle that the Cooperatives cannot overcome.⁵ For this reason alone, at the end of the day, the Cooperative proposal must be denied. Moreover, as noted below, even if it was not illegal, basic economic theory shows that the promulgation of a California Milk Marketing Order with quota will lower prices to producers outside of California. Further, the history of government intervention in the milk markets, including the

⁵ One of the major objectives of the Federal Order system is, “[t]o secure equitable treatment of all parties – producers, dealers, and consumers, not only within each local or regional market but throughout the system.” (*Nourse Report*, p. I-22.) Adopting the proposal advanced by the Cooperatives would violate one of the major objectives of the Federal Milk Marketing Order system because such an Order could not be, “effectively and equitably enforced on all parties.” *Id.*

merger of the Southeast order, has impacted and caused substantial losses to the vulnerable Southeast milk producers.

III. THE IMPLEMENTATION OF A CALIFORNIA FMMO WITH QUOTA WILL RAISE CALIFORNIA MILK PRICES, RESULT IN INCREASED MILK PRODUCTION IN CALIFORNIA, ADD TO THE NATIONAL MILK SUPPLY AND RESULT IN LOWER MILK PRICES TO ALL OTHER DAIRY PRODUCERS.

A. Past is Prologue: Government Intervention in Dairy Markets Has Detrimentially Effected Milk Producers in the Southeast.

Federal Milk Marketing Orders were promulgated to provide a framework for long-term price and market stability for milk producers. The purpose of such orders and of regulation of the dairy industry was never to raise milk prices to artificially high levels. But, in 1977, Congress used the Food and Agricultural Act of 1977 as a legislative vehicle to maintain higher prices for dairy farmers. In the four (4) years following the passage of the 1977 Food and Agricultural Act, the support price for Grade A milk rose to \$13.10 per hundred weight, and annual net governmental expenditures on the dairy sector increased to nearly Two Billion Dollars. (Eric M. Erba and Andrew M. Novakovic, *The Evolution of Milk Pricing and Government Intervention in Dairy Markets* [February 1995 E.B. 95-05], Cornell Program on Dairy Markets and Policy.)

This increase in milk prices lead to the predictable effort by milk producers to increase milk production to take advantage of the higher prices. (*Id.*) In order to curb total milk production, the 1983 Dairy Production Stabilization Act

attempted to control the supply of milk to producers to reduce marketing by a percentage of their historical base. (*Id.*) Thereafter, the Food Security Act of 1985 utilized the Dairy Termination Program in an effort to control the supply in the dairy industry and remove pounds of milk from the market. (*Id.*) While participation in the dairy termination program was not uniform throughout the country, California accounted for the largest portion of the 12.28 billion pounds of reduced production. (*Id.*) The history of federal intervention in the milk marketing order systems in the 1980s is particularly salient in looking at what is being requested today by California producers and how that might impact the Southeast.

The higher prices that California milk producers received as a result of the Food and Agricultural Act of 1977 were a “huge windfall” and producers in California responded to the increase in the prices by using the proceeds to expand dairy herds. (Exhibit 142, pgs. 5-6.) The federal intervention which raised milk raising prices, “led to the explosion of milk production in California which then led to the need to build more processing capacity.” (*Id.*) In other words, it was the consequence of federal intervention to raise prices in the dairy industry that actually helped to create the so-called “California advantage.” Once the pendulum had swung that far, however, government intervention was again required to try to curb production to try and stabilize the overall dairy markets. Unfortunately, it is dairy producers, such as those in the Southeast, that have been required to deal

with the consequences of such support programs and their aftermath. While California producers actually benefited from such programs, the Southeast milk producers suffered the exact opposite fate.

Sumners and Trihope Dairy started in the dairy business in the 1980s when there was an effort to curb production through programs such as the Milk Diversion Program. The effect was to reduce marketing by culling more cows and decreasing the amount of surplus milk available to be marketed. The Southeast milk producers then had to deal with the costs of bringing production back up after culling cows to reduce production. The cost of replacing the cows and the cost of attempting to replace the revenue from reduced production was difficult for dairy farmers in the Southeast. Thus, Southeast milk producers were required to bear the burden of the overproduction but never benefited from it. The California producers had the enviable choice of buying a new Mercedes or putting their windfall profits into additional milk production. In contrast, the question for the Southeast producers was how they would survive. For the Southeast milk producers, then, this recent effort by California producers to promulgate a FMMO to increase California prices on the backs of all of the other producers in the United States is simply *deja vu* all over again.

This regulatory burden on the Southeast milk producers was further exacerbated by the Southeast merger and federal order reform in 2000 which

resulted in the dairy farm sector in the Southeast region no longer being able to provide for the fluid demands of the market. The chronic distress of the policies of the 1980s and the Southeast merger in the late 1990s have made it difficult for the Southeast milk producers to sustain milk production and to insure the maintenance of an adequate Class I supply in the Southeast market. Adding any additional financial burden now onto this already difficult situation is an onerous weight that the milk producers in the Southeast should not be required to bear.

Federal orders were enacted to establish minimum prices, and not market effective prices. Minimum prices allow dairy cooperatives and other milk buyers to pay producers premiums above minimum prices. But, federal orders were never designed to support prices above market clearing prices. As the past has shown, when the federal orders are used to artificially support prices above market clearing prices, the result is that production increases to an unsustainable level and someone has to ultimately pay the price. The Southeast milk producers have already paid a number of times and are still paying. The Southeast milk producers should not be forced to pay again simply because California producers want a federal Class III price and not the current Class 4b price permitted by the CDFSA.

California producers want the Secretary to abandon reality and move the industry back to the halcyon days of the 1980s and 1990s when federal programs assured California milk producers of more favorable and stable milk prices and

profits. Back to a time when California producers were making more money than other portions of the country. The effect of adopting the California FMMO with a quota system is to mandate that the Southeast producers “bail out” the California producers. As noted, the Southeast milk producers have never been the beneficiaries of increased milk prices due to regulation. Instead, more times than not, they have been the regulatory “losers.” It is finally time for that to stop.

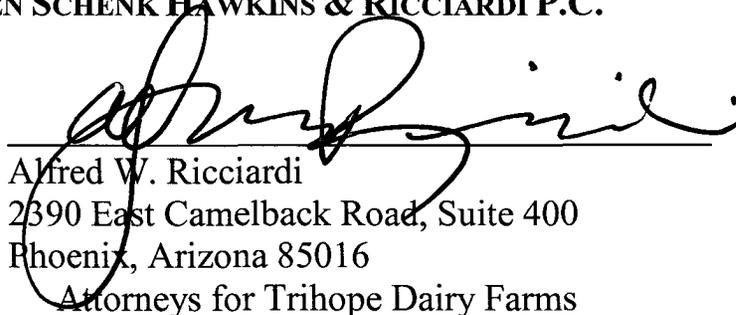
IV. CONCLUSION

For the reasons set out above, as found in the hearing record, and as set forth in its Post-Hearing Brief, Trihope Dairy Farms requests that the Secretary decline to promulgate a California FMMO at this time and under the conditions proposed.

DATED this _____ day of May, 2016.

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By



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EXHIBIT A

POST-HEARING REPLY BRIEF



February 17, 2016

Honorable Tom Vilsack
U.S. Secretary of Agriculture
U.S. Department of Agriculture
1400 Independence Avenue, SW
Washington, DC 20250

Dear Secretary Vilsack,

Dairy Farmers of America represents more than eight thousand member dairy farm operations who produce more than 20 percent of the nation's milk supply. DFA has member farms in nearly every U.S. state and markets milk on nine of the ten Federal Milk Marketing Orders (FMMO). Given our national position in the dairy industry, DFA is keenly aware that the Organic Trade Association's (OTA) request for a modified Wichita option for USDA certified organic milk would reduce regulated milk prices across the country and adversely impact all of DFA's member producers. We request that you deny the hearing request.

For more than 80 years FMMOs have operated at the discretion of dairy farmers who collectively elect to preserve orderly marketing conditions and avoid unreasonable fluctuations in milk supplies and prices by sharing a portion of their revenue from milk sales with other dairy farmers in the same marketing area. OTA's proposal greatly infringes on this aspect of the FMMO program by providing an exemption that would allow organic milk processors to avoid contributing to the revenue sharing pools even though all of their finished products are marketed in the same consumer channels as is conventional milk. Regulated minimum milk prices that many farm families look to as a form of price certainty would immediately be eroded if OTA's proposal were adopted.

More than 85% of DFA's dairy farm operations are small family farms with an average herd size of less than 70 cows and fall well below the standard USDA definition of a small business. Based on the USDA / Dairy Programs' published per farm impact analysis of removing dollars from the Federal Order pools generated from the sales of organic products, all of these DFA member farms would lose milk revenues if the organic proposal were adopted.

In some parts of the country, the published analysis indicates the financial loss is more substantial. DFA members in the Southwest FMMO could lose more than 10 thousand dollars per year if OTA's proposal were adopted. The ambiguities surrounding where these monies would go, how the proposal would benefit dairy farmers, or how it would improve the FMMO program is concerning to DFA.

However, what is more troubling to DFA is that if the Department advances to a hearing, dairy farmers across the country could face the very real possibility of voting out their individual FMMO programs. Voting against an organic exemption would terminate the FMMO program and would immediately result in disorderly marketing conditions; disrupting dairy product availability in both the organic and conventional supply chains.

FMMO's continue to evolve with industry changes. Recent examples would include the reduction in the number of Orders as increases in dairy farm size and scale, combined with the consolidation of processor assets, required larger marketing area boundaries to recognize the broader marketplace competition for milk sales and supply regions. Additionally, the changing trend in the industry to recognize milk not as just a homogenous fluid



product but a composition of fat and protein has led to component driven valuation of milk in six of the ten FMMOs. This is in direct response to differing consumer nutritional and taste preferences for those components. The current Hearing to include the California milk production and marketing area in the FMMO system is driven by significant changes in underlying marketing conditions. Importantly, none of these changes erodes the basic tenants of FMMOs and specifically the principle of market wide pooling and the benefits it provides to the industry. The OTA proposal significantly violates this principle. We encourage you to protect the ongoing integrity of the FMMO program by rejecting the OTA proposal because it does not comply with the basic rationale for the existence of Federal Milk Marketing Orders.

Sincerely,

A handwritten signature in black ink, appearing to read 'Elvin Hollon', is written over a faint, larger version of the same name.

Elvin Hollon
Vice President, Fluid Marketing/Economic Analysis

cc: Dana Coale, Deputy Administrator, Dairy Programs

