EXHIBIT

139

BEFORE THE UNITED STATES DEPARTMENT

OF AGRICULTURE

AGRICULTURE 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

Clovis, California, November 2015

Testimony of Rob Blaufuss

Part 5

Producer – Handler Regulations

As found in §1051.10 of Proposal 2, a Producer-Handler is defined as a person who operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, from which total route disposition and packaged sales of fluid milk products to other plants during the month does not exceed 3 million pounds, and who the market administrator has designated a producer-handler after determining that all of the requirements of this section have been met.

While there are many similarities between Proposal 2 and Proposal 1 with respect to §1051.10 regulations, there are also several key differences. Proposal 2 mirrors the Producer-Handler regulations that currently exist in Federal Orders 124 and 131. The key difference between Proposal 2 and Proposal 1 is the additional ownership requirements those operating in Federal Orders 124 and 131 must abide by to be considered Producer-Handlers. The increased ownership requirements borne to Producer-Handlers under Proposal 2 can be found in §1051.10(b)(1)&(2). Experience in FMMOs west of the Rockies, with its larger size dairy farms, has demonstrated that the provisions in Order 124 and 131 are needed to assure that an entity doesn't meet the Producer-Handler definition while manipulating its milk production through use of leased cows or other creative ownership structure arrangements which undermine the integrity of the purpose behind the limitations on these entities.

The fluid milk industry operates in a highly competitive market, where business can be won or lost over fractions of a penny a gallon. It is imperative that milk pricing regulations do not provide an artificial regulatory advantage to one similarly situated regulated handler over another. California state milk pricing regulations do exactly this with respect to exempt Producer-Distributors, also known as Producer-Handlers in the Federal Order system. California

Producer-Handlers enjoy a significant competitive advantage over fully regulated Class 1 handlers. Under California milk pricing regulations, Producer-Handlers effectively avoid paying into the California pool the difference between the minimum Class 1 price and the quota price on all exempt quota holdings.

Having a different set of rules for fully regulated handlers compared to those who are not, creates disruption in the Class I market. Disruptive conditions arise when some but not all Class I handlers are able to avoid paying Class I prices. Class I handlers not subject to full regulations are able to use their artificially low regulated cost structure to offer a lower price to customers than a fully regulated handler could.

Unlike Producer-Handlers in all other Federal Orders, California Producer-Handler's enjoy a soft cap exemption. A soft cap allows the California Producer-Handlers to retain the Class I exemption on a set level of quota pounds while still being allowed to increase their total Class I route disposition without the fear of ever becoming fully regulated. This 'soft cap' provision is the proverbial gift that keeps on giving. The California Producer-Handlers are able to expand their Class I sales by diluting the dollars they avoid paying into the pool over the totality of their total Class I sales. While it erodes their full per-gallon competitive price advantage, they are still able to retain a competitive price advantage over fully regulated Class I processors.

All Federal Milk Marketing Orders fully regulate producer-handlers whose monthly Class I route dispositions exceed three million pounds. The Federal Order regulations operate under what is termed a hard cap. Any producer-handler over the three million pound threshold becomes fully regulated and does not retain an exemption on any of their Class I sales. They are required to pay into the pool the regulated minimum Class I price on all milk they procure.

The California Producer-Handlers exempt quota pounds are held static regardless of their sales volumes. However, unlike current Federal Order regulations, there are no sales volume limits placed on California producer-handlers which would lead them to becoming fully regulated handlers.

USDA has ruled on multiple occasions that producer-handler exemptions create disorderly marketing and put fully regulated Class 1 handlers at a competitive disadvantage. After a 2005 hearing in Federal Orders 124 and 131, USDA found that "producer-handlers with more than 3 million pounds of route disposition per month in both the Pacific Northwest and the Arizona-Las Vegas marketing areas are the primary source of disruption to the orderly marketing of milk."[i] USDA went further in that decision when they stated that, "this disorder is evidenced by significantly inequitable minimum prices that handlers pay and reduced blend prices that dairy farmers receive under the terms of each area's marketing order."

In a 2009 Federal Order hearing decision around the Producer-Handler issue, USDA asserted that "when uniform minimum price conditions exist the basis for orderly marketing is present. In the absence of uniformity of minimum prices among producers and handlers, the basis for orderly marketing is undermined."[ii] USDA concluded its decision by stating that "producer-handlers with total Class I route disposition in excess of three million pounds per month enjoy significant competitive sales advantages because they do not pay the Class I price for raw milk."[iii] A proposal for a soft cap (regulation of a producer-handler only for route disposition greater than 3 million pounds) made in that proceeding was expressly rejected by USDA.

Dean Foods fully supports the Dairy Institute of California's proposal to cap the producer-handler exemption to those with 3 million pounds or less of monthly Class I route dispositions. We are also supportive of the Dairy Institute language which uses the current Federal Order 124 and 131 language which eliminates the potential for producer-handlers to change their ownership structure in an effort to avoid regulation. In order for a Federal Order to work effectively, all handlers must operate under the same set of rules. As stated by USDA in 2009, "producer-handlers with monthly Class I route disposition of three million pounds or less are not a cause of disorderly marketing conditions that warrant correction."[iv] In order to ensure an equal playing field, Proposal 3 must be rejected. While the Producer-Handlers downplay the impacts of exempt quota, the exemption allows them to enjoy a significant competitive advantage over fully regulated route distributing plants. This advantage has clear value, the Producer-Handlers stated as much in their amended supplemental proposal for a California milk marketing order when they said that, "between 1994 and March 1995, the Producer-Handlers collectively invested $9,298,677.84 to acquire Quota that would receive the exempt treatment."[v]

The regulatory price difference between a fully regulated California Class 1 plant and an Option 70 Producer-Distributor is readily calculable for any given month. Exhibit 140, table 1 does exactly this. Column B represents the monthly announced Southern California Class 1 price at 3.5% butterfat, Column C represents the monthly announced Northern California Class 1 price at 3.5% butterfat and Column D represents the monthly announced Quota price at 3.5% butterfat. The regulated price advantage producer-handlers in California enjoy is equal to the difference between the announced Class 1 price and the monthly announced Quota price. In order to calculate the per-cwt price advantage, I simply took the Southern California Class 1 price and subtracted the monthly announced Quota price. The results of this calculation can be found in Column E. I performed the same calculation for the producer-handler advantage compared to the Northern California Class 1 price. These results can be found in Column F. Finally, I calculated the per-gallon regulated cost advantage current California regulations provide exempt producer-handlers for a gallon of whole milk. A gallon of whole milk weighs approximately 8.62 pounds which would mean a cwt of milk would yield approximately 11.6 gallons of packaged milk. By dividing the per-cwt price advantage for both Southern and Northern California by 11.6, I was able ascertain the per-gallon regulated price advantage. The monthly regulated price advantage can be found in Column H. As the data shows, from Jan. 2010 – Aug. 2015, California Producer-Handlers enjoyed a $0.16 per-gallon regulated price advantage over fully regulated Class 1 distributing plants located in Southern California. Over that same period the regulated price advantage equaled $0.14 per-gallon compared to Northern California Class 1 plants. The single largest monthly advantage, which occurred in December 2014, was $0.50 and $0.47 per-gallon for Southern and Northern California, respectively. The lowest price advantage over that same period was -$0.11 per-gallon for Southern California and -$0.13 per gallon for Northern California. This monthly low advantage occurred in February 2011.

Proponents of Proposal 3 (based upon questions to date) appear to try to divert attention away from the magnitude of the exempt Quota pounds by comparing it to the total pounds of milk in the California pool. This comparison is a red herring. In order to gain a full appreciation of the impact that Producer-Handlers have one must compare the exempt quota pounds against the <u>total Class 1 volume</u> in the state of California. In using CDFA Table AC we can do exactly that. For the month of August 2015, Producer-Handlers exempt Class I pounds totaled 20,989,392 pounds while its total pooled Class 1 volume was 99,557,362 pounds. Total Producer-Handler Class 1 volumes, combined exempt quota and pooled pounds, equaled 120,546,754. Total Class 1 pounds from out-of-state totaled 29,756,864 pounds. With the exempt quota pounds and out of state Class 1 milk included, there was a total of 503,016,796 pounds of

Class 1 in ~~the~~ California. As the data shows, total Producer-Handler volume in August 2015 represented approximately 24% of the total California Class 1 volume.

Dean has absolutely no problems competing in a competitive environment so long as all entities are operating on an equal playing field. In recent years competition has increased not from plants located outside of California moving milk in to the state, but rather exempt producer-distributors located in the state of California who, because of a favorable regulatory advantage, are able to offer customers a lower price. Increased volatility in Class I pricing and declining sales volume could ultimately lead to an even greater competitive advantage should Producer-Handlers in the state be allowed to continue to operate as they do today. Under both Proposal 1 and Proposal 2, the four current producer-handlers operating in California would still be able maintain their producer-handler status should they have less than 3 million pounds of Class I route dispositions in a given month and meet the other requirements by not relying on other farm production. I note that from our knowledge these entities do not actually meet these definitions. California is not an island – what happens in this hearing will have ripple effects on all Federal Orders. USDA would be going against its own precedent set in previous national and regional Producer – Handler hearings should it decide to continue to allow California Producer-Handlers to enjoy all of the current regulatory advantages that exists under the California state order in a potential new Federal Order.

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[i] 70 Federal Register. December 14, 2005. P.74186. (http://www.dairyprogramhearing.com/getfile50b950b9.pdf?dDocName=STELDEV3101563)
[ii] 74 Federal Register. October 21, 2009. P.54409 (http://www.gpo.gov/fdsys/pkg/FR-2009-10-21/pdf/E9-25292.pdf).
[iii] 74 Federal Register. October 21, 2009. P. 54412 (http://www.gpo.gov/fdsys/pkg/FR-2009-10-21/pdf/E9-25292.pdf).
[iv] 74 Federal Register. October 21, 2009. P. 54408 (http://www.gpo.gov/fdsys/pkg/FR-2009-10-21/pdf/E9-25292.pdf).
[v] California Producer Handlers Association Proposal. May 27, 2015. (http://www.ams.usda.gov/sites/default/files/media/052715CPHAProposal.pdf)