

John H. Vetne

Attorney at Law

11 Red Sox Lane
Raymond, N.H. 03077-4266

Telephone (603) 895-4849
cell (978) 618-8192
fax (603) 895-4849

johnvetne@comcast.

February 16, 2009

Dana H. Coale, Deputy Administrator
Dairy Programs, AMS, USDA
USDA-AMS-Dairy Programs
STOP 0231 - Room 2971
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Via E-Mail Only: amsdairycomments@usda.gov
dana.coale@usda.gov; gino.tosi@ams.usda.gov

RE: Alternative Proposal in Response to “Invitation to Submit Proposals...” from AMS Dairy Programs, February 6, 2009, and Comments on the Merits of the NMPF-IDFA Proposals.

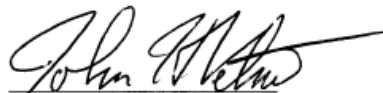
Dear Deputy Administrator Coale:

On behalf of Mallorie’s Dairy, Inc., a producer-handler located in Silverton, Oregon, attached is an alternative proposal on producer-handler issues, responding to requests for a national hearing, pursuant to 7 C.F.R. §§ 900.3 and 900.22, by NMPF and IDFA, and your invitation of February 6, 2009.

The February 6 “invitation” explains that USDA is still considering whether the NMPF/IDFA proposal to eliminate producer-handlers in the federal milk marketing order program merits a hearing. Consistent with 7 C.F.R. §900.3, we assume that USDA is conducting an initial “investigation and consideration” on the merits and credibility of proponents’ claims. The attachment addresses that question first, then proceeds to discuss Mallorie’s alternative proposal in the format suggested by 7 C.F.R. § 900.22.

The attached proposal, offered as an alternative (if the NMPF/IDFA proposal is accepted for hearing), would introduce a new concept to federal milk orders – a regulated distributing plant handler with some own farm milk production that is excluded from the market-wide pool, but not exempt from classified pricing, on an eligibility-limited basis. A pre-hearing workshop may be helpful to address questions on this proposal as well as proposals from NMPF, IDFA and others.

Very truly yours,



Ec: Charles Flanagan, Mallorie’s Dairy

Mallorie's Dairy, Inc.
Response to Invitation to Submit Proposals

Comments on the NMPF-IDFA Proposal and Stated Reasons Therefore.

The centerpiece for NMPF-IDFA's proposal to eliminate partial regulatory exemption for producer-handlers is a claim of potential "disorderly marketing conditions." Nowhere does NMPF or IDFA justify their proposals under the "only practical means" standard of the AMAA, §608c(9)(B), nor under the least burdensome alternative standard of the Regulatory Flexibility Act, 5 U.S.C. §§ 603 – 604.

The first page of NMPF's proposal provides a summary of its "disorderly marketing" justification. NMPF asserts that large dairy farms provide the prospect for a "new model of producer-handlers" that "can" disrupt a market, and "could proliferate," with a "potential" to expand in numbers, which "could" undermine market-wide pooling. NMPF's rationale ends with an amazing specter that all fluid milk Class I sales could eventually be lost to producer-handlers. NMPF Proposal, p. 5 and T. 1

After more than 70 years of marketing order administration and litigation, it is now abundantly clear that speculative predictions and hortatory are insufficient to support any amendment to milk order rules. *Borden, Inc. v. Butz*, 544 F.2d 312, 319 (7th Cir. 1976); *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 413 (3rd Cir. 1987) (a "possibility" advanced in support of a rule amendment constitutes legally insufficient speculation); 58 Fed. Reg. 33347, 33351 (1993) (rejecting proponent argument of "disorderly marketing" where claim of lost sales due to unfair price advantage was based on speculation).

A proponent's burden of proof to support a rule change, and the agency's burden to justify the change, is even higher where USDA has recently addressed the problem, and adopted a solution that is inconsistent with a remedy advanced at a later time. *Lehigh Valley*, 829 F.2d at 413. This heightened burden applies to the extension of NMPF-IDFA's proposal to the Pacific Northwest milk market, where a final rule limiting the size of producer-handlers was made effective just three years ago. 71 Fed. Reg. 9430 (Feb. 24, 2006). It is noteworthy that NMPF's recent narrative for elimination of producer-handlers is a cut-and-paste version of its September 2003 testimony in that proceeding, where it argued that a 3-million pound/month size limit was an "appropriate" solution to the prospect of marketing disorder from producer-handlers' possible expansion in size and numbers. NMPF Statement, Hearing Exhibit No. 26, AMS Docket Nos. AO-368-A32 and DA-03-04B.

NMPF and IDFA, like every proponent of milk order amendments, rely on their own view of "orderly marketing" to support regulatory changes, even where purely self-serving interests are advanced, and the "disorder" sought to be curbed is merely competition from someone else. The U.S. Department of Justice's 1977 report entitled "*Milk Marketing*," to President Ford's Task Group on Antitrust Immunities, cautioned

that federal milk orders provide a significant opportunity for cartelization of the dairy industry, and that definitions for “pool plant” and “producer milk,” in particular, provide “fertile ground” for competitive abuse. DOJ, *Milk Marketing*, pp. 292-94, 333. The NMPF and IDFA proposals to add producer-handler plants to the definition of “pool plant” raise this very concern for competitive abuse of the federal milk order system.

The term “disorderly marketing” as used in the AMAA of 1937, and the AAA of 1933, was used to describe farm conditions in the early years of the Great Depression, as explained in Erba, Eric and Andrew Novakovic, *The Evolution of Milk Pricing and Government Intervention in Dairy Markets* (Cornell University, CPDMP, EB 95-05, Feb. 1995), www.cpdmp.cornell.edu at p. 6:

Disorderliness, which refers to the lack of a predictable, sustainable, and efficient flow of a product to a specific market, ultimately led to the breakdown of dairy markets. If fluid milk markets were to have orderly supply, orderly production was required which further depended on orderly provisions for assembly and distribution.

In addition, an orderly relationship between different markets in terms of price and supply was required. Without state or federal governmental intervention, there was little chance of creating orderly marketing beyond the local level. The 1933 Agricultural Adjustment Act (AAA) sought to correct these failures in dairy markets by including provisions for milk and dairy products.

As shown below, the proposals that NMPF and IDFA claim are needed to cure “disorderly marketing,” if adopted, will create a competitive *disadvantage* for their regulatory targets, produce a real probability that many producer handlers will go out of business, and create inefficient flow of milk to fluid markets now served by these producer-handlers.¹

In the course of the prior 2003 – 2006 producer-handler proceeding in the Pacific Northwest, NMPF submitted data that it claimed to support the notion that producer-handlers operate at a competitive advantage to fully regulated handlers. Exhibit No. 26, AMS Docket Nos. AO-368-A32 and DA-03-04B, Table 3. For producer-handlers with 2 million pounds per month of milk processed, the calculated competitive advantage was \$0.006 per gallon, taking into account higher unit costs for small plants due to

¹ NMPF’s definition of “orderly marketing” is reminiscent of the oft-quoted rule of Humpty Dumpty rather than the rule of law. *E.g.*, *Finnegan v. Matthews*, 641 F.2d 1340, fn. 5 (9th Cir. 1981): “When I use a word” Humpty Dumpty said, in a rather scornful tone, “it means just what I choose it to mean, no more, no less.” “The question is,” said Alice, “whether you can make words mean so many different things.” “The question is” said Humpty Dumpty, “which is to be master – that’s all.” Reflecting that some words, like adjectives, can be made to work harder to advance a self-serving distorted meaning, Humpty Dumpty continued: “When I make a word do a lot of work like that,” said Humpty Dumpty, “I always pay it extra.” L. Carroll, *THROUGH THE LOOKING GLASS AND WHAT ALICE FOUND THERE*, *The Annotated Alice: The definitive Edition* 213, (Martin Gardner ed., Norton Publishers) (2000).

documented cost differences from economies of scale. If fully regulated, the small (2-million pound) plant would have a cost *disadvantage* of \$0.137 per gallon, and a 5-million pound producer-handler plant would have a *disadvantage* of \$0.097 per gallon according to the NMPF calculations.² NMPF's approach to cost advantage or disadvantage analysis was correct, but some of its assumptions result in a demonstrable overstatement of comparable costs to fully-regulated handlers in competition with producer-handlers, understatement of producer-handler costs, and overstatement of producer-handler imputed revenue. For example:

(1) In calculating a producer-handler's imputed procurement cost advantage, NMPF used the formula: "Class I – blend." This overstates producer-handler imputed revenue, since producer-handlers balance their own milk supplies, and some own-farm production is necessarily used in, or sold for, lower class uses. Mallorie's Dairy non-Class I use of own-farm milk, for example, averaged over 30% in 2007. The honest measure of procurement advantage, if any, would be "producer-handler blend – marketwide blend."

(2) NMPF also assumed in its calculations that the volume of an average size pool distributing plant of 9.7 million pounds/mo (simple average), and the per-gallon processing costs of that average plant, should be used in the formula to calculate a producer-handler's cost advantage or disadvantage. This simple (non-weighted) approach grossly overstates the average per gallon processing costs for products from plants that may be in competition with producer handlers. Indeed, the NMPF approach is indifferent to the identity, size, and processing cost advantage of large handler plants that are in actual and direct competition with producer handlers.

(3) For some costs, such as "cost of producing gallon jug," NMPF applied a fixed per gallon cost of \$0.088, assuming that jug costs do not vary by plant size. NMPF Ex. 26, Table 1A. In fact, jug or packaging costs vary greatly by plant size, and some smaller plants do not produce jugs at all. Mallorie's Dairy, for example,

² NMPF's Exhibit 26, Table 3 (2003) is reproduced in relevant part below:

NMPF: Table 3
Cost Advantage of Producer-Handlers of Various Sizes
Relative to Average Pool Distributing Plant
Pacific Northwest Market
September 23, 2003

Herbein						
Producer Handler						
Monthly Volume (mil. lbs.)	0.09	2.0	5.0	12.0	18.0	30.0
Plant cost	1.080	0.671	0.631	0.591	0.509	0.488
Price advantage (Class I - blend)	0.143	0.143	0.143	0.143	0.143	0.143
Plant cost - price advantage	0.937	0.528	0.488	0.448	0.366	0.345
Average Pool Distributing Plant						
Monthly Volume (mil. lbs.)	9.7	9.7	9.7	9.7	9.7	9.7
Plant cost (26.7 mil. lbs./mo.)	0.534	0.534	0.534	0.534	0.534	0.534
Producer Handler advantage	(0.403)	0.006	0.046	0.086	0.168	0.189
Without price difference	(0.546)	(0.137)	(0.097)	(0.057)	0.025	0.046

doesn't have a blow mold to produce plastic jugs, and must buy jugs produced at and transported from another location.

From these observations, it is clear that the NMPF-imputed *disadvantage* of \$0.137 per gallon to a small, 2-million pound producer-handler plant, or \$0.097 per gallon to a 5-million pound per month plant, if it were to become fully regulated, is far greater than calculated by NMPF in 2003. NMPF and IDFA seek to enlist USDA's assistance in mandating this competitive disadvantage for small business handlers that currently operate producer-handler plants. After investigation of these proposals under 7 C.F.R. §900.3, USDA should conclude that they do not satisfy any *prima facie* test for "orderly marketing," least burdensome regulatory alternative,³ or "only practical means" standards that govern regulatory intervention.

Mallorie's Dairy's Alternative Proposal

Mallorie's first alternative is to maintain regulatory status quo for producer handlers, at least for the Pacific Northwest Marketing Area in which producer-handler issues were previously raised, and resolved, after 3-years of hearing and deliberation, by a final rule effective April 1, 2006. 71 Fed. Reg. 9430 (Feb. 24, 2006). The final decision in that proceeding fixed a 3-million pound per month cap on the size of pool-exempt producer handlers.

The proposal appended to the end of this document is an alternative to be considered in the event USDA decides to call a hearing on IDFA and NMPF's proposals, or any modification or variation of those proposals, for the Pacific Northwest. Consideration of this alternative, among other objectives, will allow USDA to make a reasoned determination, based on the record, whether any amendment eventually adopted...

- (1) "is the *only practical means* of advancing the interests of the producers of [milk] pursuant to the declared policy of" the AMAA (§608c(9)(B)), and
- (2) represents the least burdensome regulatory alternative without disproportionately burdening small entities or any subset of small entities, erecting barriers to competition, or stifling innovation. 5 U.S.C. §601 *et seq.*

The proposal would, as urged by NMPF, eliminate producer-handlers in future federal milk order rules. In a nutshell, the proposal would allow producer-handlers, whose plants would become regulated pool distributing plants, to "grandfather" their existing farm milk production, up to 3 million pounds per month, by exempting such production from obligations to pay money into (or receive money from) the pool

³ For guidance on least burdensome regulatory alternative requirements, see: Small Business Administration, *A Guide for Government Agencies: How to Comply with the Regulatory Flexibility Act* (SBA, May 2003), <http://www.sba.gov/advo/laws/rfaguide.pdf> at pages 2-3, 18, 31-35 .

producer-settlement fund. Such pool-exempt milk would essentially be treated as milk in an individual handler pool. Milk production from the handler's own farm in excess of the grandfathered (exempt) volume, along with receipts of milk from other producers, would be subject to market-wide pool obligations and payments to the fund just like milk received by other handlers. We understand that USDA's staff may study this proposal for consistency with the 7 U.S.C. §608c(5)(B)(ii) requirement of uniform prices to all producers in a marketwide pool. The current view of the Secretary and at least one federal court is that USDA has very broad discretion to define "producers" and "producer milk" eligible to participate in the market-wide pool. *White Eagle Co-op. v. Conner*, 553 F.3d 467 (7th Cir. 2009). Just as USDA may exclude any or all surplus or manufacturing class milk from the definitions of pool-eligible milk, without concern for section (5)(B)(ii), so may USDA allow for exclusion of own-farm milk to a distributing plant from pool participation. The proposal, in any event, simply continues (but does not allow for expansion of) pool-exempt own-farm milk now associated with producer-handler plants. Further, the proposal – in proposed section 10(e) – would (unlike the current rules) provide a method for assuring that handlers eligible for the exemption are nevertheless accounting for pool-exempt own-farm milk at Class prices "fixed in accordance with paragraph (A)." 7 U.S.C. §608c(5)(C).

The proposal would, in effect, freeze the volume of pool-exempt milk marketed by producer-handlers at current production levels, or perhaps less in view of the monthly 3 million pound cap on pool-exempt milk. This aspect of the proposal would also fully address NMPF's claims that large dairy farms provide the prospect of a "new model of producer-handlers" that "can" disrupt a market and "could proliferate," with a "potential" to expand in numbers, which "could" undermine market-wide pooling.

In accordance with 7 CFR §900.22, we provide the following additional information and explanation concerning the proposal.

1. Explain the proposal. What is the disorderly marketing condition that the proposal is intended to address?

The proposal is explained above. For purposes of proposal consideration, we assume that USDA's preliminary investigation concludes that NMPF makes a case for existing or prospective disorderly marketing under the current regulatory scheme. If so, the alternative proposal represents an alternative means of addressing that marketing disorder. It will also avoid some disorder such as closing of producer-handler plants, inefficient flow of milk to local markets currently served by producer-handlers, reduced competition in the sale of packaged fluid milk products, higher prices to consumers with resultant loss in demand for fluid milk, that would likely result from adoption of NMPF's proposal without consideration of alternatives.

2. What is the purpose of the proposal?

The proposal, as indicated, is intended as a regulatory alternative to address the concerns expressed by NMPF and IDFA with reduced adverse impact on producer-handlers and the local consumer markets they serve. The proposal, if adopted as an alternative to the NMPF and IDFA proposals, would also avoid any

future need for producer-handlers to seek compensation from the producer-settlement funds or US General Funds for the considerable value of their plant blend income stream that would be intercepted, for a purported public purpose, under the NMPF proposal. *See, e.g., Rose Acre Farm v. United States*, 2007 WL 5177409 (Fed.Cl. 2007) (compensation for the taking of eggs for a public purpose, resulting in a producer receiving the lower value of breaker eggs for manufacturing rather than higher prices for table eggs).

3. Describe the current Federal order requirements or industry practices relative to the proposal.

Current requirements (7 C.F.R. §1124.10, and section _____.10 in other milk orders), along with industry practices, are described in detail in the 2006 decision on producer-handler issues in the Pacific Northwest. 71 Fed. Reg. 9430 (Feb. 24, 2006). These requirements and practices were previously described for all milk orders in USDA's final milk order reform decision. 64 Fed. Reg. 16026, 16037 (April 2, 1999)

4. Describe the expected impact on the industry, including on producers and handlers, and on consumers. Explain/Quantify.

The alternative proposal would retain status quo pool exemption for most existing producer-handlers' milk production, and there would be no current impact for that reason. Handlers with pool-exempt own-farm milk could not expand their exempt production in the future, thereby avoiding any significant concern of new disadvantage to competing handlers or significant future erosion of Class I contribution value to market-wide pools. Because the proposal would create some new limits on competition, consumers may see higher fluid milk prices, but not as high as elimination of competition if the NMPF proposals are adopted.

5. What are the expected effects on small businesses as defined by the Regulatory Flexibility Act (5 U.S.C. 601-612)? Explain/Quantify.

The proposal is specifically designed to provide a less burdensome regulatory alternative for small business plants operated by producer-handlers, in the event USDA is considering NMPF's proposal to eliminate producer-handlers. As shown in NMPF's own analysis in 2003 (ante, p. 3 fn. 2), a proposal like NMPF's would create a large, new, and destructive competitive disadvantage unique to small business milk plants currently operated by producer-handlers. The alternative proposal will mitigate this adverse effect.

6. How would the proposal increase or decrease costs to producers, handlers, others in the marketing chain, consumers, the Market Administrator offices and/or the Secretary? Explain/Quantify?

Because the proposal would maintain status quo pool-exemption for own farm milk, it would have little impact on costs in the current marketing chain. Some additional, but negligible, audit and verification work may be required of market administrators.

7. Would a pre-hearing information session be helpful to explain the proposal?

Almost certainly.

Alternative Proposal by Mallorie's Dairy, Inc.

I Add a new section 1000.10 to 7 C.F.R. 1000, General Provisions of Federal Milk Marketing Orders, or a new section _____.10 to each individual milk marketing order, as follows:

xxxx.10 Pool-exempt own-farm production of Distributing Plants.

Any handler operating a plant subject to regulation as a pool distributing plant, as defined in section _____.7 of any milk marketing order, or as a partially regulated distributing plant under any milk marketing order, may make a one-time election to exempt the handler's own farm milk production from the volume of producer milk receipts eligible to participate in the market-wide pool as "producer milk," and otherwise subject to producer-settlement fund payment obligations under sections _____.71 and _____.72 of the milk marketing order, or section 1000.76(b) of the General Provisions. Such election and exemption shall be subject to the following conditions and limitations:

- (a) Volume limitation for pool-exempt own-farm milk production. The volume of own-farm milk production that a distributing plant handler may elect to exempt under this section shall, for any month, be the lesser of -
 - (1) A monthly volume based on the daily average milk production marketed from the handler's own farm(s) during any three consecutive months of production, as designated by the handler and subject to verification by the market administrator, from January 2007 through February 2009, or
 - (2) A daily average production of 100,000 pounds times the number of days in the month to which the exemption may apply.Own-farm production of the handler in excess of the exempt volume shall be subject to producer-settlement fund payment obligations in the same manner as milk produced by any dairy farmer.
- (b) Limitations based upon prior operations of handlers eligible elect exemption for own-farm milk production. Handlers with own farm production are not eligible to elect pool exemption for such production under this section unless the handler operated a distributing plant supplied with milk from his own farm(s) during at least three consecutive months during the 24-month period immediately preceding the effective date of this section, and the distributing plant was either (i) a producer-handler plant, (ii) an exempt plant, or (iii) a non-pool plant during those months.
- (c) Limitations based upon common ownership in the handler's plant and farm facilities. As used in this section, "own farm" means any dairy farm(s) of the handler that is owned by the same person or persons who own and operate the handler plant facility, and their ownership in the farm(s) is at least 95 percent identical with their ownership in the handler. Additionally,
 - (1) Owners of the handler and associated producer shall not exceed 10 individual persons or owners of equitable interest in the handler or producer business entity,
 - (2) For purposes of this section, ownership held by members of a family shall be considered single ownership by one person. Members of a family for purposes of such single ownership include only: a spouse, a former spouse, and persons of lineal consanguinity of the first or second degree or collateral consanguinity to the fourth degree, and their spouses (or former spouses), and includes an

adopted child the same as a natural child and kindred of the half blood equally with those of the whole blood of the owner(s).

- (3) Property pledged or hypothecated in any manner to others shall nevertheless be considered "owned" if equitable ownership with management and control remain with the persons operating the plant and associated dairy farm(s).
- (d) Date upon which, and manner in which, the one-time election must be exercised. The market administrator shall provide timely notice in writing to handlers with own farm production who are or may be eligible to elect a pool exemption for such production under this section. The election for pool-exempt own farm production shall be exercised by an eligible handler by giving notice of election in writing to the market administrator, which notice shall contain facts upon which the handler claims to qualify under this section , on or before –
 - (1) Thirty days after the effective date of this provision, or
 - (2) For a handler with own farm production on the effective date of this provision, but without route disposition in any federal milk marketing area for twelve months preceding the effective date, thirty days following first route disposition in the marketing area, or fifteen days after notice by the market administrator, whichever is later.
- (e) Applicability of minimum classified prices to handlers with pool-exempt own farm milk. Exemption from payment obligations in §§ _____.71 and _____.72 for own farm milk under this section shall not constitute an exemption for own farm milk from compliance with minimum classified priced price obligations. For payment purposes, the handler will be deemed to have paid to its own farm a price for pool-exempt own farm milk equal to its butterfat and skim milk (or skim components) value, as provided by calculations for "handler's value of milk" in § _____.60 of the marketing order.
- (f) Waiver or loss of eligibility for pool-exempt own farm production. The own farm production of any handler
 - (1) who has failed to make the election provided by this section,
 - (2) who, after making the election, fails to conform with any limitation or requirement for such exemption, or
 - (3) who has given notice in writing to the market administrator that it no longer wishes to exempt its own-farm production from the pool,shall be regulated, pooled, and priced in the same manner as milk produced by any dairy farm not eligible for pool exemption, and the handler shall not thereafter be eligible to exercise the exemption provided herein.

II. Amend section _____.60 of each order by adding a new subsection to the end thereof to read as follows (this would be new section 1124.60(j) in the Pacific Northwest Order):

(j) For purposes of calculating the producer price differential in section _____.61, or a handler's obligation to or from the producer settlement fund in sections 71, 72, and 76, the value and volume of pool-exempt own-farm milk of the handler qualified for exemption pursuant to section _____.10 shall not be included as part of the "total value" of milk, "total hundredweight" of producer milk, or "total pounds" of milk components wherever those terms (or equivalent terms) are used in or incorporated by sections 61 and 71 through 76.

III. Amend 7 C.F.R. § 1000.14 (Other source milk) by adding a new subsection (d) thereto, to read as follows:

(d) Receipts of fluid milk products and bulk fluid cream products from any dairy farm eligible to market pool-exempt own-farm milk pursuant to § _____.10, except with respect to such receipts by the distributing plant owned in common with the farm as described in § _____.10.