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UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

In the Matter of:	)	Docket Nos.
	)	AO-14-A78, AO-388-A23,
Milk in the Northeast, Appalachian, Florida,	)	AO-356-A44, AO-366-A52,
Southeast, Upper Midwest, Central, Mideast,	)	AO-361-A44, AO-313-A53,
Pacific Northwest, Southwest, and Arizona	)	AO-166-A73, AO-368-A40,
Marketing Areas	)	AO-231-A72 and AO-271-A44,
	)	DA-09-02, AMS-DA-09-0007

BRIEF AND PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

SUBMITTED JOINTLY BY

**PENNSYLVANIA ASSOCIATION OF MILK DEALERS,
NORTHEAST DAIRY FOODS ASSOCIATION,
ANDERSON ERICKSON DAIRY COMPANY, PRAIRIE FARMS DAIRY,
DEAN FOODS COMPANY, NATIONAL DAIRY LLC,
SHAMROCK FOODS COMPANY, SHAMROCK FARMS
AND PARKER FARMS
("THE HANDLER COALITION")**

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Attorneys for the Handler Coalition

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I. INTRODUCTION

A Coalition of fluid milk processors and their trade associations and dairy farmers file this Brief and Proposed Findings of Fact and Conclusions of Law in support of proposals to eliminate, or at least significantly curtail, the so-called producer-handler exemption under Federal Milk Marketing Orders ("FMMOs") promulgated and administered by the United States Department of Agriculture ("USDA"). The members of this coalition are: The Pennsylvania Association of Milk Dealers ("PAMD"), the Northeast Dairy Foods Association ("NDFA"), Anderson Erickson Dairy Company ("AE"), Prairie Farms Dairy, Dean Foods Company ("Dean"), National Dairy Holdings LP now known as National Dairy LLC ("National Dairy"), Shamrock Foods Company ("Shamrock"), Shamrock Farms and Parker Farms. Prairie Farms Dairy is a dairy farmer owned cooperative that operates a number of regulated processing plants in addition to representing its members as dairy farmers. Shamrock Farms and Parker Farms are dairy farms that market their milk exclusively to Shamrock and are thus "pool producers" under the Arizona order. The remaining members of the coalition are, or represent, exclusively fluid milk processors subject to the pricing and pooling provisions of the FMMOs.

Fluid milk processors, known by USDA as "handlers" acquire raw milk from dairy farmers known as producers. Federal orders require these handlers to pay uniform class prices for their milk, and through the producer-settlement fund, create a "blend price" payable to all producers that is also uniform as to all producers. "The uniform pricing for producers must be combined with a pooling system for handlers in order *to avoid inequities*." *United Dairymen of Ariz. v. Veneman,* 279 F.3d 1160, 1162 (9th Cir. 2002). The underlying rulemaking proceeding herein is essentially a single issue hearing that is exceedingly

important because exempt producer-handlers are or readily can adversely affect the market for milk in and throughout the FMMO system. This is creating or will likely create in the near future the very inequities that the FMMO system is designed to prevent.

From the Handler Coalition's perspective, the proper treatment of producer-handlers is the single most important issue facing the federal order system today as it reaches to the very heart of the system—whether and how to assure uniformity by regulating some, or all, producer-handlers as handlers under the FMMO system. As will be conclusively demonstrated, the producer-handler regulatory exemption has no basis in the underlying statute and can only exist, if at all, pursuant to historic administrative convenience justifications. As such, proposals considered at the rulemaking hearing to restore equality and uniformity to the federal order system can and should be adopted as soon as possible. Moreover, if USDA is prepared to eliminate the producer-handler exemption in its entirety, then the Handler Coalition, except NDFA whose handler members are regulated on the Northeast Milk Marketing Order ("Order 1"), are prepared to accept an increase in the exempt plant limit from 150,000 to 450,000 pounds. NDFA opposes any increase in the exempt plant limit in Order 1 because of unique marketing circumstances in that order as discussed below. If USDA, however, adopts the National Milk Producers Federation ("NMPF") alternative proposal or any other proposal which does not eliminate the producer-handler exemption in its entirety, whether or not a grandfather provision is adopted, the Coalition would then oppose any increase in the exempt plant limit presently set at 150,000 pounds. Finally, of course, if USDA declines to act regarding producer-handlers in this proceeding, then the exempt plant limit should not be increased at all.

Under present federal milk order provisions, producer-handlers escape the uniform regulation required by the FMMO system. Today, separately or together, producer-handlers are, or have been in areas where some limits now exist, significant in a number of FMMOs and throughout the system. They can and do sell to major wholesale and retail outlets as price leaders. They can and do substantially affect the market for fluid milk products. They can and do have market sales removed from the regulated industry resulting in unequal treatment of the remaining competitors. They can and do negatively impact the prices paid to remaining dairy farmers. They can and do use various methods, including price cutting when they have surplus, to "dispose" of their surplus in a number of ways. They thus benefit on both sides of the regulatory equation—not paying the same uniform class prices imposed on regulated handlers and not receiving the same uniform prices paid to producers. This undermines the regulatory system entirely and is counter to the purposes of the Agricultural Marketing Agreements Act ("AMAA").

Moreover, the historic justification for USDA not regulating producer-handlers simply does not apply given the size and scope of these operations today. And it is not as if the regulatory system in question is brand new or subject to a lack of clarity as to what is demanded by the statute. "Uniform" prices paid by all handlers to all producers has long been mandated. *U.S. v. Rock Royal Co-op., Inc.*, 307 U.S. 533 (1939). Yet uniformity has been and is defeated completely by the present system that permits a certain "faction" to avoid full regulation while all others may not. Such lack of uniformity is not justified by the enabling legislation or the U.S. Constitution. It is precisely the kind of "faction" condemned by James Madison in the *Federalist Papers* [1787], no. 10 ("faction . . . adverse to the rights of other citizens, or to the permanent and aggregate interests of the community"):

> To secure the public good, and private rights, against the danger of . . . faction, and at the same time to preserve the spirit and form of popular government, is then the great object to which our inquiries are directed.

Id.

In reality, the Secretary of the United States Department of Agriculture ("Secretary") in recognizing the importance of this issue, could and should retrace his steps and restore orderly marketing through the elimination of the statutorily unjustified producer-handler exemption entirely. Notwithstanding clear statutory instruction, the Handler Coalition, as proponents of uniform treatment, is nonetheless prepared to recognize that administrative efficiency may still play a role in the Secretary's decision-making (i.e., that a genuine *de minimis* rule may be permissible). This is why some in the Handler Coalition can support a contingent and limited increase in the exempt plant limit to 450,000 pounds in orders other than Order 1. As discussed below, some members of the Handler Coalition can also live with the proposed 3,000,000 pounds limit (hard cap only). These bright line tests would restore order in most circumstances (there would still be regulatory disruption as the result of not regulating smaller operations) and restore handler and producer confidence in a system that depends not only on actual uniform treatment, but the perception of uniform treatment of the regulated industry. Failing that, regulated handlers will be faced with the following choices: continuing to comply with the regulatory program while others do not; joining the ranks of the favored few; or looking to enforce their equal protection and statutory uniform treatment rights as they may separately determine. The enormous question before the Secretary then is nothing short than a matter of survival for the FMMO system especially in the Orders not already subject to a 3,000,000 pound limit. The industry is watching and waiting with baited

breath. Will the Secretary have the will and desire to retrace his steps and fix the problem, or will the Secretary and industry through a failure of determination, lack of political will or misapplied legal analysis fail to fix this unjustified and extralegal regulatory loophole?

II. SUMMARY OF CRITICAL FACTS

- "The difference between the Class I price and the blend price is a reasonable estimate of the pricing advantage producer-handlers enjoy even if it is not possible to determine the precise pricing advantage of any individual producer-handler."
- The volume of fluid milk products sold by producer-handlers, adjusted for changes in regulation, has increased system-wide by more than 50% since 2004.
- Producer-Handlers alone or in the aggregate can have a significant impact on the market.
- Producer-Handlers at 3 million do have substantial impact on the market.
- Producer-Handlers selling to retail customers that set the market price have substantial impact on the market.
- Large producer-handlers are few and can be regulated with administrative efficiency.
- Producer-handlers today use various means to balance their milk supply – e.g. price cutting and selling to retail customers who then balance supplies for producer-handlers.
- Large retailers know about the producer-handler exemption and are using that market option with a willingness and ability to help balance the producer-handler supplies by also purchasing milk, sometimes using the same label from regulated suppliers.[1]
- Provisions regarding sales of the same or similar product to the same customer are not adequate to regulate large scale producer-handlers selling to large scale retail customers when, for instance, the Secretary's designees determine that each store is a retail customer rather than the integrated retail customer.
- Regulatory fact – the option for a "soft cap" does not lead to uniform pricing and is not administratively convenient. It has also led to a "moveable feast" in California and constant disputes.
- Claims that regulation of producer-handlers, especially large producer-handlers, will put such entities out of business must be viewed in light of the same claim made in 2003-2004 by the producer-handlers who objected to the 3,000,000 pound limit for Arizona and the Pacific-Northwest orders. All such entities were in business in May 2009 when this hearing was conducted.

[1] Let the Handler Coalition be absolutely crystal clear—there is no moral, economic, business or other criticism of any customer who naturally seeks out a legally available less expensive milk supply. Indeed any such entity owes a duty to its owners (whether or not it is publicly owned) to maximize the value of the Company. The Handler Coalition concern is not directed at customers, but rather at USDA for having created an opportunity for any and all to use.

III. PROPOSED FINDINGS OF LAW

THE LEGAL FRAMEWORK AND REGULATORY HISTORY

The Handler Coalition respectfully requests that the Secretary reach the following conclusions of law pursuant to 5 U.S.C. § 557(c):

A. The Agricultural Marketing Agreement Act Of 1937

1. "Uniform" class payments by handlers (including handlers that are also producers) to producers.

The unassailable legal fact is that there is no provision within the Agricultural Marketing Agreement Act of 1937 (7 U.S.C. § 601 *et seq.*) for any exemption whatsoever for any handler whether a producer-handler or an exempt plant. In fact the opposite is true. Prices shall be "uniform" as to "all handlers." 7 U.S.C. 608c(5)(A). Congress did not say that prices "may" be uniform or "shall be similar." Congress did not say that such prices shall apply only to "some" handlers. Instead, from adoption of this provision, Congress directed that: "[s]uch prices shall be uniform as to all handlers" subject to an express list of limited "adjustments." *Id.*

Commonly accepted rules of statutory construction require the plain meaning be applied to these words. *Tex. Food Indus. Ass'n v. USDA*, 81 F.3d 578, 582 (5th Cir. 1996) (elementary rules of statutory construction require that "the words of a statute will be given their plain meaning absent ambiguity."). BLACK'S LAW DICTIONARY 1530 (6th ed. 1990), defines uniform: "[c]onforming to one rule, mode, pattern, or unvarying standard; not different at different times or places; applicable to all places or divisions of a country." What is striking about this definition is that the term "uniform as to handlers" ought to mean the same thing as "uniform as to all handlers." The fact that Congress went out of its way to say "all handlers" after the word "uniform" leaves no room for doubt whatsoever under the

statutory construction doctrine that all words in the statute are to be given their plain effect and meaning. *United States v. Menasche,* 348 U.S. 528, 538-539 (1955); *Coyne & Delaney Co. v. Blue Cross & Blue Shield of Va., Inc.*, 102 F.3d 712, 715 (4th Cir. 1996) ("Absent clear congressional intent to the contrary, we will assume the legislature did not intend to pass vain or meaningless legislation") (quoting *Gulf Life Ins. Co. v. Arnold*, 809 F.2d 1520, 1524 (11th Cir. 1987)). But Congress went a step further providing an express list of exceptions to the "uniform as to all handlers" rule. Congress provided a list of "adjustments." Note again that the existence of the word "adjustment" as opposed to "exceptions" means that the initial calculation shall be uniform and then that uniform calculation is adjusted. The Black's Law Dictionary definition for adjust is "[t]o determine and apportion an amount due." BLACK'S LAW DICTIONARY 43 (6th ed. 1990). For instance, two handlers (with identical uses of milk and all other things being equal except one handler's plant is in Des Moines and the other plant is in St. Louis) will pay a uniform class price adjusted only for the difference between the locations of the two plants (i.e., 20 cents per cwt—the difference between $1.80 and $2.00). 7 C.F.R. § 1000.52 (2009). Congress did not use the term "exception" anywhere in the statute.

Using standard rules of statutory construction (*Reiter v. Sonotone Corp.*, 442 U.S. 330, 338-339 (1979) (strained construction cannot rob words of their ordinary meaning or convert nouns into adjectives), the fact that Congress expressly defined a list of adjustments (rather than exceptions) and nowhere included an exemption or exception or even a reference to producer-handlers, leads to the conclusion that no such exemption was contemplated by Congress. This doctrine "expressio unius est exlusio alterius" is defined as follows:

> A maxim of statutory interpretation meaning that the expression of one thing is the exclusion of another. Mention of one thing implies exclusion of another. . . . Under this maxim, if statute specifies one exception to a general rule or assumes to specify the effects of a certain provision, other exceptions or effects are excluded.

BLACK'S LAW DICTIONARY 581 (6th ed. 1990) (internal citations omitted). This leads to the conclusion that producer-handlers were never exempted by Congress from full regulation. But just to be certain, Congress added yet another term in another paragraph of 7 U.S.C. § 608(c)(5):

> (C) In order to accomplish the purposes set forth in paragraphs (A) and (B) of this subsection (5), providing a method for making adjustments in payments, as among handlers (including producers who are also handlers), to the end that the total sums paid by each handler shall equal the value of the milk, purchased by him at the prices fixed in accordance with paragraph (A) hereof.

Leaving to Section III.A.4. in this Brief the definition of the term "purchased by him," Congress' inclusion in the minimum price setting (and pool creation) of "producers who are also handlers" reinforces the only conclusion that producer-handlers will be subject to the same regulation as handlers who are not producers. Otherwise the language in the parenthetical must be read out of the statute. And, it bears repeating, under standard, uncomplicated rules of statutory construction, every word is to be given effect and meaning. *Menasche, supra.*

2. The Secretary's Administrative Convenience Exemption Of Producer-Handlers.

So just where does the producer-handler definition come from since it is clearly not authorized by statute? The simple answer is that it has evolved from the rule "de minimis non curat lex"—literally "[t]he law does not care for, or take notice of, very small and

trifling matters." BLACK'S LAW DICTIONARY 431 (6th ed. 1990). Or as Cicero might have noted: "cui bono fuerit."[2] It was to the advantage of the Secretary not to bother with those processors who were at the time regulation first began *de minimis*. And that is precisely what happened in the beginning of the federal order program. The USDA publication *Early Development of Milk Marketing Plans*, Marketing Research Report No. 14 (May 1952) (an official publication of the Secretary and not created for this proceeding 57 years later), makes abundantly clear that administrative difficulties in the early years prevented USDA from pursuing small processors (who at that time were almost all also producers). (Official Notice was taken of this publication. Ex. Twenty Three, p. 3; Cryan Tr. 3970) Three hundred and thirty five producer-distributors (the alternative term for producer-handlers) represented 50% of the Greater Kansas City sales area. *Id.* Imagine without computers and all of our other technology that has developed since then how impossible this made any enforcement of the program. Even then, legal critics (within the Department itself) recognized that the exemption was unfair to the other dairy farmers and **discriminated** against those distributors who were subject to the order. *Id.* p. 39.

Thus, the USDA created "exemption" has no statutory basis and must be understood in the context of the *de minimis* rule. And the Secretary knows (or should know) that this is the real rule since his predecessor enunciated it in 1965:

> The need for regulating producer-handlers in this [Puget-Sound] market has been considered at a public hearing on previous occasions. At those times, it was not found necessary to pool and price the milk of such persons to achieve the purposes of the statute authorizing Federal orders. *It should be made clear at this point, however, that the Secretary is empowered by the Act to impose through an order regulation*

2 "To whose advantage was it?" *Pro Milone,* IV, 11.

> *of producer-handlers in their capacity as handlers, if justified by prevailing market conditions.*

30 Fed. Reg. 15152, 15154, c. 2-3 (December 9, 1965) (emphasis added). Without using the phrase, the Secretary applied a *de minimis* exception to the general rule for uniform pricing. Handlers who were also producers were expected to pay just like any other handler: (1) if they had an impact on the market (1933 Agricultural Adjustment Act ("AAA")); or (2) as a hard and fast rule (1935 and 1937 AMAA).

Opponents of regulation may point to oft repeated Congressional statements in a number of AMAA amendments: "The legal status of producer-handlers under . . . the [AMAA] shall be the same after the amendments made by this title take effect as it was before the effective date of such amendments." So what? Leaving aside the fact that this language has not been included in the last three Farm Bills, the language is nothing more than a statement that the AMAA is not amended as to producer-handlers by those Farm Bills. Since the original AMAA clearly contemplated regulation of producer-handlers just as all handlers, the statement has no legal bearing on today's proceeding.[3] If anything it reinforces Chester R. Davis (the original Administrator of the AAA from 1933): "If the volume is large enough to be an important factor in the market, then they would be expected to come under the market plan." Hearings on H.R. 5585, 74th Cong. 1st Sess. at 14. "If . . . he became a large enough commercial operator he would have to be subject to the same regulation." *Id*. at 44.

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[3] The actual words of Congress do not constitute recognition of the exemption and are merely a restatement that their status is "unchanged." Unchanged from what? Unchanged by the statute from the fact that uniform pricing applies to all handlers. The provision merely is an expression that nothing in that particular enactment affects producer-handlers. But it does not create an exemption either. Regardless, even if Congress was somehow blessing the "exemption"—the only exemption that could be blessed was *de minimis non curat lex.*

3. **Legislative History Of The AMAA And Its Predecessor Legislation.**

The sections of AMAA of 1937 discussed above grew out of series of hearings in 1935 on H.R. 5585 before the Committee on Agriculture, House of Representatives, 74th Congress, 1st Sess. The instrument of regulation proposed by H.R. 5585 was that of a "license," as in the 1933 AAA. At a later stage in the development of the legislation the term "license" was changed to "order". A substitute bill was later submitted as H.R. 8492 when it came before the Senate.

During the House hearings on the bill, considerable discussion focused on Sections 608c(5)(C) and 608c(l3)(B)("No license ... shall be applicable to any producer in his capacity as producer") because of concern by Committee members that nothing in the bill should impose any limitation on producers. Responding to that concern, Chester C. Davis, Administrator, Agricultural Adjustment Administration, explained the relationship between 608c(5)(C) and 608c(13)(B) as follows:

> No matter what anyone has said or may say, licensing of producers is definitely not contemplated … except the licensing of a producer acting in the same capacity as a commercial enterprise; that is, where a producer also is a large distributor or engages in business in such volume that his cooperation is necessary to carry out the plan; in that case he would be licensed, not as a producer but as to his capacity as a handler and processor. Hearings on H.R. 5585, 74th Cong., 1st Sess. at 14.

During further questioning of Mr. Davis, the following colloquy occurred:

Mr. Fulmer:

> What do you propose to do with the farmer who produces and processes his own farm products?

Mr. Davis:

> If the volume is large enough to be an important factor in the market, then they would be expected to come under the market plan just the same as the man who buys and sells. *Id.* at 27.

Mr. Beam:

> Now you are talking about this licensing feature with reference to the farmer himself, in the event that he raises a certain amount of his commodity, whereby he would dispose of his product. I would just like to get clear in my own mind how far that would go, Mr. Davis.

Mr. Davis:

> In the case of a milk producer . . . it would not affect him until he became an important commercial factor in the market; . . . but when he becomes an important commercial factor he will have to abide by the same conditions as the other men marketing milk.
>
> Now, the man who is just a producer of milk for the market and is not a considerable factor - we have attempted to arrive at a figure which would exempt him from any license. Let me say the man, for instance, sold 250 quarts of milk, just some arbitrary figure. He would be free from any license up to that amount. But if he expanded his operation beyond that point he would be subject to the same license provision as the other commercial operator.

Mr. Gilchrist:

> I would like to have your comment upon the question as whether . . .producers are to be required to take out a license if this bill is passed . . . I wanted that matter cleared up for the country and the Congress.

Mr. Davis:

> Now, Mr. Gilchrist, as an illustration of the point I referred to, the producer distributor of whole milk . . . I talked to the Chief of the Dairy Section and I find that in many of the milk licenses [under the 1933 Act] in markets where the producer-distributor is an important factor ... particularly in the MidSouth and the South, the producer-distributors handle more than 50 percent of the total volume of milk handled in the market, and I find that it has been the practice to exempt from license any man who sells less than 250 quarts of milk a day to consumers direct. . . . The man who himself is a distributor shall be subject to a license to market his milk under the license plan only in case the volume he handles shall exceed 250 quarts . . . being about a wagon load of milk; that is, where he has just one wagon . . . in a neighborhood or city, he has not been considered important enough as a commercial operator to require a license. But if he gets beyond that and runs a fleet of delivery wagons, . . . then he is considered a distributor of milk and should be subjected to a license as a distributor, not as a producer. *Id.* at 51

Mr. Goodwin:

And do you presume, under the license plan, to have in mind what you may call the "producer-processor"; that is, are you going to reach the farmers of this group through that combination of producer-processor item?

Mr. Davis:

When the producer-processor becomes an important commercial figure in the market, then he is licensed as a producer-processor in competition with other producer-processors, and not as a farmer, but in his capacity as a distributor, . . . and it would be thoroughly impractical to carry that down to the point where we would attempt to license a man unless the volume of his distribution becomes an important factor in that market, such as to bring him under the license. *Id.* at 54.

When the bill reached the Senate, identified as H.R. 8492, the following colloquy occurred on July 15, 1935, appearing in the Congressional Record at page 11138:

Mr. Copeland:

In up-state New York a great many of the milk handlers are producers and distributors. According to the amendments as they are set up, if I am correctly advised, every one of those who may directly . . . affect interstate commerce would be subject to all the orders promulgated by the Secretary of Agriculture. These producers and distributors would be required to make adjustments in payments by being compelled to contribute to the maintenance of an adjustment or equalization fund and to pay their pro-rata share of the expenses to the authority or agency which administers the order. Therefore, the distributors who have an additional investment in not only producing their own milk, but also in pasteurizing the milk . . . would have to share their position in the market with other producers. Is that correct?

Mr. Murphy:

Yes; that is correct. (79 Cong. Record 11, 138 (1935).)

As explained by Senator Byrd later during debates on the floor of the Senate: “if a producer handles his own milk, he becomes a handler and therefore is subject to all the rules and regulations affecting handler.” 79 Cong. Rec. 11, 140 (1935).

Thus, as is plainly revealed by the foregoing review of the legislative history and excerpts of the debates on the bill that became the Agriculture Act of 1935, reenacted as the AMAA of 1937, it was the clear intent of the Congress that enacted Section 608c(5)(C) of AMAA that "producer-handlers" be regulated in the same manner and to the same extent as the AMAA regulates other handlers, excepting from full regulations only such "producer-handlers" who do not constitute "commercial factors" in the market.

4. "Sale of milk" as meaning "Acquired for marketing" - ***Rock Royal Co-op.*** and its progeny.

Opponents have also asserted and may be expected to assert anew that producer-handlers cannot be said to "purchase" milk from themselves. This comment runs counter to the legislative history discussed above in which it was made abundantly clear on the floor that producers who were also handlers would have to participate just as any other handler. However, we need not rely merely on legislative history for this conclusion. Decades of case law reaches the same conclusion. Opponents would have the Secretary ignore 70 years of case law. In the early days of the federal milk order program, cooperatives that acted merely as their members' agents, and did not take title to milk (as with almost all cooperatives today) in the sale of their members' milk, asserted that they did not "purchase" milk under § 608c(5)(A) and (C). Thus, they concluded they were not required to pay minimum prices or account to any federal order equalization fund. But in language heretofore unknown apparently to opponents' expert, the U.S. Supreme Court disposed of this argument: "[a]s here [§ 608c(5)(A)] used the word 'purchased' means 'acquired for marketing.'" *U.S. v. Rock Royal Co-op., Inc.*, 307 U.S. at 580. The cooperative was thus required to account to the equalization fund putting it on an equal footing with other regulated handlers.

The enabling statute also makes clear (beyond § 608c(5)(C)) that these persons are handlers. Section 608c(1) defines "handlers" as being "processors, associations of producers, *and others engaged in the handling of any agricultural commodity* or product specified in subsection (2) of this section." (Emphasis added). Thus, when a U.S. District Court in California was confronted with this issue it concluded that a brewer who consumed all of the hops which it grew in the brewing of its beer was a handler. *Acme Breweries v. Brannan*, 109 F. Supp. 116, 118 (N.D. Cal. 1952) (the specific exemptions for producers and retailers "indicates that it was intended that . . . regulation should fall upon those who do something with . . . hops other than to grow them or to sell them at retail.").

The final piece of the overwhelming legal evidence supporting regulation remains Congress' inclusion in § 608c(5)(C) of the special parenthetical "(including producers who are also handlers)." As interpreted correctly by both the Third and Fifth Circuits over 45 years ago, "[t]he more reasonable construction [of the section] is that the parenthetical phrase was meant to reach a producer-handler who handles or distributed milk which he himself produces." *Ideal Farms, Inc. v. Benson*, 288 F.2d 608, 615 (3d Cir. 1961), *cert. denied*, 372 U.S. 965 (1963); *accord Freeman v. Vance*, 319 F.2d 841 (5th Cir. 1963), *cert. denied*, 377 U.S. 930 (1964).

Congress has known for 40-50 years that USDA's interpretation (and the Courts') was that producer-handlers could (and in many cases should) be regulated. Given Congress' interest in the overall subject of the dairy industry and given the insertion of language regarding producer-handlers, if this interpretation were incorrect or the Court's conclusion wrong, Congress has had plenty of opportunity to fix it. It hasn't, and thus the Court's construction must stand. *Burlington Indus., Inc. v. Ellerth*, 524 U.S. 742, 763-64 (1998)

(Congress' failure to alter legislation interpreted by earlier judicial decision, binds court to follow such previous judicial interpretation); *Neal v. United States*, 516 U.S. 284, 295 (1996) (". . . we give great weight to *stare decisis* in the area of statutory construction [because] 'Congress is free to change this Court's interpretation of its legislation.'" (*quoting Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977)).

5. The Milk Regulatory Equity Act does not limit USDA Action.

Some Opponents suggested at various times during the hearing that the Secretary was limited in his ability to act by the terms of the Milk Regulatory Equity Act. 7 U.S.C. § 608c(5)(M)–(O) ("MREA"). Balderdash. The two operative provisions of the MREA, subparagraphs (M) and (N) expressly impose special obligations "notwithstanding any other provision of this section." Thus, the obligations imposed on Orders issued by the Secretary are required to contain the terms and conditions of paragraphs (M) and (N).

Paragraphs (M) and (N) expand, in limited circumstances, the regulation of producer-handlers. For instance, paragraph (M) expands FMMO pricing to handlers including some producer-handlers on sales into states with minimum pricing. There is an exemption in section (M)(iv) within this expansion of regulation for producer-handlers under 3 million pounds. However, this exemption modifies only the expanded regulation of handlers under section (M), which includes producer-handlers under section (M)(ii). The exemption does not expand or contract the general definition or general treatment of producer-handlers established by the Secretary. As such, Congress has acceded to the producer-handler definition set by regulation and made no provisions to lock in that definition by statute. Accordingly, if the Secretary chooses to modify that definition or remove the definition altogether, nothing in the MREA would prevent the Secretary from doing so.

In addition, subparagraph (N) expands the regulation of producer-handlers by stating that certain plants shall not be exempt from the Order provisions of Order 131. It does not prohibit the Secretary from concluding that other facilities should not also be exempt from the pricing and pooling provisions of the Order.

Even if the Secretary is limited as to the Arizona Order 131 by the MREA, subparagraph (O) absolutely and completely clarifies that no such limit applies to any other part of the country—"subparagraphs (M) and (O) shall not be construed as affecting, expanding, or contracting the treatment of producer-handlers." Congress unequivocally and absolutely stated that it was not acting in the MREA in any way whatsoever so as to limit the Secretary's regulatory treatment of producer-handlers outside of Order 131 and outside the treatment of handlers, whether or not producer-handlers, who sold from Federal Milk Orders into state areas (e.g. Montana, California). Any other construction violates every rule of statutory construction and is a deliberate effort to avoid reality.[4]

B. The U.S. Constitution's Due Process And Equal Protection Clauses As Applied In *In Re: Kraftco,* AMA Docket No. 4-15 (1974) Require Action

Thirty years ago, the Secretary was faced with a similar uniform price problem. Processors who purchased from a cooperative obtained "free" quality control work for raw milk while Kraftco, purchasing milk from independent farmers, paid the minimum price for

[4] While the Handler Coalition absolutely supports elimination of the producer-handler exemption, application of the Equal Protection arguments made above in light of this rulemaking and opportunity for the Secretary to revisit the producer-handler issue post-MREA, suggests that the MREA's establishment of a 3,000,000 pound maximum threshold for certain producer-handlers under subparagraph (M) (e.g. those located in Federal Milk Marketing Areas but selling into state system-wide pooling areas) must become the maximum limit throughout federal orders. Congress could well distinguish between various Orders as it did in adopting the MREA. And the Secretary has the opportunity to close whatever Equal Protection arguments may have been opened (as to producer-handlers located in other Orders selling into state marketing areas) by Congress in adopting the MREA and should seize that opportunity. Nothing prevents the Secretary from declaring that the producer-handler exemption would be eliminated entirely as that would then apply equally to all producer-handlers.

milk, but then deducted a charge for the quality control work that it performed. The financial impact on the handlers was the same, and Kraftco argued that the financial impact on the producers was likewise the same. However, the market administrator filed underpayment notices against Kraftco, but served none on the processors receiving the milk from the cooperative together with the "free" quality control services. Kraftco responded by filing a 15-A proceeding asserting, *inter alia*, that the imposition on it of minimum prices resulted in non-uniform prices since its competitors received the same service for free. Thus, Kraftco argued the Secretary was improperly ignoring the statutory mandate to impose uniform prices in derogation of both the AMAA and the U.S. Constitution.

After Kraftco prevailed before the Administrative Law Judge, the Secretary appealed. The Judicial Officer, in the only recorded instance of its kind in the history of the much litigated federal order program, issued a Tentative Decision and Order vacating the underpayment notices and remanding the proceeding back to the Administrative Law Judge. *In re: Kraftco Corp.* AMA Docket No. M 4-15 (January 7, 1974). The case then settled. The Judicial Officer recognized that the uniform pricing and payment provisions were not being uniformly enforced. Even though the general rule is that Kraftco could not defend on the grounds of others' failure to abide by the law, the Judicial Officer recognized the fundamental unfairness of the situation and in striking language applicable to today's situation concluded:

> However, if through a mistaken interpretation of the Order, or otherwise, the Market Administrator enforced the Order properly only against one handler, or a small number of handlers, and failed to enforce the Order properly against most of the handlers subject to regulation, a serious question would arise under the Due Process Clause of the Fifth Amendment to

> the Constitution and under the uniformity provisions of the Agricultural Marketing Agreement Act of 1937.
>
> To use an extreme illustration, if the uniform minimum Order price required to be paid for the month of January 1970 was determined by the Market Administrator to be $5, but all handlers paid producers only $4.98; and the Market Administrator sent an underpayment notice only to one handler in the market; that would raise a serious question under the Due Process Clause and under the uniformity provisions of the Act.

Id. at 100. The Judicial Officer concluded, as a matter of law, that a difference of 2 cents per cwt or 0.4% of the total price not being paid by all handlers was *an extreme* illustration of a non-uniform price.

But the Judicial Officer, in this decision, went even farther. The Secretary (through the Market Administrator) had argued that there was nothing wrong with the producers performing the quality control work themselves or hiring someone on their behalf to perform those services. As applied to this proceeding the Judicial Officer's rebuke to the Secretary is a knock-out punch to the opponents herein:

> If the Market Administrator were correct . . . then producers could themselves perform any other handler function, or hire someone else to perform any other handler function without violating the Order's minimum price requirements. Carrying that view to its *ultimate extreme, the producers could completely run a handler's milk plant*, substituting themselves for the handler's employees engaged in processing or distributing milk; or the producers could hire someone else to perform all of such handler's functions, without violating the Order's minimum price requirements.
>
> Such a construction of the Act and Order would completely destroy the uniformity of pricing required by the Act. The Agricultural Marketing Agreement Act expressly requires that all handlers be treated uniformly under a milk Order. The Act requires all Orders to fix 'minimum prices for such use classification which all handlers shall pay * * *. Such prices

> shall be uniform as to all handlers' (7 U.S.C. 608c(5)(A)). The Act also provides for the 'payment to all producers and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered' (7 U.S.C. 608c(5)(B)(ii)).
>
> 'The Congressional policy of uniformity of pricing as expressed in sections 8c(5)(A), (B) and (C) of the act is applicable to all handlers subject thereto unless *expressly* exempted by the provisions of the act. A handler is not to be allowed to gain a competitive advantage by virtue of a disregard of the minimum uniform pricing provisions of an order.' *In re Bay State Ice Cream Company*, 23 Agric. Dec. 1043, 1055 (1964).

Id. at 95-96 (emphasis added). And yet, large producer-handlers have been permitted to substitute for the handler's functions and has been allowed to gain a competitive advantage by virtue of a disregard of the minimum pricing provisions of the order. The Secretary's Judicial Officer's decision 30 years ago was right then and, if applied now, cries out for implementation immediately of a long overdue limitation on producer-handlers.

Therefore, the failure of the Secretary to implement and enforce the uniform pricing provisions violates the AMAA and the due process and equal protection clauses of the United States Constitution. The failure of the Secretary to act, especially in light of the proposed findings of fact below, would also sound disturbingly like *Kraftco* in light of the obvious discrimination arguments. Nonetheless, the Secretary's failure to act after this hearing would demonstrate beyond peradventure that there is no intention to implement and enforce minimum pricing provisions against proponents' competitors; and therefore, the Handler Coalition would be actively discriminated against at that time. There is nothing in the AMAA that permits this result.

The uniformity requirements of the Agricultural Marketing Agreements Act would be rendered null, void and meaningless if the Secretary (or a Market Administrator) is permitted by mistake, or otherwise, to enforce one provision or another against only one handler or a against only a group of handlers. *Kraftco* at 100. Ultimately the federal order system stands for uniformity, and a lack of uniformity caused by the very officers sworn to implement and enforce it would render the program meaningless.

The constitutional arguments are no less formidable to the opponents' position. As early as 1886, the United States Supreme Court has consistently and repeatedly held that the government cannot be permitted to enforce its laws with an unequal hand so as to discriminate between persons in similar positions to their detriment. In *Yick Wo. v. Hopkins*, 118 U.S. 356 (1886), an unanimous Supreme Court struck down enforcement against Chinese operators of wooden laundries of a San Francisco ordinance which made it unlawful to operate a laundry without the consent of the board of supervisors except in a brick or stone building. Not surprisingly given that era and the discrimination against Chinese, the only facilities against whom the ordinance was ever enforced were Chinese:

> Though the law itself be fair, . . . yet, if it is applied and administered by public authority with . . . an unequal hand, so as practically to make unjust and illegal discriminations between persons in similar circumstances, material to their rights, the denial of equal justice is still within the prohibition of the constitution.

Id. at 373-374.

The Handler Coalition consists of persons entitled to U.S. Constitutional protection with respect to these equal protection and due process arguments. *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (state may not lawfully impose greater tax burden on out-of-

state corporation as opposed to in-state corporation). Just as Metropolitan Life could not be taxed by Alabama as a non-resident corporation differently from a resident corporation, the Secretary may not continue to cause proponents to pay minimum prices or contribute to the federal order equalization fund when their competitor does not face the same obligations merely because the competitor is both a producer and a handler. Since the AMAA requires all handlers, including producers who are handlers, to make payments to the equalization fund, the opponents are incapable of making any kind of showing regarding a rational basis for any continuing discrimination against members of the Handler Coalition. *See Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359-360 (1973); *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526-527 (1959). Based upon the underlying legislation and discussion regarding the statutory authority above, the dual treatment of handlers and producers who are also handlers cannot be sustained by the underlying legislation or the U.S. Constitution. *W. & S. Life Ins. Co. v. State Bd. of Equaliz. of Cal.,* 451 U.S. 648, 674 (1981).

C. "Uniform" Application Or Treatment Under Other Federal Regulatory Programs

It comes as no surprise that other regulatory programs involving price or rate setting with similar statutory mandates regarding uniform pricing have reached litigation results that bolster the arguments made above. This is important because the dairy industry tends to think of itself in isolation from the remainder of the legal world, but it is not. The same principles apply in American jurisprudence generally. The most striking example is the Federal Energy Regulatory Commission ("FERC") which is charged with rate setting for electrical and gas companies delivering service through common or company owned lines or pipelines. In its rate setting, FERC is mandated to require that customers be treated uniformly. So for instance, when a power company attempted to charge new customers for

the cost of expansion of service, the D.C. Circuit affirmed a FERC order that allocated the costs of expansion across all pipeline capacity so that the unequal treatment would not provide a benefit solely based upon how long customers had been receiving gas. *Battle Creek Gas Co. v. Fed. Power Comm'n*, 281 F.2d 42 (D.C. Cir. 1960).

Similarly, FERC rejected a gas company's method for service interruption which would have only interrupted direct, not indirect customers. The direct customers had brought a claim of discrimination before FERC and the Commission agreed. *See Sebring Utils. Comm'n v. FERC*, 591 F.2d 1003 (5th Cir. 1979). A notable exception in differential treatment under FERC rules is actually supportive here. In *Newark v. FERC,* 763 F.2d 533 (3d Cir. 1985), differential treatment of cooperative and municipal customers was found permissible on the grounds that the differential treatment was temporary and there was no evidence of competitive harm. But the producer-handler exemption has been hardly temporary and as discussed in the Findings of Fact cannot be shown to have "no competitive harm." Note that under FERC rules the burden appears to have been on FERC and the supplier to establish that there was no competitive harm since uniform treatment is the rule and the exception must be justified. While the court in *Newark* does not expressly so hold, it would appear that the justification in this instance is merely a restatement of *de minimis non curat lex*.

In at least one other regulatory setting involving an extreme example, the equal protection doctrine has been applied. *Bannum, Inc. v. Louisville*, 958 F.2d 1354 (6th Cir. 1992) (holding that it was unconstitutional to require landowner to obtain special use permit to operate a landfill employing felons, where other landfills were not required to obtain such a special use permit). *See also Massachusetts v. Daley*, 170 F.3d 23 (1st Cir. 1999) (holding

that federal state-by-state quota system for limiting amount of fish caught unlawfully discriminated (no mention of equal protection), noting that no scientific data supported state-by-state quota and that quota actually harmed state that was intended to be benefited). Here the producer-handler exemption as presently set forth in current order provisions, despite the plain statutory requirement for uniform treatment of all handlers and producers, harms Prairie Farms, Shamrock Farms, Parker Farms and other dairy farmers, all of whom are intended beneficiaries of the program. Under *Daley*, the present exemption is unlawful.

Nothing in this discussion can change the plain meaning of the AMAA; however, the Secretary and the industry need to recognize that uniform treatment of all regulated industry players is a central and prevalent theme in American jurisprudence. It is long past time to treat producer-handlers uniformly as required by statute.

D. <u>Disorderly Marketing Conditions – Existing and Prospective</u>

The Secretary is obligated to maintain orderly marketing conditions. 7 U.S.C. § 602(1). At its most fundamental core, non-uniform prices paid by handlers has created or can create a disturbingly disorderly marketing condition. This is nothing more than a statement that handlers who affect the market must be regulated in order to meet both the uniform pricing and orderly marketing conditions goal.

We do not have to reach far back in the history of federal orders to find the Secretary agreeing with this concept. Most recently as to an unique regulatory provision that existed in the then Western order, processors found themselves able to (and did) purchase milk for Class I needs at less than federal order minimum prices. When this issue was presented at a hearing, the Secretary had no difficulty concluding that these relatively small (1 to 1.5 million pound per month) operations *must* be treated equally. "The record evidence also

provides strong evidence that the *Proprietary bulk tank handler* provision gives rise to disorderly marketing conditions because the order is unable to establish minimum prices that are uniform among regulated handlers, a requirement of Section 608c(5) of the AMAA." 68 Fed. Reg. 49375, 49383, c.2 (August 18, 2003 – Tentative Decision regarding Pacific-Northwest and Western Marketing Orders). That is to say, lack of uniform class pricing among handlers *equals* disorderly marketing conditions because the Secretary has recognized that the statutory mandate of requiring minimum uniform prices paid by handlers to producers is of paramount importance. When the FMMOs fails to achieve this basic statutory minimum requirement, disorderly marketing is an inevitable result.

Under the circumstances discussed in the Proposed Findings of Fact that follow, the Handler Coalition urges the Secretary to make a legal finding that there is a lack of uniform prices among handlers. This ought to be a foregone conclusion since a producer-handler has "[t]he incentive . . . [of] the additional return which he may receive by marketing his production through his own processing and distribution facilities rather than through a regulated handler. The blend price . . . of the market represents the return that he as a producer may expect for his milk under the order. . . . [A] producer handler would have available the price differential between the utilization value of his own production and the order blend price which he could retain to enhance his returns as a producer or, as a handler, could use as a price incentive to maintain or increase fluid sales." 30 Fed. Reg. at 15154, c. 3 (December 9, 1965 – Puget Sound Order). This precise conclusion was reached by the Secretary in 2005 in the more recent producer-handler proceeding involving only Arizona and the Pacific-Northwest Orders:

> In general, the difference between the Class I price and the blend price not paid into the producer-settlement fund is the pricing advantage enjoyed by producer-handlers over fully regulated handlers. While this has always been the case, those producer-handlers with route disposition of more than 3 million pounds of milk per month in these two orders are large enough to have a negative impact on the prices received by pooled dairy farmers. Since fully regulated handlers do not have the ability to escape payment into the producer-settlement fund of the difference in their use-value of milk and the order's blend price like producer-handlers, regulated handlers competing against large producer-handlers are at a competing price disadvantage.
>
> Even though producer-handlers argue otherwise, this decision agrees with proponent arguments, most notably by the NMPF witness, that the difference between the Class I price and the blend price is a reasonable estimate of the pricing advantage producer-handlers enjoy even if it is not possible to determine the precise pricing advantage of any individual producer-handler. This pricing advantage is compounded as producer-handler size, and the accompanying increase in the volume of Class I sales in the marketing area, begins to increasingly affect the blend price received by pooled producers.

70 Fed. Reg. 74166, 74186, c. 1-2 (Dec. 14, 2005).

In other words, by definition there is a lack of uniform pricing that gives the producer-handler an advantage over his producer and handler competitors. And, leaving aside for a moment the *de minimis* exception, this is disorderly marketing because the FMMOs are failing to achieve the most basic objective of requiring minimum uniform prices paid by handlers to producers. Thus the Secretary cannot permit disorderly marketing to continue without violating yet another section of the AMAA.

Furthermore, the text of the AMAA makes abundantly clear that the Secretary can respond to the threats posed by producer-handlers who operate outside of and undermine the federal milk orders. Congress sets the boundaries on the agency's authority to issue

regulations in the controlling statute. *See* 5 U.S.C. § 706(2)(c) (allowing a court to overturn an agency decision as arbitrary and capricious if it exceeds statutory authority); *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984); *Chemical Mfrs. Ass'n v. EPA*, 919 F.2d 158 (D.C. Cir. 1990). While there is ample evidence in this Hearing Record of disorderly marketing resulting from existing producer-handlers being exempt from the pricing and pooling provisions of the FMMOs, USDA may subject producer-handlers to the pricing and pooling provisions of all the FMMOs *before* the remaining orders feel the full detrimental effects because the Secretary can take that type of proactive action consistent with the AMAA. *See K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988) ("In determining whether a challenged regulation is valid, a reviewing court must first determine if the regulation is consistent with the language of the statute.") A plain reading of the statute's text shows that he can and should.

Section 602(1) of the AMAA describes one of Congress's policies in enacting the law as:

> [t]hrough the exercise of the powers conferred upon the Secretary of Agriculture under this title, to establish *and maintain* such orderly marketing conditions for agricultural commodities in interstate commerce . . . .

AMAA § 602(1) (emphasis added). In common parlance, "maintain" means to "cause or enable (a condition or state of affairs) to continue," *see* THE NEW OXFORD AMERICAN DICTIONARY (2001), "to keep in an existing state," or "preserve from failure or decline." *See* MERRIAM-WEBSTER DICTIONARY, *available at* http://www.merriam-webster.com/dictionary/maintain. Because one must assume that Congress intended each word to have a particular, non-superfluous meaning, *see Bailey v. United States*, 516 U.S.

137, 146 (1995) (citing *Platt v. Union Pac. R.R. Co.*, 99 U.S. 48, 58 (1879)), Congress plainly intended the Secretary of Agriculture to use his powers to keep marketing conditions that are not already disorderly in their existing, orderly state and to prevent them from decline or, at worst, failure. *Cf.* AMAA § 602(4) (using identical language to authorize the Secretary to provide for an orderly flow of supply to the market). Of course, in order to *avoid* disorderly marketing conditions, one cannot wait until they are *already occurring*. As such, Congress also authorized the Secretary, after notice and opportunity for hearing, to issue orders whose terms "will tend to effectuate the declared policy of [the Act] . . . ." AMAA § 608c(3)-(4). With these two sections, Congress gave the Secretary the power to issue orders not just to re-establish orderly marketing conditions when they have already failed but to avoid disorderly marketing conditions altogether. Therefore, prospective regulation that prevents disorderly marketing conditions from ever occurring is squarely within USDA's ambit.

Interpreting this identical language from the AMAA, at least one federal court has already recognized the Secretary's authority to act prospectively to prevent disorderly marketing in federal milk orders. In *Borden, Inc. v. Yeutter*, 50 Agric. Dec. 1135 (1990), the District Court for the Southern District of Texas found that the statute authorized the Secretary to act even when disorderly market conditions did not yet exist. The Secretary had amended the then Texas Milk Marketing Order (Order 126), adding 18 cents per hundredweight to the minimum price of milk received by Houston-Beaumont plants. *Id.* at 1139. Proponents of that amendment had argued that the increase was needed to compensate for the relatively higher hauling cost than that for milk received by Dallas plants, without which "disorderly and unstable marketing conditions" could "threaten the continued

availability of milk supplies" for those plants. *See id.* at 1140. In challenging the Secretary's order, the plaintiffs tried to argue that the Secretary exceeded his authority by amending the order when disorderly marketing conditions did not then exist. *Id.* The court responded:

> In making this argument, plaintiffs misinterpret the language of section 602(4), which states that the Secretary has the power "to establish and maintain such orderly marketing conditions . . . as will provide . . . an orderly flow of the supply thereof to market." 7 U.S.C. § 602(4). This section does not preclude the Secretary from acting until "disorderly marketing conditions" exist, but rather authorizes the Secretary to establish and maintain orderly marketing conditions. Plaintiffs' argument is without merit.

Id.

Furthermore, courts have asserted consistently that other agencies operating under similarly precautionary statutes have the same power—and duty—to regulate prospectively when appropriate. In defining "will endanger the public health or welfare" as "precautionary legislation," the court in *Ethyl Corp. v. EPA*, 541 F.2d 1, 12-13 (D.C. Cir. 1976) (en banc), rejected the notion that the EPA needed proof of actual harm to regulate under the Clean Air Act. In fact, it made clear that threatened harm required action:

> A statute allowing for regulation in the face of danger is, necessarily, a precautionary statute. Regulatory action may be taken before the threatened harm occurs; indeed, the very existence of such precautionary legislation would seem to demand that regulatory action precede, and, optimally, prevent, the perceived threat. As should be apparent, the "will endanger" language of Section 211(c)(1)(A) makes it such a precautionary statute.

Id. at 13. *See also United States v. Waste Indus., Inc.*, 734 F.2d 159 (4th Cir. 1984) (finding that RCRA is designed to prevent improper hazardous waste in the future, and EPA may regulate when there is "imminent endangerment" without finding actual harm). The

AMAA's mandate that the Secretary "maintain orderly marketing conditions" is no different. It, too, authorizes the Secretary of USDA to protect the federal milk order from perceived threats by taking action "before the threatened harm occurs."

Likewise, when the Department of Health, Education, and Welfare (now Health and Human Services) terminated provisional approval of the "Red No. 2" color additive, the court dismissed the challenge that the Commissioner could act only when there was an actual threat to public safety. *Certified Color Mfrs. Ass'n v. Mathews*, 543 F.2d 284, 296 (D.C. Cir. 1976). In interpreting the Commissioner's authority under § 203(d)(1)(E) of the Federal Food, Drug, and Cosmetics Act to "act 'forthwith whenever in his judgment such action is necessary to protect the public health,'" the D.C. Circuit noted that had Congress wanted to prevent the agency from acting until there was an actual threat to public safety, it would have said so in either the statute or the legislative history. *Id.* Yet, "Congress attached no such 'qualifiers' and chose instead to provide for a much broader standard, designed, we think, to allow for precautionary or prophylactic responses to perceived risks." *Id.* Similarly, nothing in the history or text of the AMAA hints that Congress intended to bind the Secretary's hands, preventing him from maintaining orderly marketing until he had already failed at the task.

Of course, the same analysis applies even when public health or human safety is not at risk. In *Chamber of Commerce of the U.S. v. SEC*, 412 F.3d 133 (D.C. Cir. 2005), the SEC promulgated a new rule requiring a larger percentage of independent directors on mutual fund boards. *Id.* at 140-41. It acted in response to what it saw as "a serious breakdown in management controls" in transactions involving boards not covered by the new regulations. *Id.* Even though none of these breakdowns involved the mutual funds at issue,

the SEC feared the breakdowns could eventually extend there if it did nothing. *Id.* Plaintiff challenged the new rule's justification claiming, *inter alia*, that existing regulations covering the mutual funds already dealt with the perceived problem, rendering a new rule arbitrary and capricious. *Id.* The court disagreed, noting that the SEC had authority to temper such conflicts of interest (*Id.* at 138-39) and had reason to fear the management breakdowns could affect these mutual fund boards even if they had not yet. *Id.* at 141. Therefore, the SEC had ample authority to act prospectively and "prevent future abuses of [these] transactions." *Id.*

Thus, when Congress charges an agency with protecting or maintaining the integrity—whether of public health, of securities trading, or of orderly marketing of agricultural products—the Agency may act on potential threats; the Agency need not wait until the threat is realized. A plain reading of the AMAA shows that Congress did in fact charge the USDA with such a duty by having the Secretary "maintain such orderly marketing conditions" and authorizing him to act whenever an order "will tend to effectuate [that] policy." No other provisions in the AMAA suggest otherwise, and a wealth of case law illustrates both that the Secretary of Agriculture has the authority to act on perceived threats to orderly marketing and that other agencies have for years shared the same authority in their own domains. Therefore, regardless of whether or not the proponents have offered evidence of ongoing disorderly marketing conditions, the Secretary may, with proper evidentiary support—such as new players seeking the preferred regulatory status, growth in producer-handler volumes over the past five years, and evidence that customers are seeking out producer-handlers to serve them—regulate producer-handlers before these disorderly conditions become reality.

E. <u>The Unsuitability of Soft Caps</u>

The proposal by opponents of any real change seeks a "compromise" from the Secretary that would subject to pricing and pooling only the Class I milk in excess of whatever fixed exempt amount the Secretary permits to continue. (Ex. One, Proposals 17 and 20.) As described by the expert testimony from the Dairy Institute of California this is properly called a "soft cap" in that the amount subject to regulation is only the amount above say 3,000,000 pounds. The first 3,000,000 pounds are not subject to regulation—leaving of course the producer-handler with the precise advantage it otherwise has, but on up to 3,000,000 pounds. The Handler Coalition opposes this proposal on legal and policy grounds.

First, the proposal cannot be implemented legally. As described above, the producer-handler exemption to date is one that is extra-legal and historically based upon "administrative convenience." The AMAA requirements for uniform pricing provide no exception from regulation, let alone a provision for a partial exemption. Today with producer-handlers exempt from regulation, there are plants subject to uniform prices and plants not subject to uniform prices. If the soft cap proposal is adopted, there will still be plants not subject to minimum prices (producer-handlers below the 3,000,000 pound threshold), but there will be multiple classes of plants subject to different minimum prices (fully regulated plants are one category and then each plant with more than 3,000,000 pounds in their own individual category). A plant with 6,000,000 pounds of Class I milk (100% Class I for this example) would be subject to pricing and pooling on 3,000,000 pounds or 50%. A plant with 9,000,000 pounds of Class I milk would be subject to pricing and pooling on 6,000,000 pounds or 67%. The effective uniform price for each is different. The AMAA does not provide for this result. And one doesn't have to look far for proof of this fact. California in order to have producer-handler exemptions that are soft caps does so by statute

not regulation. Without the statutory authority for producer-handler soft-cap treatment California would lack the authority to provide the existing exemption there.

There are two policy objections to the proposed soft cap. First, there cannot be administrative convenience for multiple categories of handlers. (Hollon Tr. 3816). The Market Administrator would have to calculate different "uniform" prices for different handlers anyway, so why are these new hybrids exempt from anything?

Just as importantly, the experience of California with soft caps is one that the Secretary should simply refuse to emulate. The testimony of the two witnesses from the Dairy Institute of California presented an extreme form of disorderly marketing condition caused by soft caps that result in the "movable feast." (Schiek and Newell Tr. 2140-2142). It was thus not surprising that one of the supporters of the soft cap notion moved at the Hearing to amend its own proposal to create a "hard cap on the soft cap" of 6,000,000 pounds. (Flanagan Tr. 2517; Vetne Tr. 3714-3716, 3743-3745). This extra-legal proposal only highlights the problems inherent in a soft cap "solution." This solution is no solution and must be rejected by the Secretary.

F. The Standard for USDA to Announce a Change in Policy

In the first instance, the Handler Coalition notes that even as the Judicial Officer has repeatedly stated that producer-handlers "have no legal right to be exempt from regulation," *In re: Indep. Milk Distribs. Ass'n*, 20 Agric. Dec. 1, 29 (1961), producer-handlers today .have no legal right to that exemption. None. Since they have no legal right to the exemption, the Secretary can and should remove it. And since there is no legal right, the Secretary is not bound to grant the exemption for any reason and can take it away for any reason. Indeed a

sufficient reason lies on the face of the AMAA which provides for no exemption of any kind. Responding to Congress' mandate for uniform pricing is a sufficient reason to remove the exemption today.

Nevertheless, the evidence in this Hearing provides ample reason and evidence to eliminate (or certainly significantly curtail) the producer-handler exemption.

To be sure, the Handler Coalition urges the Secretary to alter his previous course and thus change his policy towards producer-handlers by removing the blanket exemption under which they have operated, thereby leveling the playing field with producers benefitting from and handlers subject to the FMMOs. Nonetheless, any argument that this change is arbitrary and capricious because it breaks from prior policies lacks merit. As long as USDA "displays awareness that it *is* changing position," *FCC v. Fox Television Stations, Inc.*, __ U.S. __, 129 S. Ct. 1800, 1811 (2009), it satisfies its obligation regarding policy changes under the APA.

Previous Supreme Court holdings suggested that agencies might need to do more to explain a break with past policies, *see Motor Vehicles Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983) (holding that when agencies change their policies, they must "supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance."), but the Court made clear in its recent decision in *FCC v. Fox*, that the APA requires nothing more than expressly recognizing the change. *Fox*, 129 S. Ct. at 1810-12. In *Fox*, the FCC had changed its approach to regulating so-called "fleeting expletives" aired over broadcast media. Whereas the agency previously exhibited reluctance in calling fleeting expletives indecent, it reversed course in 2004, holding in a well-publicized case that fleeting expletives did qualify as indecent. *Id.* at 1806-10 (citing *In*

re Complaints Against Various Broadcast Licensees Regarding Their Airing of the "Golden Globe Awards" Program, 19 FCC Rcd. 4975 (2004)). The FCC specifically noted it was breaking from its past policies. *Id.* at 1808. When Fox was later fined for airing "fleeting expletives," it challenged FCC's policy change as arbitrary and capricious under the APA. Fox, relying on *State Farm*, argued that FCC needed to explain the rationale behind its change. *Id.* at 1810-11. However, Justice Scalia's majority opinion explained that the agency:

> . . . need not demonstrate to a court's satisfaction that the reasons for the new policy are *better* than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better, which the conscious change of course adequately indicates.

Id. at 1811 (emphasis in original). Because FCC had recognized its policy change, and its new policy was permissible and supported by evidence, the Court found the change to be neither arbitrary nor capricious. *Id.* at 1810-12.

While USDA has not yet issued an order here, its path to avoid claims of arbitrary and capricious action is simple. Should it choose to restore (or provide greater) equity among producers and handlers by removing or capping the producer-handler exemption, it only needs to recognize explicitly that it is changing policy. Of course, proponents must present enough evidence to provide USDA "good reasons for [the change]"—which they have amply done—but as *Fox* makes clear, the law requires nothing more from USDA beyond its recognizing that it is changing policy.

Opponents of the proposed regulations appear to argue that they have relied on USDA's past choice not to eliminate the producer-handler exemption, even though the

exemption itself belies the wording and intent of the statute. A policy change amidst such reliance interests could subject the decision to claims of arbitrary and capricious agency action. But this argument, too, finds no support in the law.

Though courts interpreting the APA have agreed that an old policy might engender reliance interests which require the agency take them into account when changing policy, *see, e.g.*, *Smiley v. Citibank, N.A.*, 517 U.S. 735, 742 (1996); *United States v. Pa. Indus. Chem. Corp.*, 411 U.S. 655, 670-675 (1973); *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 295 (1974); *Ramaprakash v. F.A.A.*, 346 F.3d 1121, 1124-25 (D.C. Cir. 2003), it does not mean the new regulation is *per se* arbitrary and capricious. It simply means that, if applicable, the agency must provide "a reasoned explanation . . . for disregarding facts and circumstances that underlay or were engendered by the prior policy." *Fox*, 129 S. Ct. at 1811. In other words, in addition to stating that it is changing policy, USDA would also need to provide an explanation *why*, with a special note to the reliance interests it was upsetting. Such a change in policy is, therefore, "not fatal." *Smiley*, 517 U.S. at 742.

This additional explanation, though, is unnecessary in this instance because there are no real, legal, recognizable "serious reliance interests" at stake. *See Fox*, 129 S. Ct. at 1811. For one thing, given that agencies are free to regulate prospectively, it is unreasonable to rely on any set of regulations remaining constant, especially here, where USDA already altered the exemption in the Pacific-Northwest and Arizona-Las Vegas orders. Moreover, the Secretary or his Judicial Officer have repeatedly said that the producer-handler exemption is not a "right." *Independent Milk Distributors, supra.* In fact, in the Final Decision for the Pacific-Northwest and Arizona-Las Vegas hearing, the Secretary noted that the history of the exemption and the record evidence could have supported eliminating the exemption

altogether.[5] Furthermore, this is not the sort of case which the "serious reliance interest" standard contemplates. Here, there is no "new liability . . . sought to be imposed . . . for past actions which were taken in good-faith reliance on [agency] pronouncements." *N.L.R.B. v. Bell Aerospace Co. Div. of Textron, Inc.*, 416 U.S. 267, 295 (1974) (rejecting argument that defendant had reliance interests on previous NLRB decisions because a new policy would not impose liability for past acts). *See also Pa. Indus. Chemical Corp.*, 411 U.S. at 670-75 (1973) (finding potential reliance interests when defendant relied on Army Corps of Engineers regulations to outline contours of criminal conduct but agency changed the regulations). *See generally United States v. Caceres*, 440 U.S. 741, 752-53, n.15 (1979) (discussing additional cases). Instead, the proposed regulations would only affect *prospective* conduct and would not penalize or affect any past conduct by any producer-handler.

Thus, even if USDA had previously said it would not remove the producer-handler exemption until it saw evidence that producer-handlers were undermining the FMMOs or affecting the marketing of Class I milk, there would be no issue with the policy change. Not only have proponents presented ample evidence to this effect, as argued extensively in this brief, but even if they had not, USDA is free to change its mind. Indeed, "agencies are free to change course as their expertise and experience require," *Ramaprakesh*, 346 F.3d at 1124, and as long as USDA "display[s] awareness that it *is* changing position," *Fox*, 129 S. Ct. at 1811, it has satisfied its requirements under the APA that its decision is not arbitrary and capricious.

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[5] "Review of the intent of the producer-handler provision and the marketing conditions arising from this provision in these orders could warrant finding that the original producer-handler exemption is no longer valid or should be limited to 150,000 pounds per month Class I route disposition limit." 74 Fed. Reg. at 74186, c.1. The entire industry has been on notice since at least December 2005 that continuation of the producer-handler exemption is not viable.

G. Regulatory Flexibility Act

The proposals should be adopted regardless of whether or not the Secretary conducts a preliminary or full Regulatory Flexibility Act analysis. 5 U.S.C. §§ 603-605 (2009). Importantly, the RFA does not exempt small businesses from regulation. There is no basis to conclude that small businesses based upon that fact alone are exempt from pooling and pricing provisions of federal orders. At no time in the history of the AMAA has USDA, Congress or the Courts concluded that being a small business exempts one from minimum price regulation entirely, except to the extent USDA has adopted a uniform definition for exempt plants that is size based, but is far smaller at 150,000 pounds than the operations in question here.

Instead, under the RFA the agency must, when it determines that there will be a substantial economic impact on a significant number of small entities, conduct additional analysis regarding the impact on small businesses. And as stated in the Hearing Notice (Ex. One), the Secretary will, within the statutory authority of the program, ensure that the regulatory and informational requirements are tailored to the size and nature of small businesses. But the limitations are clear:

> The RFA does not seek preferential treatment for small entities, require agencies to adopt regulations that impose the least burden on small entities, nor mandate exemptions for small entities. Rather, the RFA *encourages* agencies to examine public policy issues using an analytical process that identifies, among other things, barriers to small business competitiveness; and seeks a level playing field for small entities, not an unfair advantage.

The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies, U.S. SBA, Office of Advocacy, Washington, D.C., 1998, p. 2 (emphasis added).

On the one hand, the Secretary could conduct an analysis of the proposal to expand the exempt plant limit to 450,000 in at least the nine Orders other than Order 1. If so the Secretary could and should point out that the AMAA does not permit any exemptions and that the Department is nonetheless adopting an exempt plant limit, *inter alia*, in order to comply with RFA requirements.[6] The Secretary could point out that at 450,000 Class I pounds, this integrated entity (producer-handler) would no longer be a small business because the producer side of the business would have income in excess of $750,000. (Cryan Tr. 419); *See* 13 C.F.R. § 121.201 (2009). The Secretary could also point out that historically entities that are not producer-handlers have only been exempt up to 150,000 pounds. Thus the Secretary would in essence, for any Order where a 450,000 exempt plant level were adopted, be reducing regulation on handlers who are likely small businesses. Such mitigation of regulation is a proper form of RFA analysis. *Ashley County Med. Ctr. v. Thompson*, 205 F. Supp.2d 1026 (E.D. Ark. 2002).

The Secretary could note that those opposed to the changes in regulation overstate and fail to support their prediction of the possibility of catastrophic consequences. *Cactus Corner, LLC v. USDA,* 346 F. Supp.2d 1075, 1117 (E.D. Cal. 2004) (those opposed to rule regarding importation of Spanish Clementines failed to provide support for their prediction of possibility of catastrophic Medfly infestation). This applies here because those who said that there would be catastrophic (out of business) consequences if prior rule in Arizona and Pacific Northwest were adopted, were wrong. (Krueger Tr. 1361, 1363; Hettinga 2726-2731; Hollon 3813-3816). Indeed Sarah Farms is a strong competitive player in Arizona and has

[6] As discussed in greater detail below, the fact that the AMAA requires the Secretary to adopt uniform pricing as to all handlers and paid to all producers can justify, by itself, a certification that no RFA analysis need be made. Since this legal fact can be used to justify not performing the RFA analysis, this legal fact also can be used as one of its justifications for the actions taken or not taken by Secretary.

even grown since it became subject to the pricing and pooling provisions of the Order. (Krueger Tr. 1361; Hettinga Tr. 2726-2727). Also if the Secretary were so inclined as to adopt the 3,000,000 pound hard cap, he could note that with a 3,000,000 pound cap no one is "required" to be subject to the pricing and pooling provisions. For instance, Mallorie's chose to get smaller (consistent with truer small business) and thus is still not subject to the pooling and pricing provisions of the Order. (Flanagan Tr. 2514). The Secretary could thus conclude that USDA is complying with prong 5 of any RFA analysis (the agency shall describe the steps the agency takes to minimize the significant economic impact on small entities) by continuing exemption levels of 450,000 pounds, 2,000,000 or 3,000,000 pounds of hard cap.

There is an alternative. The Secretary could properly certify that no preliminary or final RFA analyses are required pursuant to 5 U.S.C. § 605(b). This is so for two reasons. First, Congress recognized that where agencies are subject to statutes that mandate uniform requirements, it is unnecessary for them to conduct an analysis of differing requirements. *See Greater Dallas Home Care Alliance v. United States*, 36 F.Supp.2d 765, 769 (N.D. Tex. 1999) (government was not required to conduct analysis under RFA where statute did not grant government discretion in creating rule). The Senate Report for the original RFA states:

> Some statutes, for example, place explicit limitations on agency discretion in rulemaking. If uniform requirements are mandated by statutes, a statement to that effect would obviate the need to solicit or consider proposals which include differing compliance standards.

S.Rep. No. 96-878 at 13 (1980); 1980 U.S.C.C.A.N. 2788, 2800. In this case, uniform requirements are mandated by the AMAA. The Secretary is required by the AMAA to regulate milk transactions through milk marketing orders, specifically through the application

of uniform rules. 7 U.S.C. § 608c(5). The AMAA requires the Secretary to set prices for milk and states:

> Such prices shall be uniform as to all handlers, subject only to adjustments for (1) volume, market, and production differentials customarily applied by the handlers subject to such order, (2) the grade or quality of the milk purchased, and (3) the locations at which delivery of such milk, or any use classification thereof, is made to such handlers.

Id. Because uniform pricing is required by the AMAA, the Secretary is not able to implement a Rule that treats small businesses differently. Conducting an analysis under the RFA to consider "differing compliance standards" for small businesses therefore is pointless. S.Rep. No. 96-878 at 13 (1980). Accordingly, the Secretary could certify that no RFA is necessary for the foregoing reasons and add that this applies equally to small and large businesses. Nothing more is required of the Secretary to comply with the RFA.

Furthermore, Congress emphasized that the RFA should not be construed to undermine other legislatively mandated goals. *Associated Fisheries v. Daley,* 127 F.3d 104, 114 (1st Cir. 1997) (citing the legislative history of the RFA). As noted above, milk marketing orders are mandated by the AMAA for the purpose of ensuring an adequate supply of fluid milk by protecting the blend price paid to producers. *See, e.g.*, *Lamers Dairy v. USDA,* 379 F.3d 466, 469 (7th Cir. 2004). It would be contrary to Congress' intent in enacting both the AMAA and the RFA to allow the procedural requirements of the RFA to trump the AMAA's mandate to ensure adequate supplies of milk to consumers using minimum uniform prices as the basis for accomplishing this goal.

In the alternative, the Secretary should conclude that it can nonetheless certify pursuant to 5 U.S.C. § 605(b) that a "substantial number of small entities" will not be

impacted significantly. This assumes, of course, that the handler element of the producer-handler governs for RFA analysis. But note that the opponents cannot have it both ways. They argue that there are few and ever fewer producer-handlers (who of course the Handler Coalition argue are ever larger); if there are few and ever fewer producer-handlers, there cannot by definition be a "substantial number" of such entities. The Secretary could point out the small number of entities who would be subject to the pricing and pooling regulations both gross and net (adjusted for entities no longer subject to regulation). Ex. Twenty. At a 450,000 pound limit, the gross would be no more than 17 (the cut-off on Ex. Twenty is 300,000 pounds). The net would be 8 because at least 9 plants are today between 150,000 and 300,000 pounds. Both the 17 and 8 numbers of impacted plants are likely overstated because the real threshold of 450,000 pounds would be 50% higher than the number in Exhibit Twenty. At 1 million pounds for producer handlers and 150,000 pounds for exempt plants, the gross number is 11. If the 450,000 number applied to exempt plants, the net would be only 2. At 2,000,000 pounds hard cap for producer handlers and leaving the exempt plant level at 150,000 pounds the gross and net are only 7 entities. If the 450,000 pound exempt plant level is used, the number now impacted is a negative 2. Finally, based upon Mallories' testimony that it falls within the 2-3 million pound group, at most 6 plants (and perhaps fewer) would be impacted at 3,000,000 pounds.

The Secretary should note that the RFA uses the terms "will have" which is a present tense verb so the Secretary must look to the number who will be impacted not some hypothetical future number. Alternatively if those who "may" be affected is to be considered, if the Secretary were to choose the 3,000,000 pound hard cap, the gap from 1,000,000 to 3,000,000 pounds (tripled in size) is significant. Moreover, a number of smaller

producer-handlers themselves endorsed the 3,000,000 pound cap. (See, e.g. Proposal 18; Gibson Tr. 636-637; Hatch Tr. 256).

In short, the Secretary can certainly make a finding that changing the regulatory status of up to 17 entities is not a substantial number. This is especially true in light of the substantial number of dairy farmers who are small businesses who are adversely affected by the present regulatory treatment of producer-handlers. (Lee Tr. 938, 943-944).

H. Miscellaneous Legal Issues

Opponents throughout the Hearing suggested a number of legal issues that are best described as red herrings. They simply distract from the requirements of the AMAA. For instance, opponents appear to believe that niche markets such as organic (but only producer-handler organic), kosher milk (but only kosher milk sold by producer-handlers), sales in glass bottles, sales through certain specialized distribution (e.g. own retail) should be exempt from regulation because of their niche market character. Again the AMAA is the starting and ending point for this discussion. There are no exceptions of this nature provided for in the AMAA.

The opponents also claim that the exemption is justified for market entry or to beat down so-called concentrated markets. These issues again fail to account for Congressional mandates in the AMAA. They are not appropriate for this proceeding.

Finally, as always, there were some evidentiary skirmishes. The detour engendered by the non-AMAA based attacks on entities certified as Organic by USDA could add nothing to this Record. Similarly the attempt to place into evidence without a testifying witness a purported check allegedly paid by one company to another company, even if it had been

admitted, was simply irrelevant and could add nothing to the discussion of whether or not producer-handlers ought to be regulated. This is because the sponsor of that exhibit cannot point to any provision in the AMAA that makes it relevant. If debate on these kinds of issues is renewed, the Secretary should properly find those materials excludable as being irrelevant.

I. The Proposed Solutions As Applied To The Law

1. The elimination of the exemption or, in the alternative, establishment of a Hard Cap

And so the Handler Coalition proposes eliminating the producer-handler exemption entirely and raising the exempt plant limit (except NDFA cannot support any increase in Order 1) to 450,000 pounds. If the producer-handler exemption is not eliminated in its entirety and the cap (of any kind) is set above 450,000 pounds, then the Handler Coalition opposes increasing the exempt plant limit at all. Some others have proposed a "hard cap" or bright line test for producer-handlers in lieu of eliminating the exemption. Determining when the perhaps permissible *de minimis non curat lex* should apply and when it should come to an end. Because the exemption's limit is not found in the statute and thus exists only as an extra-statutory creature that can and should be adjusted based upon any evidence that the *de minimis* threshold has been crossed. The labeling restriction proposed below is a linguistic effort to deal with specific situations that plainly suggest that an exempt facility of any type has crossed the line into the competitive arena of regulated handlers. The unique labeling proposal is especially necessary if any producer-handler exemption (even with a hard cap) remains and especially for those Orders where the exempt plant limit is raised above 150,000 pounds. Proponents have no illusions that the proposed linguistic changes regarding unique labeling will necessarily work precisely because there appears to be an

inability or indecision by employees of the Secretary to enforce those rules as presently written (e.g., the same product sold in the same store for the same month limitation does not appear to cause anyone at USDA any alarm (Krueger Tr. 1389)). This is another reason to eliminate the producer-handler exemption—elimination avoids administrative hassles for the Market Administrator.

So the central thrust is a bright line test that makes the rules clear for everyone, and proponents have chosen and justified at the hearing and in this and other briefs a limit of **no more** than 450,000 pounds per month for any plant that seeks exempt status. The justification for a bright line test is precisely a restatement of what it is, a cross-over from *de minimis* to competitive harm. For all the foregoing legal reasons and all the subsequent facts, the 450,000 pound limit (as a maximum threshold) is wholly justified.

2. NDFA Position - Order 1 Exempt Plant Limit Should Remain at 150,000 pounds.

NDFA, however, asks the Secretary to examine the aggregate number of existing exempt plants in Order 1 and to conclude that no change should be made to the exempt plant provision regardless of the outcome of the producer-handler exemption debate. According to Exhibit Five, 41 of 108 Exempt plants are found in Order 1. If all of these plants grew to 450,000 pounds per month, then at least 18,450,000 pound of Class I milk would be lost to the Pool; this would be at least 2% of the Pool. This aggregate loss and financial impact on the pool is too large to sustain. As to the proposed 450,000 pound exemption in Order 1, because this would be an increase in an exemption, NDFA urges that the Secretary should be extra chary in granting this benefit.

3. Proposed Unique Label Requirement is Imperative

The Handler Coalition absolutely supports implementation and enforcement of the unique label requirement found in the proposal by National Milk Producers which is Proposal 2 of the Hearing Notice. Ex. One. First, since there was some confusion at the Hearing, the "unique label" requirement does not mean that an exempt plant is limited to one label—e.g. "Jones Dairy" would not be required to market only under the label "Jones Dairy." This is not intended and cannot be considered a limitation on free speech. The purpose of the requirement is to insure that an exempt plant is not being used by anyone to balance any part of the milk supplies that would otherwise be fully covered by the Federal Milk Order system.

The unique label requirement thus is simply that an exempt facility, whether exempt as a producer-handler or under exempt plant status, must use a label not used by any other Handler when making distribution to any wholesale customer. This proposal is similar to the language found in the Arizona Order 131 at 7 C.F.R. § 1131.10(a)(6) (2009) except that previous difficulties with application of this provision in that Order should be addressed by changing "a wholesale customer" to "any wholesale customer" and "plant described in § 1131.7(a), (b) or (e), or a handler described in § 1000.8(c)" should be broadened to: "plant described in paragraph 7(a), (b) or (e) of this or any other Federal Milk Marketing Order, or a handler described in paragraph 8(c) of this or any other order."

This requirement is designed to prevent a consortium of otherwise exempt milk plants from banding together directly or indirectly to serve the market with the same label. Otherwise, capping or eliminating the exemption can have no real meaning. For example, if the unique label requirement is not adopted, or adopted and not enforced, the door is left wide open for a group of producer-handlers collectively to serve a buyer. This is actually

much easier than one might think. Take a simple example with two dairy farmers. Each would build bottling operations. The first would run whole, 1%, and skim gallons, while the other ran 2%.[7] This collection could then be delivered to a store and supplemented with a regulated handlers' product bearing the same exact label. This could be increased in complexity with no limit so long as each operation stayed under the volume that would bring regulation. It could include a number of farms with each one producing only one or two of the different butterfat-level gallons. These farms could then deliver to a common distribution center where the milk is then comingled to deliver to a customer(s). Likely in both cases at the end of the chain there will be producer handler milk and regulated handler milk with the same label in a store. Thus, not having a unique label limitation not only allows an exemption to be exploited, it helps with balancing by allowing the buyer to use a regulated handler to balance.

The Handler Coalition is adamant that such a rule be adopted if any exemption is expanded or if the producer-handler provision is not eliminated in its entirety. However, the resolve that the Handler Coalition has that this provision is necessary increases if the producer-handler provision is not eliminated by every pound of permitted exemption over 450,000 pounds. The importance of the unique label provision simply goes up if a 2,000,000 pound or 3,000,000 pound hard cap is imposed on the producer-handler exemption. This is because the value of being able to circumvent the limit exemption goes up as the size of exempt operations increases. This is because as the expert witness Mr. Wilcox testified that

[7] Fluid milk sales average to about 2%, so while the first has 3 different product the required volume would likely very closely even out. (Official Notice requested of **ESTIMATED TOTAL U.S. SALES OF FLUID MILK PRODUCTS**, available at http://www.ams.usda.gov/AMSv1.0/ams.fetchTemplateData.do?startIndex=1&template=TemplateV&navID=IndustryMarketingandPromotion&leftNav=IndustryMarketingandPromotion&page=FluidMilkSalesDataMonthlyandYeartoDate&acct=dmktord (Attached as Attachment 1)).

major wholesale purchasers of milk know about and reasonably desire to purchase milk from exempt producer-handlers for the economically valid reason that that milk is not fully subject to USDA regulation. (Wilcox Tr. 1303-1305).

IV. PROPOSED FINDINGS OF FACT

The Handler Coalition respectfully requests that the Secretary make the following findings of fact pursuant to 5 U.S.C. § 557(c):

A. The Regulatory Cost Benefit of Being a Producer-Handler

1. As discussed in Section III.D. above, the Secretary has made consistent repeated previous regulatory findings that the incentive for a producer-handler is the additional return (not cost of production) which the dairy farmer may receive by marketing his milk himself rather than through regulated handler. Thus the producer-handler has "available the price differential between the utilization value of his own production and the order blend price which he could retain enhance his returns as a producer or, as a handler, could use as a price incentive to maintain or increase fluid sales." 30 Fed. Reg. at 15154, c.3; 70 Fed. Reg. at 74186, c. 1-2. These previous conclusions are regulatory facts. Nothing said at this Hearing could be said to overcome these past factual findings.

2. Nonetheless and in confirmation of this fact, the expert witness for the Handler Coalition testified that as a producer-handler it was always clear that the customer knew that the working margin was the difference between the Class I price and the plant's blend price. (Wilcox Tr. 1316-1317). The NMPF expert witness also indicated that the advantage was equal to the pool payment dividend. (Cryan Tr. 2068). Moreover, the expert witness retained by Opponents even though he disagreed with the Secretary's prior

conclusions about the regulatory advantage expressly relied upon a Report known as RB 2006-07 of Dr. Stephenson and Dr. Nicholson which itself expressly calculated the regulatory program's impacts as being the difference between the Class I price and the blend price. (Knoblauch and Knutson Tr. 3238-3240). The Secretary should reaffirm this finding notwithstanding the statements of non-expert witnesses to the contrary. Simply put, those opposing regulation complained that they could not afford the payment to the pool, but then denied that not having to make that payment gave them a competitive regulatory advantage over their regulated counterparts. All the attempts to compare costs of production on the farm are unavailing simply because all of those costs will vary and are controllable by the business entity. What is not controllable by a regulated handler is the market administrator assessment at the end of the month for the difference between the Class I and blend price.

B. <u>Impact of Large Producer-Handlers on the FMMO Markets</u>

3. Franklin D. Roosevelt is credited with saying "Competition has been shown to be useful up to a certain point and no further, but cooperation, which is the thing we must strive for today, begins where competition leaves off." (Nathan Miller, *F.D.R.: An Intimate History* 89 (Doubleday 1983)). One could attribute this thought as coinciding with the signing of the AMAA. If he was thinking about the dairy industry from the eyes of the dairy farmer, it would be easy to see how he believed the dairy farmers had been a competitive lot and had improved the industry. Yet continuation of their competitive actions was raising questions about the industry's ability to survive at that time. The AMAA could bring together a greater degree of cooperation among dairy farmers.

4. There was no testimony produced at this Hearing opposing competition. AE for instance expressly endorsed competition. (Erickson Tr. 2282-2283). Some Opponents

position the discussion of removing producer-handlers' existing exemption from the pricing and pooling provisions of the FMMOs as eliminating competition. That simply is not true. The testimony relating to issues of competition expressly concerned a set of rules and costs being enforced on one set of competitors, while allowing another set of competitors to be unencumbered by the same rules and costs.

5. Anderson Erikson in Iowa lost business with a regional retailer to a producer-handler. In 2007, AE had annual sales to this retailer for a specific private label of 185,000 gallons, while in 2008 AE had annual sales of 40,000 gallons. (Erickson Tr. 2279). This is a loss of 145,000 gallons or 1.25 million pounds. The loss is now complete in 2009 at 1.6 million pounds. This calculation does not include any trade down loss that could has occurred as consumers opted to purchase the lower priced producer-handler product as opposed to the private label or branded product produced by AE.

6. AE further testified that the private-label business lost is absolutely 100% all about the price level. Furthermore AE established that it was not even provided the opportunity to maintain the business of the lowest price product because of the price level offered by the producer-handler. AE amplified this testimony by stating that according to a store manager the producer handler had set up pricing that was calculated by subtracting a value from AE's ultimate price. (Erickson Tr. 2300).

7. Prices Creamery in El Paso, Texas lost business with a national retailer to a producer-handler. These losses increased as recently as March 2009. Annualized losses of 472,000 gallons per month are just under 49 million pounds annual (Carrejo Tr. 1449). In

addition to this, Prices has been required to make price concessions in order to maintain business. (Carrejo Tr. 1499).

8. Bareman's Dairy in Michigan has faced a producer handler in serving C-stores in Michigan. They have watched this producer handler grow from 80 cows to a thousand. (Wernert Tr. 2310) This producer handler has made an offer to a C-store chain of 32 stores to supply milk at $1.90 per gallon for it to be priced at $1.99 retail. (Wernert 2311). This was a price Bareman's was not able to match and it was unclear if Bareman's was going to lose the business or retain it with the price reduction they offered their customer.

9. Prairie Farms in Illinois lost business with a national retail customer to another regulated handler as a direct result of that other regulated handler losing business with the national retail customer in El Paso, Tx. (Lee Tr. 947). As they faced direct competition with yet another producer-handler from Missouri, Prairie Farms lowered prices 30 to 40 cents per gallon in order to meet that competition. (Lee Tr. 945). This competitive situation and reduction in price approximated the value of any premiums in the market plus the difference between the Class I price and the blend price. (Lee Tr. 957-959).

10. Producer-handlers are competitors who are quite clearly effective competitors with regulated plants. "We were competing against an unregulated handler whose cost of milk was what he wanted it to be. And he could very easily back into what our cost was and use that as his apparent advantage." (Lee Tr. 959).

11. The other real competition of producer-handlers is the other dairy farmers who milk is pooled. This was made quite clear by a panel of three organic dairy farmers.

They expressed concerns about their milk price being lowered because a producer-handler with national distribution had grown its market share at their expense because their regulated handler buyers lost business to this Colorado based producer-handler. (Segalla Tr. 1752, Arnold Tr. 1759, Segalla Tr. 1773).

12. The fact is that a producer-handler can and does have competitive impacts far from its plant location. The producer-handler operation in El Paso had a negative impact not only in Texas, but also on Prairie Farms in Illinois. The producer-handler in Colorado had negative impacts on handlers and producers as far away as New England and the Upper-Midwest.

13. These impacts are sufficient showings of existing (as opposed to prospective) disorderly marketing conditions so as to justify the national hearing and a national uniform result.

14. This negative competitive problem is amplified when one considers that Prairie Farms' decision to lower prices to its customer in order to retain business resulted in reduced income for the mostly small dairy farmers who own the cooperative. (Lee Tr. 957-959 and 938).

15. Besides the *de minimis* rule it is possible the Secretary has attempted to justify the existence of non-uniform prices resulting from the existence of producer-handlers under the mistaken belief that producer-handler balancing costs were sufficiently high to eliminate any perceived price discrepancy. This belief should be abandoned. The record in this proceeding makes clear that regulated plants and the producers who supply them ultimately

bear the balancing costs. Bareman's Dairy succinctly articulated a repeated practice of a producer handler in their market.

> When below cost priced milk flows out into the market, we are left with two choices: Match the costs to retain the sales and the customer and lose money in the process, as we have no surplus milk at lower costs; let them have the sale and hope the surplus cycle works its way out and that they don't add more cows. Either way, the low retail prices spread across the marketplace as one retailer after another match up to prevent their customers -- their own customers from switching stores. The reality is that one below market quote affects much more milk than -- more than the milk quoted, and incumbent vendors match up and the producer-handler rolls on to other prospects. Therefore a producer-handler affects more milk than he can produce and deliver. We have watched this cycle repeat itself annually as our producer-handler competitor has worked his way up from 80 cows to a thousand.

(Wernet Tr. 2310)

While it might be thought the producer-handler bears its own cost, the reality is that it can take product to the market and shop until it moves what milk is needed to be moved. In doing so, it can grow market share and provide a growth opportunity.

16. A New Hampshire producer-handler with sales of 750,000 – 800,000 pounds per month acknowledged that it sold milk at a loss (its definition) when it needed to in order to balance its raw milk supplies. The Order 1 producer pool carried the burden of this balanced supply even as a regulated handler under Order 1 lost business that would have generated Class I dollars for the FMMO pool. (Hatch Tr. 299).

17. A producer-handler located in the Pacific-Northwest Order supports the current limitation of 3,000,000 pounds and also supports the unique labeling requirement

expressly recognizing that co-packing of dairy products can result in balancing of a producer-handler's supplies. (Gibson Tr. 636-637).

18. Shamrock further testified that prior to the amendatory hearing in 2003, the local producer-handler and Shamrock both served the same retailer with the same label. The grocery retailer used Shamrock's regulated milk as needed to balance the producer-handler. (Krueger Tr. 1384). Furthermore, in Shamrock's experience, business lost to the local producer-handlers was always based upon price. (Krueger Tr. 1366-1367).

19. The Colorado organic producer-handler effectively acknowledged how today's modern market permits balancing using alternative supplies: "Milk balancing is what we have to do when the supply and demand for our milk do not line up. Suggesting that we are somehow incapable of balancing our own supply because of our status as a producer-handler is nonsensical. *It is always the case that our customers have alternative suppliers, as well as product options and a variety of size formats.*" (Keefe Tr. 2909-10 (emphasis added)).

20. A witness for a Midwest cooperative testified about myriad ways in which a producer-handler can balance its supplies it the Order 30 market including using price as a mechanism for disposing of surplus milk and utilizing the wholesale customers who can then balance their supplies using regulated milk. (Tonak Tr. 523-524)

21. An expert witness testifying on behalf of the Handler Coalition who had been directly involved in the operation of a producer-handler turned regulated handler testified that when it operated as a producer-handler the grocer-retailer it supplied balanced its supplies using the regulated market. (Wilcox Tr. 1300 and 1311). Later, after being a regulated

handler, a large retailer sought for that handler to return to producer-handler status in order to exploit the financial benefits of the producer-handler advantage. The expert also discussed large retailers' common practice of requiring regulated suppliers to match low-cost competing offer in an entire region; this permits a small plant to affect prices for a disproportionate volume of milk in a market. (Wilcox Tr. 1302-1303 and Ex. Thirty Nine).

22. The Pacific-Northwest Order present provision limiting producer-handlers to 3 million pounds route disposition in the marketing area could be modified to account for all route disposition without importing Mallorie's. (Flanagan Tr. 2522-2524)

C. The Growth in Producer-Handler Volume and Prospective Growth

23. Notwithstanding any claims to the contrary, even though the absolute number of producer-handlers has decreased over time, the volume of milk distributed by producer-handlers has increased since 2002. This statement is true even as the volumes of milk sold by fully regulated handlers under FMMOs have decreased (and this statement accounts for the termination of the Western Order 135). There are two exhibits which describe this fact. First, Exhibit Six A produced by the Secretary in response to an industry request shows various volumes for the Eight Orders east of the Rockies.

24. For various reasons, leaving out the Arizona, Pacific-Northwest and terminated Western orders makes sense. If the data for the Western Order were included, it would only be through March 31, 2004. Thus, a timeline comparison with some years or part years with volumes and some with zero volumes would not provide a valid comparison. Similarly the fact that the producer-handler exemption was capped at 3,000,000 pounds beginning in April 2006 in the Arizona and Pacific-Northwest Orders means that a

comparison of producer-handler volumes before and after that date would be equally invalid. Exhibit Six A establishes that producer-handler volumes from 2002 to 2008 on the Eight Orders east of the Rockies has increased from 288 million to 489.1 million pounds or 69.8%. This 69.8% growth must be viewed in light of fully regulated plant reduction in sales over the same time period of 2.2%.

25. Second, although much criticized by Opponents even though the concept is the same as for Exhibit Six, Exhibit Seventy-Four A establishes a complete FMMO examination of the growth of producer-handlers from 2004 to the present. The year 2004 was chosen because industry at this Hearing has available to it in addition to the data in the exhibit the testimony and first hand recollections of witnesses involved in the prior Arizona and Pacific-Northwest proceeding. Thus, the Shamrock witness testified in detail as to his, un-contradicted, conclusion that Sarah Farms in 2003 and in April 2006 was running approximately 17,000,000 pounds. (Krueger Tr. 1363-1366). Furthermore, both Edaleen and Smith Brothers were at least 3,000,000 pounds since that was the hard cap established in April 2006 and they testified that they would be adversely affected by the regulation in the prior proceeding. (Hollon Tr. 3813-3816). In fact, the testimony of the DFA witness is that they each had more than 3 million Class I pounds. Mallorie's is listed on this exhibit at zero even though it testified that it reduced its Class I volume by at least 1 million pounds per month effective April 1, 2006 in order to retain producer-handler status. (Flanagan Tr. 2500-2501 – 2008 value of 3.1 million pounds with 63% Class I or 2,000,000 Class I pounds). The Western Order terminated April 1, 2004, so it is proper to exclude the 4.6 million pounds shown for comparison purposes. The result (minimizing the impacts of these collective conforming changes) is that from 2004 through 2008 producer-handler volumes have

increased by 52.9% in all FMMOs. Opponents objections to Exhibit Seventy Four A must be viewed in light of the fact that Exhibit Six A reflects a far larger increase for just the Eight Orders east of the Rockies.[8]

26. This growth in producer-handler volumes is of course not surprising to the Handler Coalition. The growth also must be viewed in light of the fact that with fewer producer-handlers, by definition the volume of individual plants is on the rise. This fact coupled with the regulatory fact that the advantage producer-handlers possess is the difference between the Class I price and the blend price is a serious disorderly marketing condition.

D. Other Industry Changes Since Earlier Rulemakings

27. Contrary to Opponents' assertions and without conceding that the Handler Coalition must establish that conditions have changed since Federal Order Reform in the late 1990's or since the Secretary convened the hearing regarding the Southeast and Appalachian Marketing Orders in 2004, much has changed.

28. First, the growth in producer-handler volumes as discussed above is a significant change. Second, effective in the spring 2008, "temporary" increases in Class I differentials were adopted for Orders 5, 6 and 7. These encompass all of the Orders at issue in the 2004 proceeding. 73 Fed. Reg. 14163 (Mar. 17, 2008). The increase in the Class I differentials applicable to plants in those orders increases the regulatory advantage possessed by prospective and actual producer-handlers in those markets. This may well be the reason

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[8] Opponents assert that the growth in partially regulated milk volumes must also be considered. They are wrong. First, some significant element of that growth from 2002 to 2008 (which appears to have stabilized by 2006) is likely due to the termination of the Western Order. Second, partially regulated plants must meet one of several tests to insure that the regulated market is treated

why two groups of dairy farmers, one from Virginia and one from Florida, who operate milk plants appeared at the Hearing to oppose any change in the regulations. (Bower and Montgomery Tr. 1586 and Dakin Tr. 876). In addition, dairy farmers with and without plants in Colorado testified about wanting to seek producer-handler status in the near term. (Docheff Tr. 2591). The Secretary can and should view their desire to seek out the exemption as further evidence of real, non-speculative, prospective disorderly marketing.

29. Next the Secretary should account for Prairie Farms and the Handler Coalition expert testimony to the effect that major retailers know about and seek out producer-handlers in order to control their dairy costs. (Lee Tr. 947-948 and Wilcox Tr. 1300, 1302-1305, 1311 and Exhibit Thirty Nine). The Secretary has never had this kind of evidence available to him in evaluating both existing and prospective disorderly marketing.

30. Finally, the Secretary can and should consider the testimony of handlers who have recently experienced competitive issues resulting from the producer-handler exemption as discussed above (e.g. AE, Prices, Prairie Farms, Bareman's and the organic farmers) as well as the testimony of the witness for Harrisburg Dairies. (Dewey Tr. 2366-2369). Harrisburg Dairies is a small handler located in south central Pennsylvania with very real and well described concerns about the growth of producer-handlers. In addition she testified that her company has been approached by a large farm about becoming a producer-handler. (Dewey Tr. 2370). This is the kind of growing problem that simply cannot be ignored.

E. <u>Support of Limiting Producer-Handlers from State Representatives and Others</u>

31. The Secretary should also give weight to the testimony and concerns of some neutral observers—the five-state coalition of New Hampshire, New York, Pennsylvania,

Vermont and Wisconsin. Without a direct financial bone in this fight, they convincingly stated that marketwide pooling is essential for dairy farmers to survive and argued that "continuation of an unlimited producer-handler exemption will ultimately destroy the Federal Order marketwide pools." (Bothfeld Tr. 1090). Moreover, this group opposes horizontal integration of producer-handlers. (Hughes Tr. 1164). The unique labeling requirement is one tool or mechanism to meet the goal of this opposition.

32. Smaller producer-handlers expressed concerns and reservations about the existing unlimited exemption or they agreed that a cap of some kind was appropriate or they did not oppose a cap at 1, 2 or 3 million pounds. (Hatch Tr. 256, Proposal 18; Gibson Tr. 636-637). Many of these witnesses were more truly small dairy farms unlike the producer-handlers in Missouri, Colorado or Texas. Several expressed reservation and concern about some of the larger producer-handlers who are able to sell through and into the national retailers rather than just in a very local market.

F. <u>The Risk Of Inaction</u>

33. For the Federal Order system to survive, plants need to be on a level playing field from a raw milk cost prospective. (Bothfeld Tr. 1090). Historical understandings of producer-handlers no longer apply given their size, market position and ability to dispose of surplus milk. Today's producer-handlers are causing disorderly marketing. (Lee 943-944).

34. If a large producer-handler's cost of disposal of surplus exceeded the advantage of not being regulated, it would not make any sense to remain a producer-handler. Logically, then the Secretary should conclude that the very benefits discussed throughout this

Brief and others (at least as to any plant larger than 3,000,000 pounds) must outweigh the cost of surplus disposal.

35. If changes are not made, the market will be further eroded and adversely affected. The more producer-handlers grow, as they have from 2002-2008, the more they will do. The only way to survive in this environment is to take on the characteristics of the unregulated entity because the system will not permit a regulated entity within the system to survive. (Krueger Tr. 1358-1359; Lee Tr. 943-944). If the present set of circumstances remains in place, producer-handlers will continue to grow as they have since 2002 at the expense of everyone else in the marketplace. Even the captive plants will have to evaluate their make and buy decision analysis.

36. Prairie Farms is very much like a producer-handler in that it is owned by dairy farmers who also own many dairy plants. However, the regulatory structure requires Prairie Farms to share the revenues from its Class I operations with other dairy farmers (Prairie Farms makes no complaint about this regulatory fact). (Lee Tr. 941). However, Prairie Farms believes that now is the time to deal with a problem before it becomes ever bigger. The producer-handler exemption simply cannot be reconciled with the purposes and precise language of the AMAA (Lee Tr. 942-943).

37. The FMMO system of marketwide pooling cannot survive if unlimited producer-handlers are permitted to continue to retain their regulatory advantage. (Bothfeld Tr. 1090; Krueger Tr. 1358-1359).

G. <u>Contraverted Proposed Findings of Fact by Some Opponents</u>

38. The Handler Coalition expressly opposes the Findings of Fact submitted by the New England Producer-Handlers Association et al. received prior to the filing deadline. Without limiting this opposition to those Proposed Findings, especially those others not received by the morning of July 17, 2009, or even to some of those Proposed Findings, the following specific proposed Findings of Fact are simply incorrect or irrelevant:

a. The claim that there are no large cow owners seeking Producer-Handler status is contradicted by the Handler Coalition's Proposed Findings of Fact (PPF #) above that non-small producers or producers with processing plants have sought or expect to seek producer-handler status in Florida, Virginia and Colorado. PPF 28. The existing large organic producer-handler in Colorado has disrupted organic dairy farmer businesses as far away as New England and the Upper Midwest. PPF 11. The growing volumes of fluid milk distributed by Producer-Handlers on the FMMOs also belie this claim. Finally the assertion that the number of producer-handlers is declining is irrelevant in light of the facts that all handler numbers are declining and that the overall volume of fluid milk sold by producer-handlers is increasing. Exhibits Six A and Seventy Four A.

b. The Barriers to entry claim is false (Wilcox Testimony Exhibit Thirty Nine) and irrelevant under the AMAA. The claim made by the New England Producer Handlers Association that a processing plant for 450 cows built 10 years ago is $200,000,000 and would cost $500,000,000 is preposterous and directly contradicted by the Handler Coalition expert testimony found in Exhibit Thirty Nine.

c. The Handler Coalition expressly objects to any proposal that would alter the definition of a producer-handler so as to make it even easier to qualify using assets of multiple parties titled in their own name. The ability of the Market Administrator to insure that a producer-handler is truly one integrated business would be wholly compromised if this proposal were to be adopted.

d. There is no evidence that could possibly support increasing the exempt plant (non-producer-handler provision) to 1,000,000 pounds or any level above 450,000 for the limited purpose described by Proponents of Proposal 2.

V. COMMENTS ON ADMISSIBILITY OF EVIDENCE IN RULEMAKING PROCEEDINGS

Various objections were made to the admission of evidence, especially as to evidence observed by industry as to competitive markets, the reasons why business is won or lost and the size of certain former producer-handlers. Since some of those entities were not willing or available to disclose their data (as is their right) and since the Secretary is, for confidentiality reasons, also unable to disclose data, the industry had to present their best available information and estimates. Mr. Krueger's estimates and calculations regarding the size of Sarah Farms both in 2003 and in 2006 are highly relevant and backed up by underlying data regularly collected by him because Sarah Farms is a major competitor and that as a businessman it is his job to know his competition. Moreover, the calculations were corroborated by Sarah Farm's own lawsuit in which Sarah Farms disclosed (to the penny) the amount that it was charged for the producer-settlement fund payment for the month of April 2006. (Krueger Tr. 1363-1366). This documentary information produced at the prior Arizona proceeding and the calculations performed by Mr. Krueger are quite definitely reliable and were left un-contradicted by Sarah Farms' subsequent witness. F.R.E. 803(6) is

liberally construed to permit this testimony and to rely on it. For instance, in *United States v. Reese*, 568 F.2d 1246 (6th Cir. 1977), a government exhibit consisting of copies of newspaper articles, which were dated by a hospital employee, placed in a hospital scrapbook, and which purported to show the visiting hours of patients at a hospital, were admitted under F.R.E. 803(6) through the testimony of an employee of the hospital with knowledge of the hospital's practice of keeping these records. This exhibit was admitted in this criminal action to show that the appellant could not have been visiting his wife at a certain time. In *United States v. Bowers*, 593 F.2d 376, 380 (10th Cir.), *cert. denied*, 444 U.S. 852 (1979), a postal service report concerning security procedures was properly admitted in a criminal case even though the custodian who testified as to the report's origin had not prepared it.

A USDA case is itself instructive. In *United States v. Mendel*, 746 F.2d 155 (2d Cir. 1984), *cert. denied*, 469 U.S. 1213 (1985), a USDA technician's Market Cattle Testing Program report was admitted even though the underlying report had been prepared by a slaughterhouse, not USDA.

But the test for administrative proceedings is not even as stringent as the test under the Federal Rules of Evidence. Hearsay is and has been since at least 1938 wholly admissible in such proceedings so long it is the sort upon "which responsible persons are accustomed to rely." *NLRB v. Remington Rand, Inc.*, 94 F.2d 862, 873 (2d Cir.), *cert. denied*, 304 U.S. 585 (1938). In fact, hearsay (even if Exhibits 22 and 23 are hearsay which is not conceded), "if reliable and credible" can constitute *substantial* evidence in a variety of administrative settings. *Richardson v. Perales*, 402 U.S. 389 (1971) (overruling in agency action "legal residuum rule" and inviting agencies to admit evidence that would be inadmissible in court); *Calhoun v. Bailar*, 626 F.2d 145, 149 (9th Cir. 1980), *cert. denied*,

452 U.S. 906 (1981) (hearsay as substantial evidence); *Hoska v. U.S. Dep't of Army*, 677 F.2d 131, 138 (D.C. Cir. 1982) (relevant and material hearsay is "admissible in administrative proceedings *and in adverse action proceedings in particular*") (emphasis added); *Veg-Mix, Inc. v. USDA*, 832 F.2d 601 (D.C. Cir. 1987) (administrative law judge in Perishable Agricultural Commodity Act enforcement action permitted to consider company invoices even though no custodian was offered to represent their authenticity).

Mr. Krueger's documents produced under his direction and control and his more recent calculation based upon Sarah Farms' own lawsuit are far more credible than these examples. The evidence presented especially by Mr. Krueger and Mr. Hollon concerning the size of other former producer-handlers is definitely the kind of evidence regularly relied upon by the Secretary in the past 70 years of this program. They should be considered as substantial evidence.

VI. CONCLUSION

For all the foregoing reasons, the Handler Coalition urges the Secretary to:

1. Eliminate the Producer-Handler exemption (Proposal 1).
2. If, and only if, Proposal 1 is adopted, subject to the fact that NDFA disagrees as to Order 1 only and subject to the unique labeling provision requirement discussed below, increase the exempt plant limit in each order to 450,000 pounds.
3. If the producer-handler provision is not eliminated completely or if any exempt plant limit is increased above the present level of 150,000 pounds then for any and all such facilities adopt language proposed as part of Proposal 2 that requires such entities to use only their own unique labels to wit:

"The Exempt Plant [or Producer-Handler (if applicable)] does not distribute fluid milk products to any wholesale customer who is indirectly or directly served by a plant described in paragraph 7(a), (b) or (e) of this Order or any other Federal Milk Order, or a handler described in §1000.8(c) under this Order or any other Federal Order that supplied the same product in the same-sized package with a similar label to any wholesale customer during the month."

Respectfully submitted,

_/s/ Charles M. English, Jr.________

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