UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

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

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW SUBMITTED BY SELECT MILK PRODUCERS, INC. AND CONTINENTAL DAIRY PRODUCTS, INC.

Benjamin F. Yale
Yale Law Office, LP
527 North Westminster Street
P O Box 100
Waynesfield OH 45896
419-568-6401 ext 114
ben@yalelawoffice.com
Attorney for
Select Milk Producers, Inc.
Continental Dairy Products, Inc.

TABLE OF CONTENTS

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

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

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW
SUBMITTED BY
SELECT MILK PRODUCERS, INC.
AND
CONTINENTAL DAIRY PRODUCTS, INC.

I. Introduction

A. Select Milk and Continental Dairy Products have standing to participate in this proceeding.

Select Milk Producers, Inc. is a Capper Volstead cooperative marketing primarily in the Southwest Milk Marketing Order.[1] Continental Dairy Products, Inc. is a Capper-Volstead Cooperative selling milk into the Mideast, Appalachia, and Southeastern Milk Marketing Orders. [2] Select and Continental are members of National Milk Producers, Inc. [3] They are proponents of Proposals 20 and 21.[4]

---

[1]List of Handlers on Southwest Order 126, June 2009, http://www.dallasma.com/fd?source=quick&downfile=/webfile/quick/PPD126.pdf.

[2] List of Handlers, December 2008, Mideast Marketing Area Federal Order 33http://www.fmmaclev.com/Releases/Poollist/Handler%20List%201208.pdf;, Appalachian Marketing Area , Federal Order No. 5, Handlers and Plants Subject to Federal Order No. 5 - 2009 http://www.malouisville.com/Statistical%20Material/2009%20Stat%20Mat/09t19.pdf.

[3]Exhibit 23, Top 50 U.S. Dairy Cooperatives by Volume, 2007.

[4]Ex. 1 Hearing Notice,

B. Select and Continental oppose any change in regulations that will eliminate the exemption from pool payments for producer handlers with less than 3 million pounds of milk per month.

Select and Continental support NMPF's goals as presented in proposals 1, 2, and 26 with some differences regarding aspects of proposal 26. Fundamentally they support preserving the status of existing producer handlers up to three million pounds per month. Such preservation can be either through a grandfather provision such as found generally in proposals 17 and 26 or fixing a cap of 3 million pounds per month on all producer distributers as proposed at Proposal 20. Select and Continental oppose any changes in the exemptions that would remove the exemption for existing present producer handlers under 3 million pounds of route sales per month even if that means that the status quo is maintained.

Select and Continental oppose any upper bound for exempt plants above 450,000 pounds per month. Since the raw milk cost to producer handlers of much larger, at least 3 million pounds per month, any cap above which producer handlers are no longer exempt from pooling and pricing will necessarily be higher than 450,000 pounds.

The justifications for the caps for exempt plants is different from producer handlers and combing them in a single definition cannot successfully respond to two distinct reasons.

Otherwise, except as stated, Select does not support any other proposal before the Secretary.

C. The focus of identification, analysis, and resolution of the problem must be the difference in the transfer costs between the plants that purchase raw milk at the minimum price and plants that produce their milk on their own farms.

Aside from the obvious opposing economic rent seeking by proponents of eliminating exemptions for producer handlers and those seeking to preserve or expand them, there is a more fundamental gulf between the party that goes to the validity of their arguments and, ultimately, the Secretary's decision regarding the proposals presented herein. That is this: The Class I price must exceed the cost of production for a producer handler to sustain the removal of the exemption and establishment of a compensatory payment. For proponents they assume there is such profit. For opponents they contend there is not. Therein lies the ultimate issue: Does the minimum Class I price exceed the costs for raw milk for producer handlers? The evidence in this hearing has shown that for at least the existing producer handlers under 3 million pounds, the answer is it does not. There is no economic advantage to such producer handlers and the continuation of the exemption is not only appropriate, but necessary as a matter of law.

Irrespective of various policy arguments in support of such elimination, some of which Select and Continental support, it is not policy which controls what the Secretary can do, but the legal constraints of the AMAA and facts presented at

this hearing. The Supreme Court and other courts have clearly stated that as a regulation of economic activity, decisions have to be based on economics. In the case of compensatory payments, these must be designed so as not to impose a tariff or other charge that makes the supplier artificially higher than the minimum prices imposed on fully regulated plants.[5]

This record has conclusively established that existing producer handlers under 3 million pounds of route sales per month have a raw milk cost that exceeds the minimum prices of their regulated competitors and this disadvantage has existed in recent years and is especially the case in 2009.

The USDA has in prior decisions stated that exemption for producer handlers was because they assumed the risk of the plant and the farm and were self sufficient.

> The changes in the proposed rule were not intended to fully regulate any producer-handler that is currently exempt from regulation. producer handlers have been exempt from the pricing and pooling provisions of the orders for several reasons. First, the care and management of the dairy farm and other resources necessary for own-farm production and the management and operation of the processing are the personal enterprise and risk of the owner. Second, typically producerhandlers are small businesses that operate in a self-sufficient manner. Finally, producer-handlers do not have an advantage as either producers or handlers so long as they are responsible for balancing their fluid milk needs and cannot transfer balancing costs to other market participants.[6]

---

[5]*Lehigh Valley v. U.S.*, 370 U.S. 76 (1962).
[6]64 Fed. Reg. 16026, 16037 (April 2, 1999).

In light of this hearing record, applying that standard to existing producer handlers would justify continued exemption from paying into the pool.

Ultimately, as required by law, the issue comes down to one of economics– does the exemption from pool payments provide producer handlers an economic advantage in raw milk costs over plants not exempt, what is the amount of such advantage, and what form and size of compensatory payment equalize the two models of acquiring milk.

The predominate proposals before the Secretary assume, without establishing facts, that the answer to the first is yes, do not quantify the second, and impose an arbitrary compensatory payment with no connection to actual raw milk price differences.

There are 27 proposals plus the implicit one (no change) now before the USDA. These proposals share elements between them and can be reduced to less than a dozen such elements. Rather than proposals, these elements are addressed in terms of their response to the economic situation of producer handlers as contrasted with their competitors, fully pooled plants.

Upon review of the record presented at the hearing and applying the law, the conclusion must be that removing the exemption on pool payments on existing producer handlers with sales under 3 million pounds is not appropriate. Whether

their continuation is done through some clause that "grandfathers" existing producer handlers, setting a cap at 3 million for all producer handler exemptions including new producer handlers, or no changes at all is not the issue. At the end, however, there is no basis whereby their exemption should terminate.

II. The 27 remaining proposals can be reduced to a handful of separate elements.

Appendix 1 to this brief, Producer Handler Hearing Proposals, lists all the proposals keyed to their various elements, sections of the CFR that are proposed to be changed and other aspects of the proposals.

The 27 proposals (Proposal 20 was withdrawn at the hearing) proposals plus the implicit proposal for no change can be grouped into four categories: Limits on producer handlers, limits on exempt plants, modification of other terms on producer handlers and exempt plants, and other proposals. The proposed 158 changes to the Code of Federal Regulations can be simplified to a few.

The majority of these proposed amendments to the marketing orders encompass all of the marketing areas. Some are more pointed identifying one or a few orders.[7] Proponents of 5, 6, and 28 were not at the hearing. Proponents for 3 and 7 were not opposed to the proposals being considered on a national basis.

[7]Proposals 3, 5, 6, 7, and 28.

Other proposals did not include the Arizona and Pacific Northwest areas because they already had limiting language.[8]

A. There are only three different proposals regarding the size limitation for producer handler exemption from pooling.

Proposal 21 for Order 1 provides a template for the changes to producer handlers. It reads as follows:

> § 1007.10 Producer-handler.
> * * * * *
> (a) Operates a dairy farm and a distributing plant from which there is monthly route disposition in the marketing area, not to exceed 3 million pounds; * * *[9]

This language is repeated for seven of the remaining orders. Orders 124 and 131 already have similar language.[10] By making the following modifications, to the proposal, it becomes the template that addresses the end result in all of the proposals except proposals 23, 24, and 25 and some special characteristics of proposals 17 and 26. Proposal 20 was withdrawn.[11]

TEMPLATE LANGUAGE

> § 1xxx.10 Producer-handler.
> * * * * *
> (a) [Prior to *date* operated and]***A*** Operates a dairy farm and a distributing plant from which there is monthly route disposition in the marketing area, not to exceed [*number* pounds]***B*** ; * * *

[8]Proposals 4 and 21.
[9]Exhibit 1, Notice of Hearing, p. 11.
[10]7 C.F.R. §1124.10, 7 C.F.R. §1131.10.
[11]Yale, B. Vol. XI. p. 12-13, Tr. 3432-33.

The ^{A} bracket is the "grandfather clause". This is found in proposals 17 and 26. For proposal 17, it is based upon some own farm production being processed by the distributer from January 2007 to February 2009. Proposal 26 is anytime in 2008. Although the proponents of these proposals certainly tie them to the grandfathering, the nuances such as own farm production in proposal 17 and the restrictions on labels and farms in proposal 26 are independent of deciding in the first instance as to whether there shall be grandfathering.

The ^{B} bracket is the size limitation. Whether combined with elimination of producer handler exemption and allow the exempt plant definition fill that role or continue to separately define exempt plant, the ultimate intent of the proposals is to establish a limitation. The limitations are in pounds per month: 150,000[12], 450,000[13], 750,000[14], 1,000,000[15], 1,500,000[16], 2,000,000[17], and 3,000,000.[18] Proponents for proposals 5, 6, 18, and 28 did not appear at the hearing. Their positions are already part of other proposals. Proponents for proposal 8-9 from Wisconsin Department of Agriculture and other states, were agreeable to 3 million as a cap. Shatto Farms, proponent for Proposals 11-12 acknowledged that his proposal was a "stop loss" but preferred no change and neutral to anything higher.

[12]Proposal 22.
[13]Proposals 1-2, 32, 16, 19.
[14]Proposal 5-6.
[15]Proposal 11-12.
[16]Proposal 18.
[17]Proposal 8-9, 28.
[18]Proposals 3, 7, 13-14, 15, 17, 21, and 26.

No evidence was presented as to why 1,000,000 was better than any other proposal.[19] As a result the Department has before it proposals in addition to doing nothing of three options of setting limits at 150,000, 450,000, and 3 million.

During testimony there were suggestions of numbers higher than the 3 million in order to encompass farms such as Kreider Farms. Though it did not propose such a number, it is apparent that the Pennsylvania Department of Agriculture was seeking a number that did not limit the size of any existing producer handler.[20] The Department is not constrained to these numbers.

B. There are three distinct proposals now before the Secretary regarding limiting the size of exempt plants.

Separate from the PD limitation, though many proponents link them, is a setting of new limits on exempt plants. The Department can raise or lower the current exempt plant limitations without doing anything as regards the producer handler definition. Some of the proposals regarding exempt plants include changes to the definition to incorporate terms regarding marketing areas and to branding. Those are considered separately. A consideration template for exempt plants is:

§ 1000.08 Producer-handler.

* * * * *

(a) (4) A plant that has route disposition and packaged sales of fluid milk products to other plants of [*number* pounds]***C*** or less during the month.

[19]Shatto, M. Vol. IV, p. 132, Tr. 1197.
[20]Kreider, R., Vol. VIII, p. 197, Tr. 2697.

Bracket *C*, using the same analysis as above, the proposals are narrowed down to the options of 150,000, 450,000, and 3 million.

C. Miscellaneous modifications of producer and exempt plants provide other options.

In addition to the proposals to change limits on producer handlers and exempt plants, some proposals also call for additional qualifications to the exemption including different marketing areas to measure the total sales, limitations on branding[21], number of farms owned, definitions associated with grandfathering,[22] exemptions for farm to retail sales, and soft caps.[23] Two proposals, though addressing the issues inherent in the other proposals, go a different direction and propose that certain characteristics of regulation and exemption of producer handlers be provided to all handlers including exemption of on farm production and creation of individual handler pools rather than marketwide pooling.

NMPF and IDFA proposal 2, changes to exempt plants, and NMPF proposal 26, grandfather existing producer handlers under 3 million pounds, both include provisions for refining the distribution area for determining eligibility so that it would include all sales, not sales into the marketing area. This provision can be

[21]Proposal 2 and 26.
[22]Proposal 17 and 26.
[23]Proposal 17.

considered independent of any of the others though support may be conditional upon other provisions being adopted.

Similarly proposals 2 and 26 provide for a requirement that the exempted plants only market with "unique brand". The purpose of this proposal is to avoid "integrators" who would "daisy chain" lots of small plants to supply large box or discount stores. This provision can be considered independent of any of the others though support may be conditional upon other provisions being adopted.

Proposal 26 would limit any grandfathered exempt plant from owning an interest in any other farm. The rationale for that and how that would result in different regulation than currently was never explained.

Proposal 17 provides several nuances off of both the limitation on producer handler size as well as how the caps would work. An extensive definition is provided for existing producer handlers eligible for the one time exemption as well as how the amount of their exemption would be. It also provides that grandfathered producer handlers could exempt own farm production not to exceed the historic average of non-pooled milk on its farms and total marketings of own farm and purchased milk could not exceed 6 million pounds.[24] This proposal is a counter proposal to the elimination of producer handlers or imposing limits on

[24]Vetne, J., Vol. XII, p. 13, Tr. 3744.

them.[25] As such a decision by the Secretary to make no changes would make consideration of this proposal unnecessary.

AIDA Proposal 23 would exempt all own farm production with no limits to outside purchases. This same proposal with a soft cap of 3 million pounds was endorsed by National All Jersey at the hearing.[26] This proposal could be considered independent of a decision regarding the elimination or limiting of the current producer handler and exempt plant definitions.

AIDA Proposal 24 would modify the definition of producer handler that would exempt all milk which the producer controlled from the farm to the ultimate consumer either through its own stores or home delivery routes. If the producer handler definition remains unchanged, this proposal would not require consideration.

AIDA Proposal 25 calls for the expansion of one of the characteristics of producer handlers, individual handler pool, to all handlers in the market. Like most other alternatives, it is a stand alone proposal worthy of its own consideration.

[25]See, e.g., Keefe, S., Vol. IX, p. 101, Tr. 2916.
[26]Metzger, E., Vol VIII, pp. 325-326, Tr.

D. Consideration of all proposals is controlled by the AMAA and the Administrative Procedure Act.

Primarily, this hearing is called to consider whether current market conditions exist which are disorderly and such disorder arises out of the unlimited producer handler exemption from pooling in eight orders and limited in two orders. Upon finding that such conditions do exist, consideration is given on how to address and correct those marketing conditions.

Proponents of each of the proposed amendments to the marketing orders have the burden to provide substantial evidence that supports that disorderly marketing conditions exist or that the current regulations fail to effectuate the purpose of the act and, as a consequence require amendment. The burden also applies to proving the proposed amendments will create orderly marketing and effectuate the purpose of the AMAA. Anecdotal and speculative comments are not such evidence.[27]

The Supreme Court and other courts have made it clear that the Secretary's powers are limited by the authorities within the AMAA and that evidence of a need for change is to be based in economic reality, not policy. [28]

Since it is about producer handlers, it is necessary to see what the hearing record says about them and whether they are creating marketing disorder.

---

[27] *Borden, Inc., v. Butz,* 544 F.2d 312, 319 (7th Cir. 1976).
[28] *Lehigh Valley Cooperative Farmers, Inc. v. United States,* 370 U.S. 76 (1962).

III. Producer Handlers have unique characteristics within the Federal Milk Marketing Orders.

Producer handlers, sometimes called producer distributors, and thus also called "PDs" are, in simple terms, producers who market their own milk to consumers or for immediate sale to consumers, and one who processes its own produced milk for sale to consumers. It is the holding jointly of the risk of the producer and as the processor of the milk that separates producer handlers from producers or processors. producer handlers are not producers plus processors, they are added value producers which have their own, unique risks, and opportunities.

Producer handlers are not "unregulated." The only way that a producer-handler is not "regulated" is with regard to the payment of minimum class prices and participation in the producer settlement fund. Producer-handlers are (and have been) regulated. They must satisfy all of the requirements for designation as a producer-handler set forth in the applicable order.[29] They must make and maintain records regarding the sources and dispositions of their milk. [30] They must submit monthly handler reports as must other plants located in the order. They are prohibited by rule from purchasing more than 150,000 pounds of milk per month from producers[31] in some orders or none in others.[32] They are not

[29] See, e.g, 7 C.F.R. § 1001.10.
[30]See, e.g., 7 C.F.R. §1033.10(d) and § 1033.10(d).
[31]See, e.g., 7 C.F.R. §1033.10(c).
[32]See, e.g., 7 C.F.R. §1006.10.

eligible for the benefits of a producer with regard to participation in the blend price.[33] Milk which they sell to handlers in the order is down allocated to the cheapest class.[34] As compared to "regulated plants" who have no limitation on how much milk they can purchase or who they can sell to, producer-handlers are indeed regulated.

A. The Secretary has defined producer handlers as those entities that share the risk of producers and handlers.

Producer handlers are recognized in the AMAA. They are also provided for in each of the FMMO orders. There are several definitions provided for in the orders. The following appears in five orders:

> § 1033.10 Producer-handler.
> Producer-handler means a person who: (a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area during the month;
> (b) Receives fluid milk from own farm production or that is fully subject to the pricing and pooling provisions of the order in this part or any other Federal order;
> (c) Receives at its plant or acquires for route disposition no more than 150,000 pounds of fluid milk products from handlers fully regulated under any Federal order. This limitation shall not apply if the producer-handler's own farm production is less than 150,000 pounds during the month;
> (d) Disposes of no other source milk as Class I milk except by increasing the nonfat milk solids content of the fluid milk products; and
> (e) Provides proof satisfactory to the market administrator that the care and management of the dairy animals and other resources

[33]See., e.g., 7 C.F.R. § 1126.12 .
[34]See., e.g., 7 C.F.R. § 1000.42.

> necessary to produce all Class I milk handled (excluding receipts from handlers fully regulated under any Federal order) and the processing and packaging operations are the producer-handler's own enterprise and at its own risk.[35]

A similar definition, found in 3 Southeastern orders reads:

> § 1005.10 Producer-handler.
> Producer-handler means a person who:
> (a) Operates a dairy farm and a distributing plant from which there is monthly route disposition in the marketing area;
> (b) Receives no fluid milk products, and acquires no fluid milk products for route disposition, from sources other than own farm production;
> (c) Disposes of no other source milk as Class I milk except by increasing the nonfat milk solids content of the fluid milk products received from own farm production; and
> (d) Provides proof satisfactory to the market administrator that the care and management of the dairy animals and other resources necessary to produce all Class I milk handled, and the processing and packaging operations are the producer-handler's own enterprise and are operated at the producer- handler's own risk.[36]

By regulation, producer handlers in the Pacific Northwest are subject to a limitation of 3 million pounds of Class I sales per month.[37] In accordance with statute, any PD with Class I sales in excess of 3 million pounds and sales into the Arizona order, are subject to regulation on those pounds regardless of location of the plant.[38] Some of that regulation can be as a partially regulated plant.[39]

---

[35]7 C.F.R. §1033.10, *see, also* 7 C.F.R. §1001.10, 7 C.F.R. §1030.10, 7 C.F.R. §1032.10, and 7 C.F.R. §1126.10.

[36]7 C.F.R. §1005.10, *see, also*, 7 C.F.R. §1006.10, 7 C.F.R. §1007.10.

[37]7 C.F.R. §1124.10, 70 Fed. Reg. 74165 (Dec 14, 2005).

[38]7 U.S.C. §608c(N)

[39]7 C.F.R. §1131.10(f).

B. The Producer Handler exemption is founded in law and regulation, not "administrative convenience."

During the hearing proponents of eliminating producer handlers argued that the producer handler exemption was rooted in "administrative convenience" in Kansas City in the 1930's. [40] The argument is that producer handlers were excluded under a milk licensing program that predated the AMAA because they were unwilling to agree to the program. It was deemed a better to have it without them than none at all. The proponents make a giant leap to say that it was this experience in Kansas City in the 30s that is the reason we have exemption of producer handler obligations to the pool today. It simply is not the case.

First, there is an anachronistic view of producer handlers. The definition of a producer handler in the FMMO system today is one in which there is total control of plant and milk.[41] But in the past, producer handlers also purchased milk. This was the case until the mid 1950s. In the *Ideal Dairy* case,[42] prior to the challenged regulations, producer handlers could buy milk from other producers and were exempt.[43] In California, producer handlers under that state order can purchase their own milk.[44] This is the meaning behind the language in the AMAA that says

---

[40]Cryan, R., Vol. II, P. 223, Tr. 428, referencing *Early Development of Milk Marketing Plants Kansas City, Missouri, Area*. 1952 USDA.

[41]See, e.g., 7 C.F.R. 1126.10.

[42]*Ideal Dairy Farms v. Benson,* 288 F.2d 608 (3d Cir. 1961).

[43]7 C.F.R. § 927.65 (August 1, 1957) (exempts own farm milk up with some purchases), *cf.* 7 C.F.R. §927.65 (January 1, 1956) (all own farm milk exempt).

[44]Schiek, W., Vol. VII, p. 28, Tr. 2132.

"including producers who are handlers."[45] Prior to recent decades producer handlers were handlers of other producers milk and it is only by regulatory limits in place today that they are not.

This administrative convenience argument shows up no where in the legislative history of the AMAA.[46] In all the years that Congress said that the legal status of producer handlers was to remain unchanged, it never once identified it for "administrative convenience." [47]

In the years the Secretary has considered producer handler exemptions it has never called upon "administrative convenience" as a reason. For example, when the Secretary denied efforts to change producer handler definitions during order reform, it never identified "administrative convenience" as a grounds for doing so.[48]

Select and Continental agree that good policy means that producer handlers should not have an economic advantage by virtue of their exemption from pool payments. Changing the regulations for producer handlers should be, however, based upon economic reality and sound legal authority, not historic revisionism.

---

[45]7 U.S.C.A. 608c(5)
[46]See, 79 Cong.Rec. 11, 130 (1935) and 79 Cong. 9568, 9569, 9570 (1935).
[47]See, e.g., Pub.L. 101-624, Title I, ss 112, 113, Title XIII, s 1306, 104 Stat. 3380, 3561.
[48]63 Fed. Reg. 16026 (April 4, 1999).

C. **When considered with the consolidation of milk plants and producers, the number of producer handlers under 3 million pounds per month has not changed significantly.**

The number and size of producer handlers has not been consistently tracked. Exhibit 8 lists the 40 producer handlers at the time of the hearing.[49] producer handlers are found in each of the ten orders. Sales totaled 51,227,000 million pounds for December 2008 with average monthly sales at 1,280,686 pounds.[50] As of March 2009, the number of producer handlers decreased to 37. Of the 37 all but 7 had route distribution of less than 2 million pounds per month.[51] The remaining seven range from more than 2 million to 20,000,000.[52] Based on other testimony it is known that at least five producer handlers are in excess of 3 million pounds– GH Dairy El Paso, Aurora Dairy[53], Heartland Creamery (milk herd of 4500)[54] Braum's Dairy (herd exceeds 12,000 head)[55], and Kreider Dairy (1400 cows at 70 pounds per day would be right at 3 million class I)[56]. Because of administrative limitations on issuing data when less than three entities are listed, the number between 2 and 3 million must be two meaning that there are five producer handlers with route distribution over 3 million pounds.[57] This compares with 108 regulated plants with

[49]Carmen, C., Vol. I, p. 106, Tr. 106.
[50]Exhibit 7.
[51]Exhibit 20.
[52]Exhibit 20.
[53]Exhibit 87.
[54]Hollon, E., Vol XII, p. 48, Tr. 3779.
[55]Berthiaume, L., Vol. III, p. 44, Tr. 648.
[56]Exhibit 84.
[57]Cryan, R., Vol. II, p. 174, Tr. 399.

milk distribution in over 3 million but less than 20 million pounds. Seventy-three plants exceed 20,000,000. Using the midpoints for the regulated plant sizes in Exhibit 20 below 5 million pounds times the number of plants one can estimate the pounds of milk produced by plants of that size at approximately 1.278 billion pounds per year compared with the 40 billion pounds produced by plants larger than any of the producer handlers.[58]

Of the 252 regulated pool plants, only 40 are less than 3 million pounds. Six of them may have had zero distribution but are are stand alone pool distributing plants or Class II plants that are unit pooled with Class I plants.[59]

Comparisons with the sizes and numbers of other plants is not consistent. Exhibits 14-20 which identify small plants, does so based upon Class I disposition. Large Class II plants unit pooled with Class I plants with minimal amounts of Class I sales such as drinkable yogurt are listed as "small plants".[60]

Further, the consolidation of firms also skews data. Although listed as separate plants, the plants may be owned by one person. For example Prairie Farms owns 35 plants.[61] Dean Foods owns even more.

Similarly, farms may show as individual farms in the statistics but be owned by the same person. Only one producer handler enterprise was identified owning

---

[58]Exhibit 10, Exhibit 20.
[59]Carmen, C., Vol. I, p. 98, Tr. 98.
[60]Carmen, C., Vol. I, pp. 95-6, Tr. 95-96.
[61]Lee, Vol. III, pp. 333-334, Tr. 938-939.

two plants. GH Dairy operates as a producer handler in El Paso as well as a plant in Yuma, Arizona.

Because the data does not completely correlate plant sizes between regulated and fully regulated plants and does not consider in any way the consolidation of plants, the hearing record cannot support statements that characterize the relative growth of producer handlers as distinct from the growth of dairy entities in general.

In the end such a characterization neither proves nor disproves the underlying element regarding the small producer-handler exemption from pool payments. That consideration is strictly an economic one that shows whether producer handlers' cost of raw milk is less than the uniform blend price. If there are producer handlers whose size and cost of production are such that it truly has a raw milk price advantage over regulated handlers, then consideration of removing the exemption would be appropriate but only limited to those producer handlers who truly have the advantage. There is no such evidence regarding the existing producer handlers with less than three million pounds per month distribution.

D. Producer Handler operations by virtue of their integration bring efficiencies in the production to distribution of milk.

As integrated entities, producer handlers have efficiencies that are beneficial to the enterprise and ultimately to the consumer. There is the obvious cost savings associated with the farm and plant being together.[62] They do not have costs

[62]Cryan, R., Vol VI , p. 28, Tr. 1704.

associated with acquiring raw milk.[63] As the sole source of milk, there is the important aspect of source verification.[64] This also brings better quality and control over quality.[65] producer handlers can be innovative[66] and provide special services like glass bottles, home delivery, special flavors.[67] One of the innovations of the producer handler was the higher solids, low fat milk.[68] In the case of organic milk, it provides comfort to customers that there is no chance it got mixed with non organic milk.[69]

Being from one farm brings some added value.[70] Consumers expect "...a uniform, consistent product."[71] As Kreider explained,

> 20 * * *We don't buy milk
> 21 from anyone else because we want to have complete
> 22 control of our milk supply. Being a member of a pool
> 23 plant with access to other milk would therefore be of no
> 24 benefit to Kreider Farms.[72]

He goes on to explain,

> 21 * * *where a lot of
> 22 local consumers are looking for local, sustainable
> 23 farms, and it's a benefit to them to know exactly where
> 24 their milk comes from, and they come to the barn to

---

[63]Dewey, C Vol VII p. 287, Tr. 2391.
[64]Hettiga, Vol VIII, p. 246, Tr. 2693.
[65]Hettiga, H., Vol. VIII, p. 298, Tr. 2745.
[66]Hettiga, H., Vol. VIII, p. 299, Tr. 2746; Bostwick, Vol IX, p. 75, Tr. 2890.
[67]Metzger, E., Vol VIII, p. 335, Tr. 2782.
[68]Bostwick, W., Vol IX, p. 20, Tr. 2835.
[69]Keefe, S., Vol. IX, p. 97, Tr. 2912.
[70]Gilbert, G., Vol. VIII., p. 11, Tr. 2458.
[71]Bostwick, Vol IX p. 22
[72]Kreider, Vol VIII p. 185

25 visit[73]

Another aspect that some farms argued were advantages were the ability to have Kosher status.[74] Having more choices is in the consumers best interest.[75]

Dr. Knutson, also identified producer handlers as entering into "contestable markets" where there is a oligopoly which is charging higher prices. An example was El Paso, Texas.[76]

Efficiencies not associated exclusively with producer handlers but alleged were the use of ultra high temperature pasteurization and nationwide distribution because of the extra shelf life.[77] Location of the plants can also bring in sales at drive thru or stores.[78]

One of the complaints, discussed later as part of the transfer price and compensatory payment issue, is the claim that producer handlers have the ability to underpay because they do not pay into the producer settlement fund.[79]

The other claim in terms of efficiency is that "larger producer handlers", never defined, have economies of scale that allow them to compete. [80]

---

[73]Kreider, Vol. VIII, p. 195, Tr. 2642.
[74]Kreider, Vol. VIII, p. 196, Tr. 2643.
[75]Hettiga, H., Vol VIII, p. 300, Tr. 2747.
[76]Knutson, R., Vol IX, p. 242, Tr. 3052.
[77]Arnold, K., Vol VI, p. 82, Tr. 1758.
[78]Schilter, T., Vol VI, p. 91, Tr. 1767.
[79]*See, e.g.*, Segalla, R., Vol VI, p. 98, Tr. 1774; Cryan, R. Vol VI, p. 277, Tr. 1903.
[80]Cryan, R. Vol. II, p. 205, Tr. 410.

Regulating producer handlers so as to deny them that kind of model will have the effect of removing these efficiencies from the market place.[81]

E. It is appropriate and necessary for the Secretary to from time to time make sure that producer handlers exempt from pool payments do not have an economic advantage over pooled and priced regulators.

If producer handlers have an economic advantage over pooled and priced plants, then that advantage should attract significant amounts of milk to come to the producer handler model for pricing. This is the fear repeated throughout the hearing by those seeking limitations or elimination of the producer handler exemption. It is an economic truth that cannot be denied.

The statement, however, begs the question as to what is the extent, if any, of such economic advantage. That is, if there is no such identifiable advantage based on actual costs of raw milk, then it would follow that there would not be a growth in producer handlers processing Class I milk. The potential of more and more larger producers who could be producer handlers does not drive the debate, rather it is the extent of the advantage. At the same time the relative static in the number of producer handlers suggests the economics do not support such a model. But even that is an unnecessary argument as contrasted with the actual costs of production.

[81]Knutson, R. Vol. IX, p. 240, Tr. 3055.

IV. The Secretary is faced with the challenge of equalizing the raw milk costs of two different business models.

A. The source of raw milk for regulated handlers differs from that of producer handlers.

Facing the Secretary are two different models for obtaining a milk supply. The first is clearly contemplated by the AMAA, it is the purchase of milk. The AMAA gives the Secretary the authority to establish minimum prices for purchases of milk from producers.[82]

In that regard NMPF quoted a portion of the AMAA at the hearing,

> The
> 17 Marketing Agreement Act of 1937 is amended with the
> 18 citation that provides that for the Secretary, in order
> 19 to accomplish the purposes set forth in paragraphs (A)
> 20 and (B) of this subsection, this subsection five,
> 21 providing a method for making adjustments in payments,
> 22 as among handlers (including producers who are also
> 23 handlers), to the extent that the total sums paid in
> 24 each -- by each handler shall equal the value of the
> 25 milk purchases by him at the prices fixed in accordance
> with paragraph (A) hereof. And the emphasis is added.
> 2 But that -- that phrase, including producers who are
> 3 also handlers is in the original text of the Act.[83]

The Act clearly brings into possible regulation producers who act as handlers, but only on "milk purchases by him." Further the establishment of these prices are to be "equal".

---

[82]7 U.S.C. 608c(5).
[83]Cryan, R Vol. II, p. 175, Tr. 380, quoting 7 U.S.C. 608c(5)(C).

1. Plants purchasing raw milk have a easily determined transfer cost for their input.

Today, almost all of the regulated plants subject to minimum prices purchase all their milk. Only 9 of the fully regulated plants in March 2009 had some own farm milk – 5 are in the Eastern markets and 4 are in the Western markets – 3 have between 150,00 and 1,000,000 of sales and 6 have sales between 3,000,000 and 20,000,000.[84] The AMAA authorizes the imposition of minimum prices and pooling on purchased milk.

> The
> 17 Marketing Agreement Act of 1937 is amended with the
> 18 citation that provides that for the Secretary, in order
> 19 to accomplish the purposes set forth in paragraphs (A)
> 20 and (B) of this subsection, this subsection five,
> 21 providing a method for making adjustments in payments,
> 22 as among handlers (including producers who are also
> 23 handlers), to the extent that the total sums paid in
> 24 each -- by each handler shall equal the value of the
> 25 milk purchases by him at the prices fixed in accordance
> with paragraph (A) hereof. And the emphasis is added.
> 2 But that -- that phrase, including producers who are
> 3 also handlers is in the original text of the Act.[85]

The Act clearly brings into possible regulation producers who act as handlers, but only on "milk purchases by him." Further the establishment of these minimum prices are to be "equal" except for adjustments unrelated to own farm production.[86]

---

[84]Exhibit 20.
[85]Cryan, R Vol II p. 175, Tr. 380, quoting 7 U.S.C. 608c(5)(C).
[86]7 U.S.C. 608c(5)(C).

2. **Producer Handlers do not purchase milk but produce milk.**

Erik Metzger noted an example of not purchasing milk when he related that one of his members,

> 17 . . .Bush River Farm in Newberry, South
> 18 Carolina has Class I sales in Order 5. Bush River
> 19 Farm's own-farm milk comes from their 400-cow herd.
> 20 This dairy started bottling in 2004 and has not relied
> 21 on any purchased milk.[87]

He related another,

> 23 A. They began their bottling operation in
> 24 February 2007 with six cows. The business has grown to
> 25 include 60 cows today. They use only their own-farm
> 1 milk with no outside milk purchased[88]

One producer adamantly made it clear that he did not acquire milk, but produced it.

> 8 [Miltner] Q. So you acquire -- the milk you acquire is
> 9 at a significantly higher cost than a regulated handler?
> 10 A. We don't acquire milk. We produce it.
> 11 Q. Okay. And the milk you produce is at a
> 12 significantly higher cost compared to regulated
> 13 handlers?
> 14 A. That's correct[89]

Even the regulations speak of producers receiving "milk solely from own farm production"[90]

---

[87]Metzger, E., Vol. VIII, p. 321, Tr. 2768.
[88]Metzger, E., Vol. VIII, p. 322-323, Tr. 2769-2770.
[89]Gibson, J, Vol III, p.36, Tr. 640.
[90]See, e.g., 7 C.F.R. §1001.10.

The farm and the plant are one operation and it is the cost of production that dictates profit or loss.

Q. Okay. Now, the blend price in Order 1
8 thus far this year has averaged about $12.50. You don't
9 produce your milk at anything near that price, do you?
10 A. No.
11 Q. And when the Class I price is $12.68,
12 again, you're not acquiring your milk at anywhere near
13 that price, are you?
14 A. No.
15 JUDGE CLIFTON: Just so the record's
16 clear, are you paying more or less than that
17 when you acquire milk?
18 THE WITNESS: Well, the Federal Order
19 says I cannot transfer money from my plant to my
20 farm. You can make an allowance of what's it
21 worth, what it's worth, but my cost of
22 production is what I have to work with.
23 Q. You don't pay anything. It's just
24 whatever it costs you to produce the milk?
25 A. It affects the bottom line.
1 Q. It's all one operation?
2 A. Yes. It has to be.
3 Q. And it's all one -- yeah. It has to be
4 one operation, and at the end of the quarter on the
5 year, you look at one profit or loss figure, correct?
6 A. Yeah, we look at them a lot more often
7 than that.[91]

Therein lies the problem:

[MR. YALE: Level playing field or
2 whatever the case is.
3 DR. KNUTSON: Yes, yes.
4 MR. YALE: And we have on the one hand,
5 the model of an acquisition by purchase. We

[91]Hatch, H., Vol. II, p. 67-68, Tr. 292-293.

6 know what that transfer price is because it is
7 actually a transfer price that's labeled, right?
8 DR. KNUTSON: Exactly.
9 MR. YALE: All right. And we don't know
10 what -- we don't have the beauty of an express
11 price for the production, is that fair?
12 DR. KNUTSON: Exactly, yes.][92]

Accepting the rationale that a receipt by a producer at his plant from his own farm, the question remains is what is the "transfer price" of that milk. This is critical because that is what is needed to compare the minimum price required of fully regulated and priced handlers to make it "equal" as required by the statute. Once we know what the transfer price is we can know both whether there is an advantage and the magnitude of it and, at the same time determine what compensatory payment is necessary to create the equality required by the statute.

So in the end, the statute quoted by NMPF, is not so much centered on the issue of purchase or not, but how to make it equal. If it turns out measuring the transfer price makes it impossible to establish an equal price between handlers, then the Secretary cannot ignore the statute by creating a more than equal or less than equal compensatory payment.

But as an integrated operation, the transfer price is not a purchase nor is it easily identified.[93] The answer, "A producer-handler acquires milk at the cost of

[92]Knutson, R., Vol. IX, p. 228, Tr. 3043.
[93]*See*, Bostwick, W, Vol. IX, p. 59, Tr. 2874.

production on the farm,"[94] explains what is happening but raises the next, more important question–at what cost?

As self evident this seems, there were those who insisted that the transfer price was the Class I less the uniform price.[95] But one proponent of that argument acknowledges that his idea of the uniform price being the transfer price is theoretical.[96] One witness called by proponents recognized that the transfer price was not the quota price [a price fixed by the California state order] in California, but the producer handlers own costs.

> In reality, integrated firms will
> establish transfer prices to maximize the
> profits of the entire integrated operation, not
> just each component operation.[97]

B. **The argument is that Producer Handlers solely because they are subject to minimum price one has an economic advantage over the other.**

Repeatedly throughout the hearing, witnesses stated that they wanted a "level playing field" and that was defined as producer handlers paying into the producer settlement fund the difference between the plant blend and the uniform price.[98] The assumption of this argument is that the raw milk cost of a producer

[94]Keefe, S., Vol IX, p. 96, 2911.
[95]Tonak, D., Vol II, p. 291, Tr. 496.
[96]Tonak, D., Vol II, p. 321, Tr. 326.
[97]Schiek, W., Vol. VII., p. 33, Tr. 2137.
[98]Newell, B., Vol. III, p. 88., Tr. 692.

handler is less than the regulated handler paying minimum prices. This leveling is one of raw milk cost, equal raw milk cost.

C. Changes to FMMO regulations to comply with a public policy statement must be based upon evidence of market conditions supporting the change and have a solution that is economically based.

To remove exemptions from pool payments for producer handlers is in response to a policy shift. Rather than exempt producer handlers because of administrative relief or political expediency as argued by some, [99] the risks they take in selling their own milk, or interpretation of law, the USDA must determine that producer handler exemption must be determined on a different basis. Irrespective, it must be consistent with the law.

1. The public policy argument by itself cannot justify changes to the milk marketing regulations.

Just a desire to change the policy rationale, does not, by itself, justify elimination of the exemption. There are good policy reasons for at least considering some restrictions. One reason is the lack of transparency of PD pricing counters the benefits of minimum pricing.[100] producer handlers do not contribute to the producer settlement fund and therefore producers do not benefit from those Class I sales.[101] That producer handlers do not pay into the pool constitutes an

[99]Cryan, R., Vol II, p, 223, Tr. 428.

[100]Carrejo, G., Vol V, p. 79, Tr. 1511; Newell, M, Vol. III, p. 134, Tr. 738; Knutson, R, Vol X, p. 236, Tr. 3365.

[101]Carmen, C., Vol V, p. 202-205, Tr. 1634-37; Ex. 57 Theoretical Pool with Changes of 1, 2, and 3 million pounds;

economic advantage over handlers that pay into the pool[102] to the point that some consider producer handlers as being subsidized by the pool.[103] producer handlers with an economic advantage could undercut prices sold to customers and thus create disorderly marketing conditions.

> A. In several markets, producer-handlers
> 7 have a substantial and growing share of Class I sales.
> 8 They pay a price that is substantially lower simply by
> 9 virtue of not contributing to the producer settlement
> 10 fund, and that creates disorderly marketing because
> 11 there's an unjustified competitive disadvantage to
> 12 people who are participating in the system.[104]

For these and other reasons, there were numerous witnesses who argued that since the exemption of producer handlers from pooling violates these policy constraints, that producer handler exemptions should be limited or even eliminated and that is the end of the argument. Select and Continental are among those who support a policy denying exemption to larger producer handlers as evident from Proposal 21. NMPF and IDFA led the effort.[105] They were not alone. Others made the request, both regulated handlers[106] and some producer handlers requested limitations on the exemption from pooling.[107] Though many of the latter did so as

[102]Segalla, R., Vol. IV, p. 76, Tr. 1141.
[103]Cryan, R., Vol. VI, p. 287, Tr. 1963.
[104]Cryan, R., Vol VI p. 1693.
[105]Proposal 1 and 2.
[106]Proposal 19
[107]Proposal 5, Proposal 12.

stop losses wanting to make sure that the exemption they enjoyed or wanted to enjoy was not lost.[108]

2. The AMAA while authorizing minimum payments and equalization of payments, such changes must provide for equal prices paid for milk purchased.

The first question is whether the AMAA will permit the Secretary to remove the exemption of producer handlers from the pool. The AMAA gives the Secretary the authority to establish minimum prices of handlers.

> (A) Classifying milk in accordance with the form in which or the purpose for which it is used, and fixing, or providing a method for fixing, minimum prices for each such use classification which all handlers shall pay, and the time when payments shall be made, ***for milk purchased from producers or associations of producers***. ***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.[109]

The requirement for the prices for purchases is that it be uniform. On the one hand, this means that handlers under the regulations have to pay the same price, an argument in favor of limiting producer handlers. On the other hand, any such payment must be uniform. That is what is good for the goose is good for the sauce. The Secretary cannot impose a payment that results in a producer handler paying more for his milk than a non-producer handler.

---

[108]Hatch, H, Vol II, p. 31; Dunajski, T. Vol II, p. 127; Shatto, M, Vol IV, p. 1199.
[109]7 U.S.C.A. §608c(5)(A) [Emphasis added]

Further, along this line, the AMAA authorizes the market wide pooling of milk sales so as to provide "uniform prices for all milk" except for adjustments not relevant to the distinction between producer handlers and handlers who are not producers and producers who do not process their own milk.[110] In short, the law requires that any pooling of receipts from producer handlers must result in a uniform price to producers.

Finally, in this line, the AMAA gives the Secretary the authority to establish the producer settlement fund to equalize the payments.

> (C) In order to accomplish the purposes set forth in paragraphs (A) and (B) of this subsection, 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) of this subsection.***[111]

Thus, if the Secretary decides based upon good policy reasons to impose payment obligations on producer handlers and record evidence supports the theory underlying the policy he has the obligation to set that payment on an equal basis, he has to assure the producer side of the equation receives a uniform price as his fellow producer, and the Secretary has to make sure that the producer handler pays the same price as the handlers who do not have own farm production. The expression "including producers who are handlers" may mean, for example, that

[110]7 U.S.C.A. §508c(5)(B).
[111]7 U.S.C.A. §508c(5)(C) [Emphasis added].

producer handlers in times of high milk production costs would receive additional payments from the pool to equalize their costs with the handlers.

The compensatory payment into the producer settlement fund does not operate in a vacuum. It is invoked based upon economic necessity, not policy view. It is intended to *equalize* the prices paid by handlers for milk purchased by producers as required by subsections (A) and (B).

D. Economic Conditions both at the producer to plant level as well as within the order provide the legal and factual foundation to consideration of changes in the orders regarding producer handler exemptions.

The Supreme Court provides guidance in this case. In *Lehigh Valley v. U.S.*[112] the issue was focused on the issue of non regulated plants bringing packaged milk into the market place. The argument made in the underlying hearing was that these plants were only paying the "surplus" price for the milk and thus had an economic advantage over fully pooled and priced regulated handlers. This opportunity potentially was disruptive to the marketplace because "Pool handlers in the marketing area who are required to pay the minimum class prices for their milk may find their selling prices undercut by those of nonpool handlers dealing in outside milk purchased at an unregulated price." and diminishing the blend price for producers. [113]

---

[112] *Lehigh Valley v. U.S.,* 370 U.S. 76 (1962).
[113] *Ibid.,* at 81.

This is the identical claim underlying proposals for changes to the exemption of producer handlers– producer handlers' exemption gives allows them to undercut the prices of regulated handlers and the loss of class I proceeds diminishes the pool. As such the Supreme Court's rationale in *Lehigh Valley* is instructive as to what the Secretary can and cannot do as regards producer handlers.

The Secretary's answer to the problem of unregulated outside milk was the imposition of a compensatory payment equal to the Class I - Class III difference, a payment which the Secretary believed was "a suitable charge on such unpriced milk in an amount sufficient to neutralize, compensate for and eliminate the artificial economic advantage for non-pool milk which necessarily is created by the classified pricing and pooling of pool milk under the order. "[114]

This is identical to that proposed by in this case. The effect of eliminating exemption for some or all producer handlers is to impose a compensatory payment (Class I less blend) on all milk produced and marketed by producer handlers. After all, because producer handlers have their own farm production they cannot be assured any minimum payment as producers from the pool. Thus the compensatory payment found in *Lehigh Valley* is virtually identical to that being proposed here. As a result we have the benefit of Supreme Court analysis to aid us

[114]*Ibid.*

in (1) defining what the issue is (2) measuring the advantage of unpriced milk, and (3) crafting the solution.

As to measuring the economic disadvantage, the Court rejected the "irrebuttable presumption" by the Secretary that the appropriate compensatory payment was the fixed difference between Class I and Class III because that the Secretary presumed that the milk being marketed by partially regulated handlers had been purchased at the surplus milk price.[115] Rather the Court insisted that any such compensatory payment reflect the handler's actual costs so that, in fact, the prices paid by handlers are in fact, as opposed to theory, uniform and the imposition of the compensatory payment does not create a trade barrier in violation of the AMAA.[116] It stated "the effect of the fixed compensatory payment is to make it economically unfeasible for a handler to bring such milk into the marketing area."[117] In the effort to effectuate the AMAA through insuring equity among handlers with producer handlers, the final decision of the Secretary cannot do the same thing.

This decision by the Supreme Court guides the Secretary as he considers removing the exemption for pooling by producer handlers.

---

[115] *Ibid.* 370 U.S. at 84-85.
[116] *Ibid.* 370 U.S. at 90. 7 U.S.C.A. §608c(5)(G).
[117] *Ibid.* 370 U.S. at 84.

Described in other terms, the concept outlined by the Supreme Court is that the transfer cost plus compensatory payment must equate with the minimum prices required of pool plants.

> There seems little doubt that an assessment equal to the Class I-Class III differential would, in all but rare instances, nullify any competitive advantage that nonpool milk could have: only if the sum of the purchase price of the outside milk and the cost of its transportation to market were less than the Class III price would a handler find it profitable to bring such milk into the marketing area. ***But it must be obvious that this payment is wholly or partially 'compensatory'-i.e., puts pool and nonpool milk 'on substantially similar competitive positions at source' ...-only if the milk has been purchased at not more than the Class III price.*** If the purchase price of the nonpool milk exceeds the Class III price within the area, the effect of the fixed compensatory payment is to make it economically unfeasible for a handler to bring such milk into the marketing area.[118]

For partially regulated handlers, there is in response to Lehigh Valley a relief provision. Today, partially regulated handlers have two options for compensatory payments into their programs. One is to pay the difference between Class I and the order blend, or to show that the handler has paid at least the blend to its producers on the volume of milk marketed into the FMMO.[119] The proposals before the Secretary which would cause some producer handlers to lose their exemption, only provide for the former, not the latter.

---

[118]*Ibid.* 370 U.S. at 85.
[119]7 C.F.R. §1000.76.

The effect of *Lehigh Valley* on this producer handler proceeding is that the imposition itself of a compensatory payment must be based upon facts that show that there is in fact an economic advantage and then to craft the payment so as to equalize not penalize producer handlers. In short, what is the transfer cost for producer handlers.

E. Identification of the transfer cost or transfer price of milk produced by a producer handler is the necessary first step an addressing the PD problem and policy issues.

The transfer price is the price at which one unit of a firm sells goods or services to another unit of the same firm.[120] The inability to have a number for intra company transfer price is illustrated by the answer Braum's witness gave to a question trying to find what its company used for that purpose.[121]

> Q. But in the end, it ends up with the same
> 20 bottom line for your stockholders, right, regardless --
> 21 A. Exactly. And the tax returns look the
> 22 same. Everything is the same. It doesn't make any
> 23 difference. That's why it's a -- I don't get the
> 24 argument, frankly. It's my costs. That's what it costs
> 25 me. Anything else is -- to me, is a dishonest way of
> 1 looking at it.[122]

In this case transfer price for raw milk of a producer handler is the cost of production for that milk. This is the number that determines whether or not producer handlers can in their model acquire milk significantly less costly than

---

[120]The Financial Dictionary, The Free Dictionary http://financial-dictionary.thefreedictionary.com/transfer+price (July 4, 2009).

[121]Bostwick, W., Vol IX, p. 59, Tr. 2875.

[122]Bostwick, W., Vol IX, p. 76, Tr. 2892.

regulated handlers are required to pay for their milk.[123] As a result it is the first step in determining if there is an advantage, and, if there is, the appropriate payment to equalize the cost of milk by handlers.

> MR. YALE: Okay. So the first step is to
> 6 determine whether it's equal or not. And,
> 7 really, the first step is to know what those
> 8 transfer costs are, is that a fair statement?
> 9 DR. KNUTSON: Yes.[124]

By identifying the farm to plant transfer price, this can be compared to the minimum prices under the order imposed on Class I handlers. If the minimum price exceeds the farm-to-plant-transfer price then the PD advantage so often claimed in the hearing has a factual basis. Further the difference between the two establishes the appropriate level of a compensatory payment.

The ultimate value of knowing the transfer price and using that to determine whether and at what rate to establish compensatory payments brings the policy desires in line with the legal constraints.

The challenge of establishing the farm-to-plant transfer price is that on the one hand the obvious, logical, and most appropriate method (cost of producing the milk) is more complex than simple minimum prices. The proposed methodology, though simple, (class I less uniform blend) does not align with financial reality.

---

[123]Knutson, R. Vol X, p. 229, Tr. 3358.
[124]Knutson, R., Vol X, p. 230, Tr. 3359.

The complexity of the issue explains why some say requiring compensatory payments of producer handlers at all is bad.

> 3 DR. KNUTSON: Yeah. Well, you know, I
> 4 think this whole idea of compensatory payments
> 5 for producer-handlers is a pretty ludicrous
> 6 idea.[125]

1. The Use of Class I Blend is simple and easy to define and monitor.

Under all of the proposals which seek to either limit producer handler exemption from pool payments or eliminate it altogether, the result is that the producer handler will pay into the pool the difference between its plant usage and the uniform blend price. For the milk sold as fluid milk, this means that the difference is Class I less the blend price. As USDA explained when imposing a three million cap in the Pacific Northwest,

> Assuming that some current producer-handlers will have route disposition of fluid milk products of more than 3-million pounds during the month, such producer-handlers will be regulated subject to the pooling and pricing provisions of the orders like other handlers. Such producer-handlers will account to the pool for their uses of milk at the applicable minimum class prices and pay the difference between their use-value and the blend price of the order to the order's producer settlement fund.[126]

This is contemplated if any of the limitations or eliminations are enacted. NMPF appended Table 1 to his presentation which identified the Class I less blend

---

[125]Knutson, R., Vol X, p. 233, Tr. 3362.

[126]Milk in the Pacific Northwest and Arizona-Las Vegas Marketing Areas; Final Decision on Proposed Amendments to Marketing Agreement and to Orders, 70 Fed. Reg. 74165, 74166 (Dec. 14, 2005)

prices per cwt and per gallon for 2007 average prices.[127] He identified this as the measure of the difference between what processors have as a minimum price and what producer handlers do not.[128]

In an answer to a question regarding costs of producer handler the following exchange takes place.

> Q. Okay. And when the milk arrives at the
> 3 producer-handler's plant, the cost of the plant is
> 4 whatever it cost the producer-handler to produce that
> 5 milk on its farm, correct?
> 6 A. The cost of the plant?
> 7 Q. The cost of the plant.
> 8 A. Is the internal transfer price between
> 9 plant -- between farm and plant.
> 10 Q. What is the internal transfer price?
> 11 A. It's whatever -- it's whatever the --
> 12 it's whatever the producer-handler decides it is.
> 13 Q. I'm sorry. I didn't mean to cut you off.
> 14 A. Yes, it is.
> 15 Q. The -- so the price -- you're saying the
> 16 price to the plant is whatever the producer-handler says
> 17 it is?
> 18 A. Well, for -- in terms of -- for purposes
> 19 of an analysis, it can be the -- it can be a number of
> 20 different things, but what really matters is the -- the
> 21 set of costs from cow to bottle. And in that set of
> 22 costs from cow to bottle, the producer-handler has the
> 23 same costs that another farm, another plant, ***have,***
> ***24 except that they're not paying into the producer***
> ***25 settlement fund.***[129]

[127]Exhibit 23, Table 1. Testimony of Dr. Roger Cryan, National Milk Producers Federation In support of Proposals 1, 2 and 26: Eliminate the producer-handler provision; Increase the limit for the size-based plant exemption; And provide a qualified exemption for existing producer-handlers.

[128]Cryan, R, Vol II, p. 407, Tr. 612.

[129]Cryan, R., Vol. VI, p. 1693.

Producers, however, do not pay into the producer settlement fund. If producers consistently produced milk profitably at the uniform blend price, the the proponents' assertion that the difference between Class I and the blend appropriately measures the benefit of acquiring milk by production as opposed to purchase. But, as is the case today, the Class I price is less than cost of production it does not. The Supreme Court said it this way:

> But it must be obvious that this payment is wholly or partially 'compensatory'-i.e., puts pool and nonpool milk 'on substantially similar competitive positions at source'-only if the milk has been purchased at not more than the Class III price. If the purchase price of the nonpool milk exceeds the Class III price within the area, the effect of the fixed compensatory payment is to make it economically unfeasible for a handler to bring such milk into the marketing area.[130]

Evidently recognizing that producers' cost of production is less than Class I, the argument is that the blend price received by producers who participate in the pool represents the market value of milk.

> 22 A producer-handler, by avoiding full
> 23 Federal Order regulation as a distributing plant, can
> 24 pay, effectively the uniform price for milk at the
> 25 plant. (This is effectively the market price for
> 1 producer milk on the market, and is therefore the
> 2 appropriate transfer price for analysis of the
> 3 regulatory impact on the producer-handler plant.)[131]

---

[130]*Lehigh Valley v. U.S.,* 370 U.S. at 84.
[131]Cryan, R., Vol II, pp. 406-407, Tr. 611-612.

The witness goes on further to say that producers have to have profits or there will be no milk. ("In the long return, the regulated handler has to be able to pay the producer a price that covers 7 his cost of production.")[132] Similarly, the overall profitability of the farm-plant integration includes the value attributable to the milk from cost of production in excess of the uniform price.[133]

This underlying assumption of profitability is explained by a proponent of eliminating the exemption.

> A. The nature of the advantage is cost. The
> 1 reality for every entity that operates under the system
> 2 is that their cost for fluid milk is at a minimum, the
> 3 Federal Order Class I.
> 4 And the cost of milk for an exempt entity
> 5 is their cost of producing milk at the farm. And, you
> 6 know, the current situation is pretty interesting,
> 7 because currently it would not favor producer-handlers.
> 8 The cost of producing milk at the farm is -- is less
> 9 than -- certainly less than the blend is providing in
> 10 most orders.
> 11 But on a historical basis, whenever
> 12 there's profit -- which -- which there has to be in
> 13 order to sustain milk -- milk production.
> 14 I mean, let me back up. If the current
> 15 situation were to continue for the long run, we could
> 16 all go home because there wouldn't be any milk for any
> 17 of us to process, because nobody is being rewarded by
> 18 the current marketplace for the production of that milk.[134]

Dr. Knoblauch stated it more directly,

---

[132]Cryan R., Vol VI, p. 378, Tr. 2054.
[133]Bostwick, W. , Vol. IX, p. 76, Tr. 2892.
[134]Krueger, M., Vol. IV, p. 290-291, Tr. 1355-1356.

> Given this fact [the costs of production exceed price], dairy farmers, regardless of the size of their herd, cannot rely on simply marketing their raw milk to ensure long-term economic viability of their farm operations.[135]

No evidence was, or could be presented, that shows that the uniform price in any of the orders represents a profitable price for milk for producers, any producer, and, thus, justifies it as the basis for a transfer price. In justifying exemption of producer handlers at less than 450,000 pounds per month, proponents implicitly uses the cost of production at the farm as the transfer price. Using and ERS study on dairy farm profits,[136] a proponent witness noted that the cost of production for a farm at such a small size was considerably higher than the advantage created by not paying into the pool.

> ...Dairy farms have economies of scale such that there are cost disadvantages to a producer-handler with less than 500,000 pounds of monthly production. This is the conclusion of a USDA study of farm size. In 2005, it was estimated, farms with 500 to 999 cows had a $4.75 per hundredweight cost advantage over farms with 100 to 199. This is a difference of 41 cents per gallon and represents a substantial scale economy. In addition, this study showed that 500,000 pounds per month of production (about 300 cows) is near the point where the cost curve begins to get quite steep.[137]

---

[135]Knoblauch, W., Vol IX, p. 209, Tr. 3025.

[136]MacDonald, James M. and others, *Profits, Costs, and the Changing Structure of Dairy Farming*, ERS Pub. No. 47.

[137]Cryan, R, Vol II., pp. 417-418, Tr. 622-623.

The same witness agreed that firm profitability of a producer handler included cost of production.

> Q. All right? Now, their cost is whatever
> 12 it costs them to produce the milk plus their cost of
> 13 processing, kind of a grass to glass, to get it to the
> 14 consumer, right? Or to the store, wherever they market
> 15 it. That's their -- economic costs will determine their
> 16 profitability, right?
> 17 A. Yes.
> 18 Q. Okay. And over time --
> 19 A. Looking at it as an integrated firm,
> 20 considering it as a -- you know, considering the bottom
> 21 line of the firm only.
> 22 Q. Right.
> 23 A. Yes.[138]

Will Hughes speaking on behalf of Wisconsin Department of Agriculture, Trade and Consumer Protection and other state departments of agriculture argued in support of a cap of 2 million pounds below which the producer handler exemption from pool plant payments continued. In his argument he considered the transfer price of producer handlers at approximately 2 million pounds.

> In the low price year of 2006, the Class I and Statistical Uniform price did not cover the total cost of production, reduced by 15.4% as shown by USDA, in 7 out of the 10 Federal Orders. In low cost years, there is very little price advantage if Class I and Statistical Uniform Price prices do not cover the cost of production. The numbers change for high price years with 5 Federal Orders showing Class I and Statistical Uniform prices above total costs of production and 5 Federal Orders below.[139]

---

[138]Cryan, R., Vol VI, p. 372, Tr. 1520.
[139]Hughes, W. Exhibit 36.

Accompanying that statement was a table which compared for several years the average Class I and uniform prices as well as average cost of production information. That Table 3 in Exhibit 36 is reproduced below. The first column identifies the Federal order as well as the states from which the ERS cost of production data is taken. These all represent averages– average Class I prices, average statistical uniform prices (SUP), and average cost of production. The 15.4% is a reduction based upon statements in the publication Profits, Costs, and the Changing Structure of Dairy Farming where it was stated that larger (1000 cow) farms have 15.4% less costs than the average dairy farmer.

Table 3								
			Operating	total			operating	total
Cost of Production	2006		Reduce	reduce	2007	2007	reduce	reduce
	Class I	SUP	15.40%	15.40 %	Class I	SUP	15.40%	15.40%
Northeast VT, NY, PA	$15.13	$13.53	$10.92	$19.19	$21.39	$19.92	$13.16	$21.79
Appalachian - VA, TN, KY	$14.98	$13.99	$12.36	$23.96	$21.19	$20.36	$14.02	$25.73
Southeast - GA, MO, TN	$14.98	$13.90	$11.36	$21.91	$21.20	$20.09	$13.28	$24.22
Florida	$15.88	$15.23	$11.12	$16.88	$22.01	$21.29	$12.33	$18.14
Mideast- OH, MI, IN	$13.75	$12.40	$9.70	$17.02	$20.12	$18.75	$10.94	$18.25
Upper Midwest - MN, WI, IL	$13.55	$12.04	$9.73	$17.87	$19.94	$18.41	$10.76	$19.26
Central -IA, IL	$13.88	$12.26	$9.81	$18.24	$20.12	$18.67	$11.20	$20.15
Southwest - NM, TX	$14.88	$13.16	$8.15	$11.82	$21.09	$19.35	$10.08	$13.95
Arizona - Las Vegas - CA	$14.10	$13.71	$8.86	$12.22	$20.47	$18.95	$10.07	$13.54
Pacific Northwest - WA, OR, ID	$13.65	$11.95	$9.81	$15.65	$20.04	$18.62	$11.20	$17.28

That table is amplified to compare the effect of adding the Class I to blend difference to operational costs which producer handlers would have to pay if not exempted to the Class I price which pooled plants are required to pay. This was done by computing the Class I to the Table's "SUP difference." This was added to both the operating and the total costs of production. The difference between the total cost of production and Class I is then computed.

	2006			2007		
	Class I less	Total	Class I less	Class I less	Total	Class I less
Cost of Production	SUP	Plus Diff	Cost	SUP	Plus Diff	Cost
Northeast VT, NY, PA	$1.60	$20.79	($5.66)	$1.47	$23.26	($1.87)
Appalachian - VA, TN, KY	$0.99	$24.95	($9.97)	$0.83	$26.56	($5.37)
Southeast - GA, MO, TN	$1.08	$22.99	($8.01)	$1.11	$25.33	($4.13)
Florida	$0.65	$17.53	($1.65)	$0.72	$18.86	$3.15
Mideast- OH, MI, IN	$1.35	$18.37	($4.62)	$1.37	$19.62	$0.50
Upper Midwest - MN, WI, IL	$1.51	$19.38	($5.83)	$1.53	$20.79	($0.85)
Central -IA, IL	$1.62	$19.86	($5.98)	$1.45	$21.60	($1.48)
Southwest - NM, TX	$1.72	$13.54	$1.34	$1.74	$15.69	$5.40
Arizona - Las Vegas - CA	$0.39	$12.61	$1.49	$1.52	$15.06	$5.41
Pacific Northwest - WA, OR, ID	$1.70	$17.35	($3.70)	$1.42	$18.70	$1.34

Amplification of Table 3, Exhibit 36.

This table shows that for 2006 only two orders, Southwest and Arizona, had an small amounts in excess of cost of production plus the Class I less uniform price. The assumption by the State Departments of Agriculture Witnesses was that 15.4% represented differences in costs from the average to the larger producers in all of the orders. But that assumption is wrong for the Southwest or Arizona as the sizes of those farms are such that the cost of production at that size of farm is already in the ERS data. Removing the 15.4% difference, reflected in the following table, shows no cost advantage even for Arizona in 2006 but small ones in 2007.

	2006			2007		
Cost of Production	Class I less SUP	Total Plus Diff	Class I less Cost	Class I less SUP	Total Plus Diff	Class I less Cost
Northeast VT, NY, PA	$1.60	$24.57	($9.44)	$1.47	$27.49	($6.10)
Appalachian - VA, TN, KY	$0.99	$29.49	($14.51)	$0.83	$31.39	($10.20)
Southeast - GA, MO, TN	$1.08	$27.17	($12.19)	$1.11	$29.94	($8.74)
Florida	$0.65	$20.72	($4.84)	$0.72	$22.29	($0.28)
Mideast- OH, MI, IN	$1.35	$21.71	($7.96)	$1.37	$23.19	($3.07)
Upper Midwest - MN, WI, IL	$1.51	$22.91	($9.36)	$1.53	$24.57	($4.63)
Central -IA, IL	$1.62	$23.48	($9.60)	$1.45	$25.53	($5.41)
Southwest - NM, TX	$1.72	$16.00	($1.12)	$1.74	$18.55	$2.54
Arizona - Las Vegas - CA	$0.39	$14.91	($0.81)	$1.52	$17.80	$2.67
Pacific Northwest - WA, OR, ID	$1.70	$20.51	($6.86)	$1.42	$22.10	($2.06)

Exhibit 36, Table 3 Amplied and Adjusted with No Reduction in Operating Costs

When the same approach is applied to 2008 and what months that are available for 2009 the following table results using the 15.4%. None of the areas show that there is an advantage.

	2008			2009		
Cost of Production	Class I less SUP	Total Plus Diff	Class I less Cost	Class I less SUP	Total Plus Diff	Class I less Cost
Northeast (VT, NY, PA)	2.58	26.32	(5.11)	2.38	24.56	(9.83)
Appalachian (VA, TN, KY	1.41	31.76	(10.48)	1.29	27.69	(12.80)
Florida (FL)	1.05	21.37	1.52	1.05	17.26	(0.39)
Southeast (GA, MO, TN)	1.39	28.99	(7.45)	1.58	24.38	(9.10)
Upper MW (MN, WI, IL)	2.17	24.56	(4.80)	2.61	23.31	(10.03)
Central (IA, IL)	2.58	25.91	(5.94)	2.48	23.98	(10.49)
Mideast (OH, IN, MI)	2.02	24.41	(4.47)	2.02	22.72	(9.23)
Pacific NW (WA, OR, ID)	2.87	23.70	(3.84)	2.41	22.15	(8.77)
Southwest (TX, NM)	2.56	18.31	2.65	2.43	17.25	(2.76)
Arizona (CA)	2.88	20.49	(0.18)	2.56	19.01	(5.25)

Amplification of Table 3, Exhibit 36 for 2008 and 2009

When the reduction in costs are not applied, as would be appropriate for the western orders, there is even more economic disadvantage with the compensatory payment.

	2008			2009		
Cost of Production	Class I less SUP	Total Plus Diff	Class I less Cost	Class I less SUP	Total Plus Diff	Class I less Cost
Northeast (VT, NY, PA)	2.58	30.64	(9.43)	2.38	28.60	(13.87)
Appalachian (VA, TN, KY	1.41	37.28	(16.00)	1.29	32.49	(17.60)
Florida (FL)	1.05	25.07	(2.18)	1.05	20.21	(3.34)
Southeast (GA, MO, TN)	1.39	34.01	(12.47)	1.58	28.53	(13.25)
Upper MW (MN, WI, IL)	2.17	28.63	(8.87)	2.61	27.08	(13.80)
Central (IA, IL)	2.58	30.16	(10.19)	2.48	27.89	(14.40)
Mideast (OH, IN, MI)	2.02	28.48	(8.54)	2.02	26.49	(13.00)
Pacific NW (WA, OR, ID)	2.87	27.49	(7.63)	2.41	25.74	(12.36)
Southwest (TX, NM)	2.56	21.18	(0.22)	2.43	19.95	(5.46)
Arizona (CA)	2.88	23.70	(3.39)	2.56	22.01	(8.25)

Amplification of Table 3, Exhibit 36 2008 and 2009 with no Reduction

Though there are some areas where there are small advantages, overwhelmingly for the last four years there has been none. That shows the current economic

conditions do not support changing the producer handler exemption for the smaller producer handlers.

More importantly the data in Exhibit 36 and its wide disparity between orders and between years shows that a universal application of a Class I less uniform price compensatory payment has no correlation with reality.

The information in these tables is derived from documents of which official notice was taken. These include the USDA Economic Research Services, monthly estimates of cost of production for New York, New Mexico, California, Iowa, Vermont, Ohio, Michigan, Missouri, Illinois, Wisconsin, Washington, Virginia, Georgia, Texas.[140] The ERS data represents the data available on cost of production[141] except California which is audited by the state.[142] Dairy Programs of USDA does not prepare any cost of production information.[143] The ERS data was used by Dr. Knoblauch in his analysis.[144] Further the *Profits, Costs, and the Changing Structure of Dairy Farming* article referenced by several witnesses[145] also references the ERS data.[146] The Cost of Production data by month by states for 2006 to 2009 is attached as Appendix 2.

---

[140]Carmen, C. Vol. XI, p. 28, Tr. 3448; Official Notice taken, Vol. XI., p. 34, Tr. 3454.
[141]Carmen, C., Vol. I., p. 188, Tr. 188.
[142]Schiek, W., Vol VII, p. 138, Tr. 2242.
[143]Carmen, C., Vol. I, p. 188, Tr. 188.
[144]Knoblauch, Vol. IX, p. 208, Tr. 3023.
[145]Huges, W., Vol. IV, p. 83, Tr. 1148; Cryan, R., Vol VI, p. 201, Tr. 1877; Knoblauch, W., Vol. IX, p. 291, Tr. 3106.
[146]*Profits, Costs, and the Changing Structure of Dairy Farming*, p. 8.

The argument presented at the hearing that the ERS data is unusable because an unnamed witness 19 years earlier testified in an unrelated case that the data developed decades ago had problems[147] simply does not speak to data which is only two to three years old and relied upon by several learned witnesses and documents in the record. Besides, because of the importance of cost of production as a descriptor of the transfer price, it was incumbent upon those who want other numbers to either provide better cost of production data or provide a theory and mechanism that is legal in setting the compensatory payments.

The ERS data is supported by testimony by producer handlers as to their own costs.[148] A dairy farmer witness in support of eliminating the exemption for producer handlers acknowledged that the current uniform price exceeds her cost of production and such shortfall was universal among producers.[149] Another proponent of elimination who is a dairy farmer agreed.[150]

The real world reality of transfer costs for smaller producer handlers is shown by this statement by one producer handler in describing his costs,

> But today, I'm in a real disadvantage
> 14 going to my cost of production. I could buy milk on the
> 15 market and save money. But I can't guarantee -- make

[147]English, C., Vol. XI, p. 30, Tr. 3450.

[148]Gibson, J. Vol III, p. 25-26, Tr. 629-630, ($18.30 per hundredweight); Shatto, M. Vol IV, p. 124, Tr. 1189 ("much closer to the 25 to $30 level."); Rooney, J. Vol V, p. 89, Tr. 1521 ($19.65); Docheff, J, Vol VIII, p. 147, Tr. 2594 ($17.00 for out of pocket).

[149]Damm, C, Vol III, p. 142, Tr. 6146.

[150]Traweek, J., Vol III, p. 144, Tr. 6148.

16 the guarantees that I can when I have my own.[151]

He goes on to explain

Q. Okay. Now, the blend price in Order 1
8 thus far this year has averaged about $12.50. You don't
9 produce your milk at anything near that price, do you?
10 A. No.
11 Q. And when the Class I price is $12.68,
12 again, you're not acquiring your milk at anywhere near
13 that price, are you?
14 A. No.[152]

Again, in actual practice, the Class I is rejected as a price for producer handlers.

4 Q. I wanted to do some kind of follow up
5 with some points I'm trying to clarify from the
6 testimony you've already given today.
7 In pricing your milk, do you -- you know
8 there's a minimum Class I price that's announced by the
9 Market Administrator for your plants, right? I mean,
10 you don't have to pay it, but there's a price that's
11 announced for minimum Class I price. You're aware of
12 that?
13 A. I'm aware of it. I don't look at it.
14 Q. You don't look at it?
15 A. No.
16 Q. So that's not a factor at all in your
17 pricing?
18 A. (Shaking head.)
19 Q. You look to cover your costs?
20 A. I look to cover my costs. What governs
21 me on change of price -- most usually our price stays
22 the same year round unless our distributors say we're
23 getting -- we're being undersold, can you bring it down
24 a little bit. I'll bring it down. But sometimes they

[151]Hatch, H, Vol II, p. 66, Tr. 271.
[152]Hatch, H., Vol II p. 67, Tr. 272.

25 don't.[153]

Another producer-handler testified:

4 It is simply not possible to look at the
5 present situation in the dairy industry and
6 conclude that producer-handlers have any unfair
7 advantage over cooperatives or process -- and
8 processers [sic]. For example, I cannot buy milk if
9 anything goes wrong with our cows or our farm
10 supply. The regulated market can. We have to
11 find our own customers for our own milk; pool
12 producers do not have that burden. We have to
13 handle our own milk to -- we have to haul our
14 own milk to our bottling plant; pool producers
15 do not -- they do not have that burden. We each
16 pay for the service in different ways, but that
17 does not mean our competitive positions are
18 inequitable.[154]

There is nothing in the record that shows producer handlers at three million pounds or less have any raw milk cost advantage over pooled processors. The necessary predicate to requiring producer handlers to pay a compensatory payment for the privilege of bottling and marketing their own farm milk is not existent. To make an assessment that would make producer handlers non-competitive does not effectuate the purpose of the AMAA in this situation. The exemption for producer handlers at this size should remain.

The inequity can be shown by example. Assume three scenarios. In Scenario 1, the producer-handler has a cost of production of $13.00, the uniform

[153]Hatch, H., Vol II, p. 88, Tr. 293.
[154]Sharpe, C., Vol XI, p. 177, Tr. 3597, See, also, Arkema, P. Vol XI, p. 246, Tr. 3666.

price is $15.00 and the Class I price is $16.50. Scenario 2 is the same as one, but the cost of production is $16.00. Scenario 3 is the same but the cost of production $17.50. Assume for all three scenarios that the exemption from pooling and pricing for producer handlers is not in effect.

	Scenario 1	Scenario 2	Scenario 3
Cost of Production	$13.00	$16.00	$17.50
Class I less Blend	$1.50	$1.50	$1.50
PD Cost for Milk	$14.50	$17.50	$19.00
Regulated Handler Cost	$16.50	$16.50	$16.50
Cost Difference PD over Regulated Handler	-$2.00	$1.00	$2.50

For proponents of changing the exemption, they see Scenario 1 as the only one that exists but with different magnitudes of economic advantage. For producer-handlers and their defenders, they see Scenarios 2 and 3. To the same degree that advantages found in Scenario 1 could undermine the pricing system, imposing tariffs on own farm production in Scenarios 2 and 3 are equally unfair and the Secretary is legally obligated such results.

The ERS cost of production reports shows that Scenarios 2 and 3 are the reality in today's market place.

2. **The use of producer cost of production as the transfer price is the only one that has factual support.**

"First, because we are independent, we get our milk at the cost of production on the farm, not the price the producer receives from the pool."[155]

"A producer-handler acquires milk at the cost of production on the farm."[156]

Though there was evidence that cost of production for dairy farmers who sold their milk was not the same as those who were producer handlers, the latter being more expensive[157], NMPF's chief witness, correctly argued that the cost of production of a producer handler "are perfectly comparable to those of a farming plant."[158] Dr. Knoblauch argues as regards the cost of production as the transfer price, the following:

> DR. KNOBLAUCH: You might also add the
> 3 caveat that operating a farm, you would like to
> 4 have profits above just covering all your costs.
> 5 So in some circumstances, you could say that it
> 6 should be the cost of production plus some
> 7 value. And we could talk about what or how you
> 8 might calculate what that some value may be.[159]

Producer handlers repeatedly identified their cost of production as the cost of their milk. One noted that the Class I price was not enough to cover costs:

> As USDA

---

[155]Bostwick, W., Vol IX, p. 25, Tr. 2840.
[156]Keefe, S., Vol. IX, p. 96, Tr. 2912.
[157]Rooney, J. Vol V, p. 91, Tr. 1523; Kreider, Vol. VII, p. 186, Tr. 2290; Keefe, S., Vol IX, p. 95, Tr. 2911.
[158]Cryan, R. Vol VI, p.6-17, Tr. 1692-1693.
[159]Knoblauch, W., Vol X., p. 283, Tr. 3412.

21 cost-of-production figures for the Northeast Region of
22 the United States demonstrate, the total cost of
23 production, not just operating costs, was never exceeded
24 by the Class I price.[160]

A witness for the proponents in describing producer handlers in California identified the transfer cost as cost of production.

In the 12 days of testimony not one single proponent for limiting producer handlers' exemption from paying into the pool established that in fact, a producer-handler's cost of production was less than the minimum prices imposed on regulated handlers. In fact aside from the ERS data of which there was official notice taken, the analysis done by independent testimony of the State Ag Department Witnesses, and the Economists, all showed a higher transfer cost.

3. Using the cost of production as the transfer price shows that for smaller producer handlers, there is no economic advantage over processors who pay into the pool.

"The ERS average data demonstrates that even when measured against the Class I price, the cost of production exceeds the Class I price by 5 to 8 dollars per hundredweight."[161]

The only real and appropriate transfer
20 price is the producer-handler's cost of
21 producing milk, which, as we have seen from the
22 testimony of Professor Knoblauch and verified by
23 my AIDA member survey, is substantially higher
24 than the uniform blend price calculated by the

[160]Rooney, J., Vol V, p. 87, Tr. 1519.
[161]Knoblauch, W., Vol IX, p. 208, Tr. 3024.

25 Federal Order Market Administrators.[162]

[... [Of] particular
22 relevance to this hearing, it is important to
23 note that the cost of production exceeds the
24 uniform price for small herds in all years but
25 not for large farms in good milk price years,
1 notably 2007 and 2008. While 2009 data is not
2 available, it can be expected that for all herd
3 sizes, the costs of production will by far
4 exceed the uniform price.[163]

The cost of production information in the record represents the best available. As size goes up, the costs come down. Knowing where the transfer price exceeds the Class I price for a producer handler is missing in the record evidence, but what is clear is that producer handlers under 3 million pounds have no economic advantage.

Q. Okay. Would you agree that there is a
10 point which, based on cost, will determine whether they
11 can be competitive with you as a supplier to a major
12 bottler?
13 A. Yes.
14 Q. Okay. But you have not done studies to
15 determine what that number might be in terms of herd
16 size?
17 A. No, no. Correct, I have not.[164]

In fact, the chief proponent witness explained that he had no evidence as to the costs.

---

[162]Knutson, R., Vol. IX, p. 252, Tr. 3068.
[163]Knoblauch, W., Vol IX, p. 207, Tr. 3023.
[164]Rowe, S, Vol .IV, p. 219, Tr. 1284.

17 * * *You have no evidence as
18 to the cost to operate a producer-handler in the range
19 of 2 to 3 million pounds, is that correct?
20 A. That's correct.[165]

The conclusion must be that the evidence shows that for at least the producer handlers under 3 million pounds per month, if not larger, the cost of production or transfer price exceeds the Class I price paid by regulated handlers who pay into the pool enough months as to end the argument that producer handlers have a cost advantage in their obtaining raw milk for their plants.

During periods of low milk prices such
2 as we are experiencing at this time, the cost of raw
3 supply for a producer-handler already exceeds his pooled
4 competitors' cost. If the proposal put forth by NMPF
5 and IDFA is adopted by the USDA, affected
6 producer-handlers in the Northeast would find themselves
7 with an untenable disadvantage. Far from removing the
8 price advantage, as stated by IDFA, this
9 producer-handler would be faced with a cost of over $20
10 a hundredweight, compared to his pooled competitor's
11 cost of under $14 per hundredweight for the current
12 month of May.[166]

F. Imposition of a compensatory payment that exceeds the difference between Class I and blend or, currently, when the cost of production exceeds the Class I or uniform prices acts as a trade barrier to producer handlers.

As Dr. Knutson, noted,

Is at the cost of
5 production of the producer-handler. I mean, the

[165]Cryan, R., Vol. VI. p. 371, Tr. 1436.
[166]Rooney, J. P. Vol. V, p.88, Tr. 1520-1.

6 rationale is that you base the transfer price on
7 the market price. You don't base a transfer
8 price on a regulated Federal Order price that
9 doesn't exist in the market.
10 So, you know, the best basis that you've
11 got for what that transfer price is by a
12 producer-handler is the producer-handler's cost
13 of production.[167]

Obvious result of imposing an uneconomic compensatory is to tax producer handler's out of existence. This was noted by more than one producer handler or other witnesses.

In summary, figures compiled by the USDA
17 shows that without a doubt that the total cost of
18 producing milk in the Northeast exceeded the Class I
19 price in both 2006 and 2007. If one accepts USDA
20 numbers, there can be no claim that producer-handlers
21 enjoy a price advantage over pooled processors, and USDA
22 numbers also show that producer-handlers' percentage of
23 the national or even regional total milk production is
24 less than 1 percent of that total. Therefore, the only
25 real impact of a ruling in favor of the proposals
1 submitted by NMPF and IDFA to limit Class I sales by
2 producer-handlers to less than 450,000 pounds per month
3 would be to drive those small producer-handlers affected
4 out of business, thereby consolidating further the power
5 of the large processors who are already found at the top
6 of the list of the largest processors in the U.S.[168]

A producer handler explained the problem with Class I less uniform as a compensatory payment in this way:

5 Secondly, to simply say that a

[167]Knutson, R., Vol. IX, p. 305, Tr. 3120.
[168]Rooney, J., Vol. V, p. 91, Tr. 1523.

6 producer-handler can pay the uniform price for
7 milk at the plant ignores completely the cost a
8 producer-handler occurs in balancing his own
9 milk supply. A producer-handler is left on his
10 own to market his balance of surplus production,
11 usually at a price below production cost, if he
12 can find a market at all. Whatever return is
13 realized is most certainly below uniform price,
14 and usually incurs extra freight costs. Another
15 cost factor in balancing for a producer-handler
16 is marketing the cream that's surplus in today's
17 fluid milk market.[169]

Not one single witness provided any evidence that a producer handler had an identifiable economic advantage in today's marketing conditions.

G. The use of Class I less uniform blend as a compensatory payment for small producer handlers is arbitrary and capricious.

Even if the evidence at the hearing showed an economic advantage, which the record showed the opposite, for producer handlers under 3 million pounds, the imposition of a compensatory payment of plant blend less uniform blend is arbitrary and capricious. This is sometimes stated as Class I less uniform blend because all of the difference between plant blend and uniform blend will be the result of Class I sales.

[169]Gibson, J., Vol. III, p. 26, Tr. 630.

The arbitrariness is because this compensatory payment varies widely. The following table shows the difference between the Class I and statistical uniform price in the Southwest order from January 2000 through June 2009.[170]

Class I less Statistical Uniform Blend Order 126 2000 - Jun 2009											
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	
Jan	1.89	3.37	1.30	1.68	1.56	3.61	1.88	1.82	0.27	2.24	
Feb	1.89	1.70	1.67	1.81	0.92	1.55	2.65	1.41	0.40	-0.59	
Mar	1.94	1.47	1.85	1.71	-0.93	2.64	2.54	1.38	-0.62	-2.02	
Apr	1.88	1.53	1.76	1.45	0.46	1.85	1.81	1.03	0.43	-1.53	
May	2.05	1.16	1.84	1.41	3.98	2.70	1.71	0.41	-1.26	-0.87	
Jun	1.95	1.14	1.92	1.41	4.73	1.75	1.39	0.36	-0.84	-1.56	
Jul	2.10	1.22	1.81	0.76	3.87	2.45	2.02	1.22	0.69		
Aug	1.79	0.97	1.53	1.04	2.13	2.74	1.31	2.00	-0.85		
Sep	1.56	0.96	1.54	1.58	1.19	1.00	0.65	2.48	-0.81		
Oct	2.00	2.88	1.08	1.73	2.10	1.69	1.77	2.97	-1.73		
Nov	2.23	3.68	1.63	2.84	1.41	2.41	1.57	2.87	0.44		
Dec	2.22	1.53	1.60	2.98	1.76	1.97	1.38	2.03	0.68		
Avg	**1.96**	**1.80**	**1.63**	**1.70**	**1.93**	**2.20**	**1.72**	**1.66**	**-0.27**	**-0.72**	**1.36**
Min	**1.56**	**0.96**	**1.08**	**0.76**	**-0.93**	**1.00**	**0.65**	**0.36**	**-1.73**	**-2.02**	**-2.02**
Max	**2.23**	**3.68**	**1.92**	**2.98**	**4.73**	**3.61**	**2.65**	**2.97**	**0.69**	**2.24**	**4.73**

This table shows a range in compensatory payments from lowest to highest of 6.75 per cwt or 70 cents a gallon! There is no rationality to this whatsoever. To make matters even more irrational, the producer handler will not know which of these widely ranging payments is due until after it sold the milk.

H. The timing of proposed compensatory payment (Class I less blend) rate further exposes producer handlers paying into the pool with additional risk and cost.

The proposed compensatory program of Class I less the uniform blend will place a producer-handler be at an added disadvantage. A fully regulated handlers without production know what their pool obligations are by the 23rd of the month

[170]Milk Market Administrator Federal Order 126, "Producer Price Differential" http://www.dallasma.com/order_prices/producer_price_reports.jsp (July 17, 2009).

prior.[171] On the other hand, producer-handlers would not know their obligation until after the blend price is announced on the 14th of the following month in Order 126[172] and similar dates in other orders. The Department has long held that advance pricing for Class I milk is essential for the orderly marketing of milk, but as Class I handlers, these producer-handlers with more than three million pounds of route disposition per month would be denied the benefits of advance pricing without any rational basis for the distinction.

This delayed pricing coupled with a widely fluctuating spread between Class I and the blend means that this payment is unpredictable. As a consequence producer handlers are placed at the additional risk of pricing milk they sell in advance of the sale, as their regulated competitors, but not knowing when they do whether that gallon will cost them as much as an extra 50 cents two months later or entitle them to a payment of 20 cents.

This post sale obligation of unpredictable amount on top of cost of production in excess of the class price makes it clear that the Secretary cannot impose on producer handlers a compensatory payment based on this formula.

[171]7 C.F.R. § 1000.50(q).
[172] 7 C.F.R. § 1126.62.

V. Proposals other than considering producer handler exemptions should not be adopted.

A. Exemption from pool plants for non producer handler plants should not be expanded beyond 450,000 pounds.

Raising exempt plant limits beyond 450,000 poses a threat to orderly marketing. Even though continuation of producer handler exemption up to 3 million are appropriate, such is not for exempt plants. The reason was expressed well by one of the producer handlers who testified.

> [Q. Ten. Thank you. If the Department were
> 16 to adopt your proposal, do you see a need to, in
> 17 addition to adopting your proposal, to make any
> 18 adjustment in the exempt plant limitation of
> 19 150,000 pounds per month?
> 20 A. I think the exempt plants are the plants
> 21 that are small and they have no regulation. Is that
> 22 what an exempt plant is, 150,000 pounds?
> 23 Q. Well, one of the features of the exempt
> 24 plant definition, it tries to describe those people who
> 25 are not subject to pricing and pooling like
> 1 producer-handlers, but it -- but it doesn't talk about
> 2 ownership of -- where everything, like, in your
> 3 operation has to be under your own sole ownership and
> 4 risk. Where an exempt plant is somebody that, for
> 5 example, can buy all their milk from another source.
> 6 A. Yeah. I think I -- I think it should be
> 7 kept at 150. I don't think it should be raised to 450[173]

As explained above, the justification for producer handler exemption from payment for those under 3 million pounds is because the transfer price (cost of

[173]Dunajski, T., Vol. II, p. 159, Tr. 384-385.

production at the farm) of those producer handlers exceeds that of the class I price and such disparity has been in place more or less for several years. For exempt plants, however, the transfer price would be at whatever price they could purchase the milk with no cost of production or minimum price constraints. A 3 million pound cap represents two loads of milk per day and approximately 160,000 gallons. Nothing would prohibit the plant from buying surplus milk at cheap discounts and then selling it as fluid milk.

> It'd be pretty easy for
> 4 anybody to get in the milk business and out of the milk
> 5 business if they had a 450,000 pound cap.[174]

Since the rationale for producer handlers to have exemption from pooling and pricing is that they are already paying more for their milk than the minimum price, such cannot apply to exempt plants for purchases.

The average size of farms has nothing to do with setting exempt plants, unless of course the producer-handler definition is eliminated and only to the extent it deals with own farm production. Exempt plants by definition do not need to own any farms or cows. They just need to operate a plant when they want and buy milk when they want at prices they want to pay. Even if the average size of a farm was 3 million pounds per month, the rationale against exempt plants at that level remains–they can buy milk with no bottom price constraints.

---

[174]Hatch, H., Vol. II, p. 105, Tr. 310.

The rationale for exempt plants, on the other hand, is administrative convenience.[175] At 450,000 up to twelve plants would become exempt.[176] A 450,000 pound per month plant would pay only about $200 in administrative fees, a sum probably inadequate to cover the cost to review and audit reports. At 3 million pounds 33 new plants would become exempt.[177] At 3 million the payments for administration would approach $1500 and more than cover the costs of administering the order.

B. Grandfathering of existing producer handlers should be considered by the Secretary if he finds it necessary to remove the producer handler exemption.

Part of at least two remaining proposals are provisions that would "grandfather" existing producer handlers if the exemption is removed.[178] Neither of these are true grandfather clauses in that each impose new limitations or restrictions. For example, Proposal 17 limits the exemption to only those who now own or inherit the operation. Current producer handlers can sell their operations. Proposal 26 proposes limitations on branding, ownership of farms, and other new restrictions on producer handlers.[179]

---

[175]Cryan, R., Vol. VI, p. 349-50, Tr. 2025-2026.
[176]Exhibit 20.
[177]Exhibit 20.
[178]Proposal 17 and Proposal 26.
[179]Proposal 26.

There has been much opposition to the proposal to limit producer handler exemptions to only existing producers. One producer handler proponent of a cap said

> A. No, but closing the door, I wouldn't -- I
> 12 had an offer to me to be able to start. I wouldn't want
> 13 to be attached to a proposal that prevents someone else
> 14 from starting up[180]

His opposition was not alone as other producer handlers agreed.[181] The State Department of Agriculture Witnesses testified in opposition to grandfather clauses:

> The Grandfather Clause. The States
> 6 support a hard cap of 2 million pounds per month
> 7 for producer-handlers in all Federal Orders.
> 8 Attempting to add a grandfathering language adds
> 9 complexity to regulations and is not necessary
> 10 with a hard cap as The States propose. Audits
> 11 needs only to focus on volumes processed and
> 12 distributed.[182]

Similarly, the witness for National All Jersey said that grandfathering was not a good idea.

> 1 NAJ opposes these so-called grandfather
> 2 clauses for two reasons. First, several of NAJ's
> 3 producer-handler members are new processors. Fittingly,
> 4 they began or will begin their operations on a limited
> 5 scale in order to mitigate the risk associated with the
> 6 enterprise. To their credit, they have been (or may be)
> 7 able to grow their sales and -- their sales and praises.
> 8 Previous months' sales volume will not adequately

[180]Hatch, H., Vol. II, p. 38, Tr. 243.
[181]Dunajski, T., Vol. II, p. 141, Tr. 346; Gibson, J., Vol. III, p. 32, Tr. 636.
[182]Bothfield, D., Vol. IV, p. 46, Tr. 1111.

> 9 reflect their current sales, which are in excess of the
> 10 average from previous months. These handlers would be
> 11 penalized for their success if historical sales are used
> 12 to establish a volume exemption to be used from a given
> 13 point in time. In addition, new processors do not have
> 14 previous sales figures to grant them a base although
> 15 they planned their bottling operations under current
> 16 regulations.
> 17 Second, NAJ does not believe it is
> 18 equitable to treat existing producer-handlers
> 19 differently than producers who may want to become
> 20 producer-handlers in the future. Granting pool
> 21 exemption to existing producer-handlers would, in
> 22 essence, be giving them an advantage over others who may
> 23 want to become producer-handlers in the future.[183]

Continental and Select remain committed to see that existing producer handlers at or below 3 million pounds remain unaffected by any changes to the exemptions for producer handlers. Grandfathering was one of the options. In light of the testimony and the complexity of the grandfathering proposals, these cooperatives suggest that if the Secretary decides to remove or reduce the exemption, that it do so simply by adding to the existing producer handler definitions an opening clause which says,

> § 100_.10 Producer-handler.
>
> * * * * *
>
> (a) Prior to July 1, 2009 operated and for the month operates a dairy farm and a distributing plant from which there is monthly route disposition in the marketing area, not to exceed 3 million pounds; * * *

[183]Metzger, E., Vol. VIII, p. 327, Tr. 2774.

On the other hand, a 3 million pound cap available to existing as well as future producer handlers is acceptable. The other acceptable alternative is to make no changes whatsoever to the definition. In all of these, the goals of protecting existing producer handlers with less than 3 million pounds is preserved.

VI. Since the comparison of transfer costs is the legal basis for determining exemption from pooling, other rationales or arguments which support or oppose the imposition of compensatory payments on producer handlers must be given less weight.

As explained above, the focus of whether or not there is an imbalance in the order system due to producer handlers not paying into the system or not and, if there is, how to create a compensatory system to remove the advantage and, at the same time, not drive such a business model out, is the transfer cost or price from the production of milk to the processor. As a result many other arguments presented at the hearing, while compelling or touching, or suggestive, cannot control the Departments decision as to whether smaller producer handlers lose their exemption from pool payments, and, if they do, in what manner.

A. There is a basis for using total route sale, not just sales in the marketing area, to determine eligibility for the exemption from pooling for producer handlers.

Proposal 2 and Proposal 26 both call for using total route distribution irrespective of marketing area to determine eligibility for the exemption from pooling and minimum pricing. NMPF clearly explained this:

5 finally, with respect to Proposal 2,
6 NMPF proposes a change in the wording of the size-based
7 exemption, to make clear that the expanded 450,000-pound
8 monthly allowance applies to a plant's total sales, not
9 only to sales in an individual market.[184]

Since under the NMPF and IDFA proposals the producer-handler and exempt plants are being combined into one definition, it is easy to use the rationale that applies to one and ignore how it applies to the other when it comes to limitations.

As for exempt plants, the only rationale that would support a purely exempt plant exemption is administrative convenience. That is if the production is so small that it has no impact on the order and the cost of administration exceeds the benefits. If a plant is small enough to fit that criteria, it should make no difference where the sales are.

In an answer to a question, NMPF's witness explained that this all inclusive marketing area did not mean that the milk would be administered. The partially regulated plant definitions would still apply. But on close examination, this makes no sense.

As an example, a plant with 500,000 pounds of total route distribution has only 50,000 in the marketing area. To require compensatory payments on one load

[184]Cryan, R. Vol. II, p. 197, Tr. 403.

of milk per month because out of area sales made it a pool plant is inconsistent with the administrative convenience argument.

As for producer handlers, NMPF is correct but for other reasons. Since the criteria for exempting producer handlers from pool payments is that the producer handler's cost of raw milk exceeds the Class I price. That cost of production goes down as the size of the producing unit goes up. Any limitation of size is based upon a factual finding that at a certain point the total size of the production and processing reaches the economy of scale that brings its cost below Class I. This would be on all of the sales regardless of market. Further if the plant was partially regulated such a plant could truly claim that it was paying more for the milk than the FMMO and therefore take the Wichita Plan exemption for partially regulated plants.[185]

B. The cost of processing is of limited use as a basis for determining whether or not producer handlers are creating market disorder.

Throughout the hearing a number of witnesses, testified regarding processing costs,[186] volunteered the processing costs of their plants[187] or

[185]7 C.F.R. §1000.76(b).

[186]Cryan, R., Vol. II, p. 243, Tr. 448-449; Hughes, W., and Bothfeld, D. Vol. IV, p. 71, Tr. 1136-1137; Knoblauch, W., Vol. IX, p. 214, Tr. 3120. Taylor, W., Vol. XI, p. 141, Tr. 3561.

[187]Gilbert, G., Vol. VII, p. 14, Tr. 2118.

prospective plants[188], referenced the inefficiency of the plants,[189] or responded to questions regarding processing costs.

This evidence is helpful to further substantiate the fact that producer handlers with higher processing costs on top of higher costs for raw milk cannot be the cheap discounters in the market place as claimed by those seeking their eradication. Evidence of processing shows that smaller producer handlers are even less likely to have an advantage in pricing over larger regulated handlers. On the other hand the use of processing costs as evidence supporting an exemption pose a number of unanswered questions.

The first question is how does the cost to process beverage milk factor into the value of that milk delivered to the plant?

> Q. Would you agree that it would be
> 24 preferable to have actual costs of production and actual
> 25 costs of plant expenses for producer-handlers? That
> 1 would be a preferable series of economic data.
> 2 A. Well, on the one hand it might help
> 3 define the limits we're talking about.
> 4 But on the other hand that hasn't -- that
> 5 hasn't figured -- those sorts of considerations have not
> 6 figured significantly into the previous hearing on the
> 7 previous decision on a similar topic. So I'm not sure
> 8 how useful it would be.[190]

---

[188]Wilcox, J., Vol. IV, p. 240, Tr. 1305.

[189]See, e.g., Gibson, J., Vol III, p. 24, Tr. 2128; Hettiga, H., Vol VIII, pp. 253-254, Tr. 2701-2702.

[190]Cryan, R., Vol. VI, p. 260, Tr. 1936-1937.

The reason cost of processing has been given little concern is that historically, for beverage milk, as opposed to manufactured products, end product pricing of finished product has never been part of the equation.

> Q. Dr. Cryan, does the Department consider a
> 15 distributing plant's costs with respect to the minimum
> 16 prices it establishes and imposes upon them?
> 17 A. I don't believe so.[191]

The second unanswered question is exactly what does it cost to process milk. The information presented at the hearing has largely been anecdotal and very incomplete. Though two studies were presented, both are not current and have large gaps in the size of dairy plants studied.

> 6 So while these studies do demonstrate the
> 7 principle of costs falling as the -- as the size
> 8 of the plant grows, they by no means provide a
> 9 basis for determining what the cost is for a
> 10 plant that's 5 million pounds or 3 million
> 11 pounds or 2 million pounds, or especially
> 12 450,000 pounds. So we've -- we've not relied[192]

There is no evidence that producer handlers as producer handlers have any inherent cost advantage or disadvantage over regulated handlers.

> Then, Dr. Cryan, could you please detail
> 20 what you believe to be the costs for a producer-handler
> 21 to go from cow to bottle?
> 22 A. They're the same costs as another set of
> 23 producers and plants of similar size and similar

---

[191]Cryan, R., question by Tosi, G., Vol. VI, p. 403, Tr. 2379.
[192]Cryan, R., Vol. VI, p. 302, Tr. 1978.

24 arrangement.[193]

In the end, the question of exempting producer handlers has to be on proof through solid evidence that the transfer price of a producer handler is consistently and identifiably less than the Class I price paid by priced and pooled handlers. What either of these handlers do after that and how much it costs and what they sell for is not as material. What the cost of processing does, particularly the admitted higher costs for smaller processors such as producer handlers under 3 million pounds, is provide added insurance that in conjunction with high costs of production, producer handlers do not have as a matter of fact a cost advantage over larger retailers.

C. Retail pricing cannot be the basis for determining disorderly marketing.

A lot of testimony at the hearing dealt on examples of price differences in retail outlets and schools. The underlying thesis of these statements was that these isolated examples of sales or loss of sales were evidence of the underlying raw milk price and from these isolated sales (none of them were part of a systematic study of all retail prices or school purchases, for example) the Secretary could determine that in point of fact there was a raw milk price disadvantage. From that, it would follow that producer handlers were or were not causing disorderly marketing within the market place.

---

[193]Cryan, R., Vol. VI., p. 19, Tr. 1694.

The record evidence, however, makes it clear that such analysis is flawed. The following colloquy establishes that retail prices are not telling of raw milk prices.

> 22 Q. Let me go on. If we look at the shelf
> 23 price of milk in any particular location -- let's say,
> 24 for example, we're in Michigan and $1.98 is a price
> 25 charged by Family Fair or Meijer for a gallon of milk in
> 1 May of 2009. What does that tell us about the wholesale
> 2 cost or price of that milk, anything?
> 3 A. It may tell us some things, but I would
> 4 agree with you, it doesn't tell us everything.
> 5 Q. It doesn't tell us, for example, what the
> 6 actual cost to the customer was from the handler,
> 7 correct?
> 8 A. In your example, the cost to Meijer from
> 9 the processor?
> 10 Q. Yeah, from Dean Foods.
> 11 A. No, it doesn't tell us the exact nature
> 12 of that price.
> 13 Q. Okay. It doesn't tell us the raw milk
> 14 price that was paid by the handler for the milk, right?
> 15 A. The fact that it is on the shelf for 1.99
> 16 does not tell us that.
> 17 Q. It doesn't tell us what the profit markup
> 18 for processing was by the handler for that milk,
> 19 correct?
> 20 A. That's correct.
> 21 Q. And that would be true in Michigan and
> 22 that would be true in El Paso, Texas, correct?
> 23 A. Correct.[194]

Exhibits prepared by the USDA from reported series on retail prices and minimum class I prices in the orders further shows that reliance on retail prices is

[194]Hollon, E., Vol. XII, p. 158, Tr. 3889-90.

not predictive of raw milk costs. The following table summarizes the information presented in Exhibit 53.

Summary Exhibit 53

Ten Pricing Points Whole Milk in Ten Orders Compared to Retail and Cost per Gallon

Averages January 2007 to April 2009

City	Diff.	Coop Class I $/cwt	Federal Class I $/cwt	Over Order $/cwt	Retail Price Collected by MA's hole $/ga	Coop Class I $/gal	Federal Class I $/gal	Over Order $/gal	Retail Price less Coop Class I $/gal	Retail Price less Federal Class I $/gal
Boston	$3.25	$21.91	$20.37	$1.53	$3.70	$1.88	$1.75	$0.13	$1.82	$1.95
Louisvill	$2.20	$22.34	$19.38	$2.96	$3.46	$1.92	$1.67	$0.26	$1.54	$1.79
Miami	$4.30	$26.09	$22.17	$3.92	$3.98	$2.24	$1.91	$0.34	$1.73	$2.07
Atlanta	$3.10	$23.72	$20.54	$3.18	$3.87	$2.04	$1.77	$0.27	$1.83	$2.10
Chicago	$1.80	$21.63	$18.94	$2.69	$3.75	$1.86	$1.63	$0.23	$1.88	$2.12
Kansas C	$2.00	$20.94	$19.14	$1.81	$3.86	$1.80	$1.65	$0.16	$2.06	$2.14
Clevelan	$2.00	$21.70	$19.14	$2.56	$3.56	$1.87	$1.65	$0.22	$1.69	$1.91
Seattle	$1.90	$19.74	$19.04	$0.71	$3.36	$1.70	$1.64	$0.06	$1.66	$1.72
Dallas	$3.00	$21.82	$20.14	$1.68	$3.22	$1.88	$1.73	$0.15	$1.34	$1.49
Phoenix	$2.35	$19.95	$19.49	$0.46	$3.67	$1.72	$1.68	$0.04	$1.96	$2.00
Average		**$21.98**	**$19.83**	**$2.15**	**$3.64**	**$1.89**	**$1.71**	**$0.18**	**$1.75**	**$1.93**

Averages of Data in Exhibit 53

During the entire testimony in the hearing, no one presented evidence that milk was being sold by producer handlers at less than the minimum raw milk price of the FMMOs. Exhibit 53, Ten Pricing Points Whole Milk in Ten Orders Compared to Retail and Cost per Gallon estimated the retail to minimum prices under the orders and minimum prices plus announced cooperative over order obligations. This document was prepared by USDA. It incorporates the Retail Prices Whole Milk collected by the milk market administrators. It is taken the same day every month from the same stores. The data has been collected since 2001 and appears on the official website of Dairy Programs.[195] Official notice of

[195]Carmen, C., Vol. I, p. 181, Tr. 181.

this was taken.[196] The other data represents Class I prices which are announced by the market administrators and available in Dairy Market News. The information in Dairy Market News was given official notice.[197] It also includes information regarding cooperative announced over order prices. This data, also in Dairy Market News, has had official notice taken. Using the conversion charts in Exhibit 22 to convert the hundred pounds of milk into per gallon prices.[198]

The process of creating Exhibit 53 was explained:

> The first group of sheets in that packet
> 20 are ten printouts that contain the -- by column,
> 21 indicated month and year, the cooperatives Class I price
> 22 for that location in case -- in terms of looking at the
> 23 page it would be Boston, Massachusetts.
> 24 What I've done is selected one city in
> 25 each of the ten orders where we have both a retail price
> 1 and a co-op Class I over-order price. It's simply a
> 2 rendition of that data in terms of hundredweights for
> 3 the first three columns, and then the collected MA milk
> 4 price for whole milk in that location, and then
> 5 converting the co-op Class I, Federal Class I, and the
> 6 over-order charges to per gallon numbers and then just
> 7 simply making a couple of comparisons of the retail
> 8 price to the co-op Class I price or to the Federal Order
> 9 Class I price.
> 10 Those ten pages, one for each of the ten
> 11 orders,[199]

[196]Carmen, C., Vol. XI, p. 24, Tr. 3444.
[197]Vol. XII, p. 237, Tr. 3967.
[198]Carmen, C., Vol. I., p. 181, Tr. 181.
[199]Carmen, C., Vol. V, p. 190, Tr. 1621 to 1622.

Because the uniform price represents 3.5% butterfat and the whole milk priced at retail is approximately 3.25%, the minimum prices for raw milk are over stated by an amount depending on the price of butterfat.[200]

Table 3, which summarizes that information shows that the difference between retail prices collected in this study is the minimum order prices and the minimum coop prices. The minimum raw milk values were nearly one half of the retail price as shown by the following table.

	Retail Diff to Coop Price				Retail Diff to FMMO Price		
City	%				%		
Boston		96%				111%	
Louisville		80%				108%	
Miami		77%				109%	
Atlanta		90%				119%	
Chicago		101%				130%	
Kansas City		114%				130%	
Cleveland		91%				116%	
Seattle		98%				105%	
Dallas		72%				86%	
Phoenix		114%				119%	
Average		93%				113%	

When the cooperative price is included the amount narrows.

	Retail Diff to Coop Price				Retail Diff to FMMO Price		
City	%				%		
Boston		90%				106%	
Louisville		75%				106%	
Miami		78%				111%	
Atlanta		83%				115%	
Chicago		57%				83%	
Kansas City		113%				139%	
Cleveland		82%				111%	
Seattle		87%				94%	
Dallas		90%				109%	
Phoenix		63%				67%	
Average		82%				104%	

[200]Carmen, C., Vol. XI., p. 25, Tr. 3445.

The information in this table represents a simple average of three different style retailers and ignores the volumes of milk sold at those rates. Official Notice was taken of A.C. Nielsen Data as reported by the California Department of Agriculture.[201] The most current three months are posted on its website. http://www.cdfa.ca.gov/dairy/retail_prices_main. To obtain information for prior months an email request was made by the undersigned to CDFA. Copies of the email correspondence are attached as Appendix 3. The result was a report prepared by CDFA showing the average retail prices for whole milk, 2%, 1% and skim milk using Scantrack®. The data for January 2008 through May 2009 is in Appendix 4. These are weighted average prices of actual sales.

The limitations of FMMO differentials changing for three orders in 2008 and the lack of adjustment of the 3.5% raw milk price to the 3.25% whole milk price found in the table using MA data are the same. The results do not correlate city to city. The following table, like the one done for the MA collected retail prices still shows nearly a doubling of the retail price over the minimum FMMO prices.

The ratio of FMMO pricing to the retail is the appropriate one in this instance as producer handlers do not charge over order pricing. Since the FMMO is designed to establish and enforce its minimum prices and not those of the cooperatives, it is

[201]Yale, B., Vol XI, p. 83, Tr. 3503.

the actual underpricing of milk below the FMMO prices that would establish that producer handlers are creating disorderly marketing.

The point of these exercises are two fold. First, the difference in the data reported shows a wide range in retail pricing depending upon city and type of store. Reported differences in prices between competitors to a single sale to a single store or even a single sale to a chain of stores fall well within the range of differences in prices shown above.

Summary Exhibit 53 Refised with CDFA Data										
Ten Pricing Points Whole Milk in Ten Orders Compared to Retail and Cost per Gallon										
Averages January 2008 to April 2009										
										Retail
					Retail				Retail	Price
					Price				Price	less
		Coop	Federal	Over	Reported by	Coop	Federal	Over	less Coop	Federal
		Class I	Class I	Order	CDFA	Class I	Class I	Order	Class I	Class I
City	Diff.	$/cwt	$/cwt	$/cwt	whole $/gal	$/gal	$/gal	$/gal	$/gal	$/gal
Boston	$3.25	$21.17	$19.61	$1.56	$3.47	$1.82	$1.69	$0.14	$1.65	$1.78
Louisville	$2.20	$21.98	$18.66	$3.32	$3.31	$1.89	$1.61	$0.29	$1.42	$1.70
Miami	$4.30	$26.07	$21.96	$4.11	$3.99	$2.24	$1.89	$0.35	$1.75	$2.10
Atlanta	$3.10	$23.55	$20.01	$3.54	$3.70	$2.03	$1.72	$0.31	$1.67	$1.98
Chicago	$1.80	$21.23	$18.19	$3.04	$2.86	$1.83	$1.57	$0.26	$1.03	$1.30
Kansas City	$2.00	$20.60	$18.39	$2.21	$3.77	$1.77	$1.58	$0.19	$2.00	$2.19
Cleveland	$2.00	$21.36	$18.39	$2.97	$3.34	$1.84	$1.58	$0.26	$1.51	$1.76
Seattle	$1.90	$19.02	$18.29	$0.73	$3.06	$1.64	$1.57	$0.06	$1.42	$1.48
Dallas	$3.00	$21.39	$19.39	$2.00	$3.49	$1.84	$1.67	$0.17	$1.65	$1.82
Phoenix	$2.35	$19.24	$18.74	$0.50	$2.69	$1.66	$1.61	$0.04	$1.04	$1.08
Average		**$21.56**	**$19.16**	**$2.40**	**$3.37**	**$1.85**	**$1.65**	**$0.21**	**$1.51**	**$1.72**

Second, and this is the real reason the retail sales prices are not indicative of raw milk pricing, is that the difference itself between the raw milk price and the retail price almost equals the raw milk price. This difference encompasses many costs and profit opportunities between the farm and the store shelf including

transportation, processing, packaging, advertising, marketing, and the like. Where any raw milk cost advantage exists is masked by all of the other costs and charges that the gap covers. Without having intense detail of retailing companies as to how they price their milk in the store, all we know is that we do not know. To claim otherwise is mere speculation.

D. Requirements of unique brands or labels does not settle the underlying issue in exempting producer handlers from pricing and pooling and should not be adopted.

Proposals 2 and 26 both provide for any exemption to be dependent upon the exempt handler.[202] This exemption was explained by its proponent witness:

Regarding unique labeling. NMPF further

> 9 proposes that an exempt plant should not produce any
> 10 products under brands that are also produced by other
> 11 plants. Clearly associating an exempt plant's products
> 12 with plant-specific brand or brands will enforce the
> 13 plant's independent nature. This is intended to reduce
> 14 the potential for the assembly of a supply of packaged
> 15 milk by a cost-oriented "integrator" with substantial
> 16 control of the exempt plant's product. Without such a
> 17 limitation, a large retailer, for example, could recruit
> 18 small exempt plants, organizing production in such a way
> 19 as to remove the diseconomies of scale in marketing and
> 20 distribution and even, through line specialization, of
> 21 processing. Such an "integrator" arrangement would
> 22 violate the intent and spirit of size -- of the
> 23 size-based exemption which is intended to accommodate
> 24 small businesses that are unlikely to affect their
> 25 market, either individually or collectively. This
> 1 qualification of exemption should be included in any

[202]Exhibit 1.

2 decision arising from this hearing.[203]

This position is further supported by the State witnesses.

Unique branding. The Producer-Handlers
14 in The States are marketing unique brands
15 produced at their farm and processing location.
16 These producer-handlers operate one farm and
17 processing facility and the products produced
18 are specifically labeled for sale in their local
19 communities. The States do not support
20 producer-handlers banding together across
21 geographic locations to produce a brand for mass
22 distribution.[204]

This was clarified further when one of the State witnesses said

I think our point is that if
18 there's any kind of franchising, to bundle, it
19 would probably not be the entities that we're
20 talking about, some new entities that might
21 enter the business that have a different modus
22 operandi. That's not something we're advocating
23 to sort of make a big dent in the marketwide
24 pooling, so –[205]

But the State Departments of Agriculture witness went on to qualify this statement,

Other than the concern about
14 syndication, integration, ***I don't think labeling***
15 should be under the purview of the Federal
16 Orders. It has to do with ownership, structure
17 and size limit. Those that exceed the size
18 limit are not -- I mean, they -- they can still
19 stay in business and can operate, do what they
20 want, but they're subject to regulations. We

[203]Cryan, R. Vol. II, p. 196-197, Tr. 421-22.
[204]Hughes, W., Bothfield, D, Vol. IV, p. 46, Tr. 1111.
[205]Hughes, W., Vol. IV., p. 85-87, Tr. 1150-1152; concurs, Bothfeld, D., Vol. IV, p. 87, Tr. 1152.

21 reserve, under the size limit, the exception.[206]

He agreed that the "syndication" or "integration" does not depend on a single label.

MR. YALE: But the syndication doesn't
14 necessarily require that everybody have the same
15 label, does it? I mean, syndicator could still
16 syndicate an aggregate with using different
17 labels, right?
18 MR. HUGHES: Presumably.
19 MR. YALE: So the single label issue
20 doesn't really address the aggression or
21 integration, per se.
22 MR. HUGHES: I don't think that it has
23 to, no. [207]

This answer does not mean, that the State witness agreed that syndication or integration of producer handlers was to be allowed.

I do. I do, thank you. And it would --
14 it would mirror what was said earlier today, that we
15 would want to avoid allowing integrators to avoid what I
16 believe this rulemaking is trying to accomplish.[208]

Other supporters of limiting producer handlers agreed with some restriction on labeling.[209]

The clear intent of these "unique brand" statements is a division of the retail market place between proponents and smaller family operations. One witness explained it this way,

The restrictive verbiage

[206]Hughes, W., Vol. IV., p. 101, Tr. 1166. [Emphasis added]
[207]Hughes, W., Vol. IV., p. 102, Tr. 1167.
[208]Hughes, W., Vol. IV, p. 186, Tr. 1151.
[209]Krueger, M., Vol. IV, p. 321, Tr. 1286.

> 7 proposed which prevents producer-handlers from
> 8 co-branding is based on protecting the large lucrative
> 9 supermarket business and relegating smaller producers to
> 10 costly, less than desirable small regulators. That's
> 11 not a level playing feed.[210]

This type of restriction is outside of the legal authority of the Secretary. First, it is clearly and openly an attempt to create a trade barrier to one part of the market for a particular, lawful business model supplying milk to consumers. Trade barriers are prohibited by the AMAA.

> (G) No marketing agreement or order applicable to milk and its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of any milk or product thereof produced in any production area in the United States.[211]

Further, the AMAA prohibits limits on advertising:

> No order shall be issued under this chapter prohibiting, regulating, or restricting the advertising of any commodity or product covered thereby, nor shall any marketing agreement contain any provision prohibiting, regulating, or restricting the advertising of any commodity, or product covered by such marketing agreement.[212]

Finally, it is unlikely that any division of the market other than by marketing areas is beyond the power of the Secretary in any event.

But again, because the law only authorizes the Secretary to equalize, not penalize, processor costs, the rationale justifying the elimination of the producer

---

[210]Taylor, W., Vol. XI, p. 137, Tr. 3557
[211]7 U.S.C.A. 608c(5)(G)
[212]7 U.S.C.A. 608c(10)

handler exemption has to be based upon the producer handler having a lower raw milk cost creating a competitive advantage. If there is a lower raw milk cost, then assessment of proper compensatory payments to equalize the cost takes care of the problem and if a producer handler or series of them obtain a particular sale, then it is competition between handlers.

If the basis for the exemption is that there is no price advantage then there is no lawful justification for the department to impose a regulation on advertising or branding or to create a trade barrier denying one handler from particular sales in the market place.

The limitation on the branding would be useless in any event. Creation of special store brands for the lower price level would not require them to be the same. In the case of Heartland Dairy getting access into one chain of stores with its milk, the buyer replaced the private label milk supplied by Erickson-Anderson with the Heartland brand.[213] This was further explained,

> [Q. So if you made a limitation that said you
> 24 couldn't -- you had to have a unique label, that in
> 25 itself wouldn't necessarily stop a PD or anybody else
> 1 from getting into a store, the sales. This would be
> 2 price, right?
> 3 A. A lot of that decision is based on price.[214]

[213]Erikson, W., Vol. VII., p. 175, Tr. 2278.
[214]Erikson, W., Vol. VII., p. 182, Tr. 2285-2286.

Further, the use of two or more producer handlers to serve the same store with the same label is unlikely. A witness in response to a question from a proponent attorney said

> Do you sell milk under a label to a
> 23 retailer where the same retailer gets the same label
> 24 from another processor?
> 25 A. Not in the same region. So in other
> 1 words, I have a relationship with -- with a grocer who
> 2 has different regions from which he purchases milk.[215]

Another producer handler explained the reality:

> A. Yes, I've heard of that.
> 22 Q. All right. And that -- the contention is
> 23 that, in fact, the pool plant is balancing the supply of
> 24 that producer-handler under that scheme? I mean,
> 25 that's -- you've heard that?
> 1 A. I've heard that contention. But in my
> 2 experience with our private label customers, that's not
> 3 the way that it works at all.
> 4 Q. Okay. And that's what you were saying.
> 5 Although there may be multiple sources of the same brand
> 6 to the same customer, but it's not at the same location
> 7 at the same time?
> 8 A. That's right.
> 9 Q. All right. You would not walk into any
> 10 of your customers' stores and see the same brand with
> 11 different plant numbers on it?
> 12 A. That would be -- that would be unusual
> 13 for the same size format. But you might see -- you
> 14 might see the same brand with one vendor supplying half
> 15 gallons, another vendor supplying gallons, another
> 16 vendor supplying the -- the heavy creams and half and
> 17 halfs and the like.
> 18 I mean, that's the customer's choice as

[215]Arkema, P., Vol. XI, p. 260-261, Tr. 3681-3683.

19 far as which -- which supplier is the best fit for --
20 for the product.[216]

Not only would the restriction limit sales to certain stores, it would also impair relationships with milk dealers.

Q. Okay. So within the Michigan area, you
9 do not have a label that is being -- that is shared in
10 the sense that a retailer has another processor using
11 that label within Michigan?
12 A. There is a label that would have that.
13 Q. In Michigan?
14 A. Yes.
15 Q. Okay. And is that product also sold
16 through your exclusive distributorship?
17 A. Yes.[217]

Compounding the problem of violating the AMAA, the decision of whether a label violates this or not will be in the eyes of the beholder.

4 Q. Which brings now the question, how unique
5 is unique in the label?
6 A. I would say the Market Administrators
7 would know it when they see it.[218]

Finally, this spirit of the labeling to deny producer handlers sales to certain customers, can be avoided by the buyer.

Q. The assumption is that the integrator
20 model requires that it be the identical label, right?
21 A. Well, that it's the same brand. We're
22 talking about a brand. And it's -- it's certainly
23 possible that -- I mean, I could picture a large chain

[216]Keefe, S., Vol. IX, p. 160-161, Tr. 2975-2976.
[217]Arkema, P., Vol. XI, p. 261, Tr. 3683.
[218]Cryan, R., Vol. VI., p. 388, Tr. 2064.

24 going on a -- on a -- on a buy local kick to happen to
25 allow them to exploit this with multiple labels. These
1 kinds of things are certainly possible. But the
2 principle and the spirit of the labeling is intended to
3 avoid that.[219]

The evil which proponents of unique label are seeking to prevent is either the use of the FMMO program to divide up the market place between different processors, which is prohibited, or to protect against buyers of processed milk purchasing milk from a series of priced advantaged producer handlers eroding the sales of priced and pooled plants. But as explained elsewhere in this brief, it is the lack of raw milk price advantage that justifies the exemption and, in that event, there is no advantage for milk buyers to exploit. It is thus unnecessary for the Secretary to even consider violating the limitations of the AMAA against trade barriers and restrictions on advertising by adopting a "unique brand" label.

E. The cost of balancing associated with a producer handler should be a consideration in terms of the costs.

There were some who argued that the fact that producer handlers do or do not balance their sales was a determinative in whether or not to remove or restrict the exemption from pooling. Proponents of limitation argued that producer handlers balance off of the order and that is an unfair advantage.[220]

Well, unless they're locked in a bubble
2 city as the only bottler, with people not able to go in

[219]Cryan, R., Vol. VI., p. 387-388, Tr. 2063-4.
[220]Cryan, R., Vol. II, p. 185, Tr. 410; Tonak, D., Vol. II, p. 296, Tr. 501.

3 and out, they're not truly balancing their own supply.
4 They are not -- they can be -- they can adjust their
5 pricing in ways that encourage their customers to come
6 in with -- if they have surplus, they can run a sale.
7 They can run specials and draw people in to take the
8 surplus off their hands. And that all comes at the
9 expense of the rest of the market.[221]

At the same time producer handlers maintained that because they were not part of the system they bore an unreasonable cost for balancing their milk.[222]

Secondly, to simply say that a
6 producer-handler can pay the uniform price for
7 milk at the plant ignores completely the cost a
8 producer-handler occurs in balancing his own
9 milk supply. A producer-handler is left on his
10 own to market his balance of surplus production,
11 usually at a price below production cost, if he
12 can find a market at all. Whatever return is
13 realized is most certainly below uniform price,
14 and usually incurs extra freight costs. Another
15 cost factor in balancing for a producer-handler
16 is marketing the cream that's surplus in today's
17 fluid milk market.[223]

This was also stated by another small producer handler,

A processor who
15 acquires a new customer simply needs to order more milk
16 from the cooperative that supplies him with raw milk.
17 Or, for example, if demand climbs or falls suddenly, as
18 it can on occasion, a fluid bottler gets first choice on
19 available milk and can order up a couple of extra loads
20 of milk or cancel a load or two, as the case may
21 require. A producer-handler, on the other hand, must

[221]Cryan, R. Vol. VI, p. 346, Tr. 2022.
[222]Gilbert, G., Vol. VII, p. 15; Tr. 2119.
[223]Gibson, J., Vol. III, p. 26, Tr. 630.

22 constantly balance demand with available supply and pay
23 a premium over Class I to purchase extra, or receive the
24 lowest class price available to ship excess.[224]

Whether the producer handler balances or not is not relevant unless it is brought within the context of cost of the raw milk. If the producer handler has a distinct price advantage over the priced handlers, then any balancing costs born by producers who participate in the pool is unfair because it would amount to a subsidy. On the other hand when the raw milk cost of producer handlers exceed the fully regulated handlers, there is no such advantage or lack of fairness.

To the extent that comparison of the transfer price of producer handler milk to the Class I price of a regulated handler, the cost of balancing by the producer handler can constitute part of that comparable transfer price.

At the end of all of the arguments, the issue is this: What is the transfer price of a producer handler for its own milk and how does that compare to the Class I price regulated handlers pay? If it is less, create a compensatory system that fairly equalizes, not penalizes, the difference. Balancing costs may be a factor in that determination.

F. The nature of the risk held by producer handlers is a factor in consideration of limitation of the exemption.

Some of the producer handlers noted that there is a risk associated with being a producer handler that is neither shared by producers or processors. That

[224]Rooney, J., Vol. V., p. 90, Tr. 1522.

risk is that as a producer, the producer handler has the risk also of being a handler and the risk as a handler, the producer handler has the risk of also being a producer. The regulations recognize this. All of the exemptions for producer handlers requires that the entity have all of the risk of the farm and the plant. For example:

> §1126.10 Producer-handler.
>
> Producer-handler means a person who: * * *
>
> (e) Provides proof satisfactory to the market administrator that the care and management of the dairy animals and other resources necessary to produce all Class I milk handled (excluding receipts from handlers fully regulated under any Federal order) and the processing and packaging operations are the producer-handler's own enterprise and at its own risk.
>
> * * * [225]

Exposure to risk both as processor and producer does not alone justify the exemption. Rather it defines who is entitled to it. As the underlying economic basis for the exemption is that producer handlers' transfer cost is the cost of production, if it is in fact one in which the producer handler is not really bearing that risk as the processor, then there is no justification for the exemption.

G. The growing size of producers is not relevant to the issue of whether or not producer handlers are creating disorderly marketing conditions.

There was some discussion about the growing share of milk being produced by a smaller number of producers. Though the data shows that ownership of plants

[225] 7 C.F.R. §1126.10.

and milk marketed by cooperatives has shown even more dramatic concentration, the implication of the testimony was that the larger producers posed the potential of becoming producer handlers.[226]

The most recent report of by NASS, *Farms, Land in Farms, and Livestock Operations 2008 Summary*: Released February 1, 2009, by the National Agricultural Statistics Service (NASS), Agricultural Statistics Board, U.S. Department of Agriculture[227] shows that in 2008 the number of dairy operations with 500 or more cattle was 3,320 producing 57% of the milk. In comparison, the same report for 2007 showed 3,215 farms in that size group producing 54% of the milk. For 2004, the earliest report under Farms, Land in Farms, and Livestock Operations, though earlier information is available in other reports, the numbers were 3,010 operations with 47. 4% of the milk. In these five years there was an increase in the number of operations of this size by 310 or more than 10%. The percentage of total production from operations of this size increase by about 20%.

Evidence shows that growth of producer handlers is just the opposite.

Then
10 in three months from December 2008 to
11 March 2009, the number of producer-handlers
12 decreased by 21 percent. This rapid and
13 substantial decline indicates that a large
14 number of producer-handlers closed their doors,

[226]Cryan, R. Vol. II, p. 179, Tr. 384; Hollon, E., Vol XII, p. 45, Tr. 3776; Yonkers, B., Vol. VII, p. 333, Tr. 2437.

[227]The report for 2007 was referenced by Cryan, R., Ex. 23, p. 5.

15 given the adverse economic climate for milk
16 production and the lack of sufficient
17 producer-handler margins in processing and
18 distribution to absorb the losses in production.[228]

According to Exhibit 13 at the beginning of 2005 there were 48 producer handlers in the FMMO. The same exhibit shows 37 producer handlers at the beginning of 2009 in the FMMOs. That is a reduction by 9 during that period. Exhibit 12A shows the increase in distribution from producer handlers from 2005 to 2008 to be 21.8 million pounds over 546.5. The 21.8 million represents one 1000 cow farm with a herd average of 21,800 pounds or two 500 to 600 head farms. Assuming that all of the producer handlers that went out were the small ones and all of the addition came from a new larger one or two herds, not evident in the evidence, it is apparent that the growth of larger farms is not seeing a conversion into producer handlers. In short there is no evidence of this and any statements made in this regard is pure speculation.

This is further substantiated by the list attached to Exhibit 23, Top 50 U.S. Dairy Cooperatives by Volume, 2007.[229] The two cooperative members of the federation, Continental and Select Milk Producers, Inc. represent the largest and second largest average cows per farm of the cooperatives listed. These estimated

[228]Knutson, R., Vol. IX, p. 238, Tr. 3053.
[229]Cryan, R., Vol. II, p. 232, Tr. 437.

averages of 3199 and 2594 respectively represent farms 2.5 to 3 times the size of farm that these cooperatives proposed setting limits.[230]

In short, the support of the largest farm size cooperatives of limits on producer handlers, the data showing flat growth of producer handlers while farms of that size are growing rapidly undermine the speculative fear of massive farm to producer handler conversions.

In any event, the segment of dairy farmers that represents over half of milk produced and the segment which will continue to grow, is a phenomena which the USDA should embrace as its largest constituency, not base regulations based upon size of farms.

H. The regulation of organic milk production and distribution should not be part of the Dairy Programs policies.

In determining whether and to what degree to change producer handler regulations, the Department should ignore the issue of organic milk. There were a number of organic producers,[231] organic producer handlers,[232] consumer groups,[233] trade groups,[234] and government organizations,[235] which put emphasis on organic milk and organic farming. Implicit in some of the arguments was that restrictions were required for organic producer handlers because some farms producing

[230]Proposal 21, Ex. 1.
[231]Segalla, R., Vol. IV, p. 75, Tr. 1751.
[232]Arnold, K., Vol. IV, p. 80, Tr. 1756.
[233] Casteel, M., Vol. III, 451 ff., Tr. 1055.
[234]Exhibit 70, Exhibit 71.
[235]Exhibit 36.

organic milk were too big[236] or that preservation of producer handlers was necessary to promote the organic milk products.[237]

As meritorious as the production and marketing of organic milk is, and it is an innovative and positive product of the dairy industry, preserving or promoting organic milk producers or organic producer handlers on the basis of their being organic is not the role of USDA in this hearing or under the AMAA.

VII. Conclusion: Existing producer handlers with less than 3 million pounds of Class I sales per month should not lose the exemption.

The record evidence shows without any repudiation that producer handlers at or below 3 million pounds have no on going advantage to pricing of milk. Their cost of production is more than the Class I price and the addition of a compensatory payment would be penal, not remedial. Regardless of opinions for or against producer handlers, by imposing such a penalty on a legitimate, historic, and efficient model of supplying bottled milk, the Secretary is outside of his legal authority. But because the hearing shows that the purported economic advantage is not there, the refusal to regulate producer handlers under 3 million pounds will not itself harm the marketing orders.

The preservation of the milk marketing orders and their minimum prices requires that those who pay the minimum prices are not placed at an economic

[236]Arnold, K., Vol. IV, p. 82, Tr. 1758.
[237]Segalla, R., Vol. IV, p. 75, Tr. 1751.

disadvantage in competition with handlers who are exempted from the pooling and pricing requirements of those orders. To the extent that the exemption of producer handlers from pooling and pricing provides them an economically identifiable advantage, it is appropriate for the Secretary to find a means to correct the imbalance.

The focus of this question is the comparison of the cost of raw milk acquired by handlers either by purchase or own farm production. The economic disadvantage dictating the need for corrective action occurs when the cost of production of a producer handler is at the most less than the Class I price. Anecdotal stories of milk sales shifting from one account to another does not, cannot, provide evidence of what the relative transfer costs are.

The administration of the order yields the transfer cost for plants purchasing milk. For producer handlers, the transfer cost is the cost of production of the milk. Determining the first whether there is an inequity begins by comparison of the cost of production with the transfer costs. Testimony by State Departments of Agriculture witnesses as well as economic experts reporting on peer reviewed literature supported by USDA data on the cost of production show that for producer handlers with sales under 3 million pounds of Class I sales per month, there is not disparity in price as a matter of fact.

These reported costs of production were independently substantiated by actual costs of productions reported by witnesses, in support and in opposition to PD exemption.

Other evidence that the transfer costs are equivalent besides the costs of production for producer handlers having less than 3 million pounds per month is the nearly universal consensus from all witnesses that there is no evidence of producer handlers at that size creating any disorderly marketing.

To comply with the law and fairness, the Secretary must not change the exemption for producer handlers such that existing producer handlers with less than 3 million pounds lose that exemption. This can be done by defining them and "grandfathering" existing farms without imposing other restrictions designed to terminate the producer handlers, setting the cap at 3 million pounds without change to the regulations or find that that there is no economic proof that the transfer costs of any producer handler is less than the minimum prices under the orders, and make no change. Select and Continental support all three of those and oppose anything else.

The first proposed language reads as follows:

> § 100_.10 Producer-handler.
> * * * * *
> (a) Operates a dairy farm and a distributing plant from which there is monthly route disposition in the marketing area, not to exceed 3 million pounds; * * *[238]

[238]Exhibit 1, Notice of Hearing, p. 11.

To provide for a grandfather clause, the above would read as follows:

§ 100_.10 Producer-handler.
* * * * *
(a) Prior to July 1, 2009 operated and for the month operates a dairy farm and a distributing plant from which there is monthly route disposition in the marketing area, not to exceed 3 million pounds; * * *

Respectfully submitted,
YALE LAW OFFICE, LP

Benjamin F. Yale
P O Box 100
527 N. Westminster St.
Waynesfield, Ohio 45896
419-568-6401 ext 114
ben@yalelawoffice.com
Attorney for Select Milk Producers, Inc. and Continental Dairy Products, Inc.