

**BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE**

<b>In the Matter of</b>	:
	:
<b>MILK IN THE NORTHEAST AND OTHER MARKETING AREAS</b>	<b>: Docket Nos.: AO-14-A74 et al; DA-06-01</b>

**POST HEARING BRIEF OF  
THE ASSOCIATION OF DAIRY COOPERATIVES IN THE NORTHEAST**

**I. Introduction.**

This Brief is submitted on behalf of the Association of Dairy Cooperatives in the Northeast (“ADCNE”). The Association consists of the following member dairy cooperatives: Agri-Mark, Inc.; Dairy Farmers of America, Inc.; Dairylea Cooperative Inc.; Land O'Lakes, Inc.; Maryland and Virginia Milk Producers Cooperative Association, Inc.; O-AT-KA Cooperative; St. Albans Cooperative Creamery, Inc.; and Upstate Farms Cooperative, Inc. The members of ADCNE market in excess of 65 percent of the milk in Order 1, the federal order regulating the marketing of milk in the Northeast marketing area. Order 1, in turn, represents more than 20 percent of the milk in the Federal Milk Marketing Order system. Each of the ADCNE member cooperatives are Capper-Volstead qualified cooperatives recognized to represent their members in federal milk market orders.

ADCNE members have a diverse set of operations and, consequently, a diverse set of individual interests. Agri-Mark, Inc., headquartered in Methuen, Massachusetts, has approximately 1,300 members located in the six New England states and New York. It markets about 2.5 billion pounds of milk annually. Agri-Mark owns and operates four manufacturing

plants including cheese plants in Middlebury and Cabot, Vermont, and Chateaugay, New York, and a butter and powder plant in West Springfield, Massachusetts. Dairy Lea Cooperative Inc., headquartered in Syracuse, New York, has 2,400 dairy farmer members in the northeast, most of whom are pool producers in Order 1. Dairy Farmers of America, Inc. ("DFA") is a national cooperative of more than 13,000 farms. The DFA Northeast Area Council represents 2,200 dairy farmers, with most being Order 1 pool producers. DFA owns two Order 1 area powder plants at Reading and Middlebury Center, Pennsylvania, under the name of Dietrich's Milk Products, LLC and is, also, an owner-member of O-AT-KA. Land O'Lakes, Inc. ("LOL") is a cooperative with a national membership base. In the Northeast, Land O'Lakes has over 2,000 members who are pooled on Order 1. LOL owns and operates an Order 1 pooled butter/powder plant located in Carlisle, Pennsylvania. Maryland and Virginia Milk Producers Cooperative Association, Inc., is a cooperative headquartered in Reston, Virginia, with approximately 1,400 producers in 11 states in the east and southeast. It owns and operates an Order 1 pool plant at Laurel, Maryland, which has butter and powder manufacturing capacity; is an owner of an Order 5 pool manufacturing plant at Strasburg, Virginia; and owns and operates Class I distributing plants in Virginia and North Carolina. O-AT-KA Milk Products Cooperative, Inc., is a federated cooperative owned by Upstate, DFA and Niagara Milk Producers of Niagara Falls, New York. O-AT-KA owns and operates the manufacturing plant at Batavia, New York. St. Albans Cooperative Creamery, Inc., is a Capper-Volstead cooperative with 600 members headquartered in St. Albans, Vermont. It owns and operates an Order 1 supply plant which includes facilities receiving, separating, condensing and drying milk. Upstate Farms Cooperative, Inc., is headquartered in Buffalo, New York, and has about 300 member dairy producers the majority of whom are pooled on Order 1. Upstate owns and operates a pool distributing plant at Rochester,

a cultured products plant at Buffalo, and is a member-owner of the O-AT-KA butter-powder plant at Batavia.

The positions advanced in this Brief represent the consensus of the positions of these dairy farmer cooperatives and, to that extent, do not necessarily represent the narrow economic interest of each organization. In reaching and advancing consensus positions, ADCNE has attempted to balance the interests of the dairy farmer members as producers and of the cooperatives' operations as both marketers of milk to third parties and manufacturers of all classes of dairy products. The Association's position on the several issues presented in this hearing was summarized in Dennis Schad's testimony at the hearing for ADCNE:

[I]t is urgent to adjust the Class III and IV make allowances, . . . [however] it is not necessary, and would be positively detrimental, to allow the changes to impact Class I and Class II prices. . . . These uses do not operate on pre-set make allowances; and the prices charged for the finished products are not reflected back in the minimum class prices. . . . There is no reason that producers should suffer price reductions on these classes of utilization. It would mean, in Order 1, that producers would suffer price reduction on two pounds of production for every pound requiring the make allowance adjustment. The status quo should be preserved for Class I and II prices by simply retaining the current order language and formulae for advance Class I and II pricing factors. These prices are calculated independently of Class III and IV prices and should not be changed. (Tr. 245 (January 27))

Agri-Mark, Dairylea, DFA and Land O'Lakes have separately stated positions on some issues.

With this perspective in mind, we will discuss the Hearing Record and our positions on the issues, as follows: (1) proposed changes to Class I and Class II prices; (2) proposed changes in the manufacturing allowances; and (3) adoption of an interim final rule.

**II. The NMPF Request to Maintain the Status Quo on Class I and II Prices Should be Heard and Adopted.**

A. The Appropriate Legal Standard for the Scope of the Hearing contrasted with the ALJ's Ruling.

The most recent Court of Appeals decision concerning interpretation of the scope of a milk order hearing notice fully explained the appropriate standard by which this hearing notice should have been interpreted and applied. Judge Posner, writing for the panel in Alto Dairy v. Veneman, 336 F.3d 560 (7<sup>th</sup> Cir. 2003), explained:

We have said that "notice is adequate if it apprises interested parties of the issues to be addressed in the rulemaking proceeding with sufficient clarity and specificity to allow them to participate in the rulemaking in a meaningful and informed manner." American Medical Ass'n v. United States, 887 F.2d 760, 767 (7<sup>th</sup> Cir.1989). But "while an agency must explain and justify its departures from a proposed rule, it is not straitjacketed into the approach initially suggested on pain of triggering a further round of notice-and-comment." *Id.* at 769. "The law does not require that every alteration in a proposed rule be reissued for notice and comment. If that were the case, an agency could 'learn from the comments on its proposals only at the peril of' subjecting itself to rulemaking without end." First American Discount Corp. v. CFTC, 222 F.3d 1008, 1015 (D.C.Cir.2000). The purpose of a rulemaking proceeding is not merely to vote up or down the specific proposals advanced before the proceeding begins, but to refine, modify, and supplement the proposals in the light of evidence and arguments presented in the course of the proceeding. If every modification is to require a further hearing at which that modification is set forth in the notice, agencies will be loath to modify initial proposals, and the rulemaking process will be degraded.

336 F.3d 569–570. The Circuit Court in Walmsley v. Block, 719 F.2d 1414, 1418 (8<sup>th</sup> Cir. 1983), stated similarly in a milk order case: "Notice of proposed rule making under 5 U.S.C. § 553(b) 'must be sufficient to fairly apprise interested parties of the issue involved . . . , but it

need not specify every precise proposal which [the agency] may ultimately adopt as a rule.’ Trans-Pacific Freight Conference of Japan/Korea v. Federal Maritime Comm., 650 F.2d 1235, 1248 (D.C.Cir. 1980) [additional citations omitted].”

As these cases reveal, the appropriate scope of milk order hearings has been litigated a number of times over the years, but we are aware of no cases where testimony which advocated maintenance of the status quo has ever been rejected as beyond the scope of the hearing. As the Court in Friendship Dairies v. Butz, 432 F.Supp. 508, 515 (N.D.N.Y. 1977) observed in the context of a case involving proposals to change the lowest Class price: “The dairy farmers wanted higher prices and the handlers wanted to keep the status quo.” The change to the status quo was supported there, after debate, a debate which was foreclosed here.

If the ruling of Administrative Law Judge Davenport in this proceeding is upheld, the milk order rulemaking process will have been seriously degraded and the notice will have been construed to, in essence, require publication of the precise proposal to be adopted. The Department should overrule ALJ Davenport’s ruling and allow the testimony of Dr. Cryan, (embodied in Exh. 58) to be heard in full. The refusal to hear Dr. Cryan’s testimony is a serious departure from the historical scope of milk order hearings.

#### B. Dr. Cryan’s Testimony was Improperly Excluded

The ALJ’s erroneous ruling seems to have been premised on multiple incorrect readings of the hearing notice. First, ALJ Davenport relied heavily on the preliminary economic analysis done by the Department and published in the hearing notice. (Tr. 61–62 (January 27)) The language the ALJ quoted (Tr. 31 (January 27)) and re-cited (Tr. 62 (January 27)) was from the preliminary analysis. But that analysis **by its very own terms** was “conducted for *illustrative*

*purposes* (emphasis supplied)” and never purported to be exhaustive with respect to the scope or contours of even the hearing proposal and it made no attempt whatsoever to represent the possible impact of any potential modifications of the hearing proposals. In other words, in finding Dr. Cryan’s testimony outside the scope of the hearing notice, the ALJ relied on the description of an “illustrative” economic study of the proposal which did not even attempt to depict or describe the possible scope of permissible modifications. Reliance on the scope of the preliminary economic analysis to define the scope of the hearing notice was misplaced and an unfortunate, but gross, error.

In addition, his Honor Judge Davenport noted the fact that the hearing was being conducted on an expedited basis and that emergency relief was being requested. (Tr. 62 (January 27)) In the cruelest of ironies in this dairy farmer program, Judge Davenport then reasoned that “Due to the significant financial impact which will likely follow any adjustment, consideration of a modification which has not been subjected to a thorough and deliberate analysis, I think, is unwarranted.” (*Id.*) In other words, because limiting the make allowance changes to Classes III and IV “will likely” have a significant financial impact upon the objecting Class I and II handlers, it could not even be discussed! What about the impact on dairy farmers? ALJ Davenport lost sight of what the Friendship Dairies Court (among many others) kept in mind when determining the appropriate procedures in a milk order hearing (432 F.Supp. at 515): “In conclusion, it is important to recall that the Act is designed to improve marketing conditions for the benefit of producers. Waddington Milk Co. v. Wickard, 140 F.2d 97, 101 (2d Cir. 1944); Lewes Dairy, Inc. v. Freeman, 401 F.2d 308, 311 (3<sup>rd</sup> Cir. 1968).”

C. The NMPF Proposal was an appropriate modification to Proposal I which simply preserves the status quo with respect to Class I and II prices.

ALJ Davenport was misled by the objectors to Dr. Cryan's testimony who mischaracterized his proposal to make it appear to be beyond the scope of the hearing. There were several elements to these arguments. First, the contention was made<sup>1</sup>, and adopted<sup>2</sup> that NMPF was advocating "decoupling" of Class I/II prices from Class III/IV prices. This was manifestly incorrect. Under the NMPF proposal the very same relationship between Class III and IV product values and Class I and II prices would exist as exists now, the status quo would be retained. There would be no de-coupling.<sup>3</sup> Secondly, the assertion was made that the NMPF proposal was tantamount to reopening the entire process of FAIR Act federal order reform. Giving the speaker(s) the benefit of every doubt, this is gross hyperbole; one might fairly say that it was intentionally misleading. The "advanced pricing factors," 7 C.F.R. §1000.50(q), which under the NMPF proposal would retain the same formulae as they currently have, were minuscule parts of the federal order reform debate. With respect to Class I, they have no impact whatsoever on the regional relationship of Class I prices, the price surface, which was the core of the debate. With respect to Class II, since the level of Class II prices is related to costs of drying and reconstituting condensed milk under federal order reform, the Class II price **should** increase

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<sup>1</sup> Tr. 254, 258 (January 25).

<sup>2</sup> ALJ Davenport stated, in the buildup to his ruling: "[S]uffice it to say that all of those changes deal with the decoupling of the make allowances to the current system." (Tr. 17 (January 27)).

<sup>3</sup> This term is nowhere defined, but it has come to describe a system in which Class I prices are established on a basis different, separate, and independent of manufacturing product prices and values.

with respect to Class IV and that would be a by-product of retaining the status quo formula. The representations of the enormity of the significance of the NMPF proposal were vastly overstated. The worst that could happen to the Class I and II prices under the NMPF proposal was: Nothing. They would be the very same prices after the hearing as before.

NMPF's concept for modification of Proposal 1 was very simple: Some of the prices which could be reduced should be reduced; other prices which could be reduced should not be reduced – they should retain their current level. We are quite certain that never before in milk order hearings has a modification to mitigate, or limit, a proposed price reduction to dairy farmers been ruled beyond the scope of a rulemaking hearing. It should not have been ruled out here.

D. The Hearing Should be Promptly Reconvened to Remedy This Serious Error.

The Rules of Practice for milk order hearings, 7 C.F.R. 900.8(d)(6), prescribe what should occur in circumstances such as this:

Whenever evidence is excluded from the record, the party offering such evidence may make an offer of proof, which shall be included in the transcript. The offer of proof shall consist of a brief statement describing the evidence to be offered. If the evidence consists of a brief oral statement or of an exhibit, it shall be inserted into the transcript in toto. In such event, it shall be considered a part of the transcript if the Secretary decides that the judge's ruling in excluding the evidence was erroneous. The judge shall not allow the insertion of such evidence in toto if the taking of such evidence will consume a considerable length of time at the hearing. In the latter event, if the Secretary decides that the judge erred in excluding the evidence, and that such error was substantial, the hearing shall be reopened to permit the taking of such evidence.

The hearing, pursuant to the Rules of Practice, should be promptly reopened to take Dr.



Cryan's<sup>4</sup> full testimony, as proffered in Exhibit 58. This should not unduly delay matters. Notice can be as few as 3 days under the AMAA. The cost or inconvenience to the potential hearing participants of attending a promptly called reopened hearing pales in comparison to the cost to the nation's dairy farmers of the automatic, lock-step reduction in Class I and II prices, which the Department has estimated would be \$90 to \$100 million in the first year alone. (Exh. 2)

**III. The Manufacturing Allowances for Class III and Class IV as Advocated by the National Milk Producers Federation Should Be Adopted.**

The manufacturing allowances for Class III and Class IV should be updated as advocated in Proposal 1 as supported by Dr. Cryan for the National Milk Producers Federation and Mr. Schad for ADCNE.

A. The 2006 Make Allowance Crisis

The Department should continue to adhere to the golden mean position it has taken with respect to make allowances. This principle was initially articulated in the final decision of April 2, 1999, which stated:

If the make allowances are established at too low a level, manufacturers will fail to invest in plants and equipment, and reduced production capacity will result. If the make allowances are established at too high a level, there will be unwarranted incentive to increase capacity above the needs of the industry, leading to over capacity and resulting losses to manufacturers. Either scenario would not be in the best interests of the dairy industry. (64 Fed. Reg. 16097, April 2, 1999)

Make allowances must be set at a level which is fair and equitable to all concerned. The current make allowances are neither fair nor equitable to plant owners and operators. Without

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<sup>4</sup> And the testimony of others, such as Mr. Pittman. See Tr. 63-64 (January 27).

question there is an urgent need to adjust the make allowances because of substantial changes in the costs for manufacturing Class III and IV products which have occurred since the current allowances were established in the 2000 hearing, using 1998 costs. As discussed at greater length hereafter, the manufacturing allowances proposed by the National Milk Producers Federation endorse and apply, to the most current data available, the Department's technique for determining make allowances as utilized in prior decisions.

Energy costs are a major factor in the 2006 make allowance crisis; but they are not the only factor. As the RBCS, CDFA, and individual plant owner testimony established, there have been substantial general inflationary increases across the board in the costs of production inputs for dairy manufacturing plants since 1998. The energy issue needs to be addressed individually as proposed by Dr. Cryan and NMPF. An index and automatic adjusting formula is appropriate to reflect contemporaneously both the increases, and decreases, in the volatile energy sector.

B. RBCS and California Data Should Continue To Be Used to Determine the Make Allowances.

In determining the appropriate make allowance for Class III and Class IV prices, the Department should use the best information available to it. That continues to include the RBCS survey data presented by Dr. Charles Ling, as well as the data compiled, published, and testified to by the officials of the California Department of Food and Agriculture. In addition there is substantial data presented for the hearing record by individual plant owners and operators.

The RBCS survey, about which Dr. Ling testified, continues to present a probative, reliable data series which should be used to establish the make allowances for Class III and IV products. The RBCS survey information is reliable for a number of reasons, including: (1) it

has been collected annually for better than twenty years; (2) it has been assembled for independent business reasons; (3) the reported information is independently scrutinized by Dr. Ling, who has no representational or advocacy interest in the results of the survey; and (4) Dr. Ling testified and was available to answer questions about the survey data, clarifying what was included and not included in the materials. The RBCS data was found useful in the 1999 Final Decision, as well as the subsequent 2003 Final Decision and it should be utilized in updating the make allowances. The RBCS data represents manufacturing plants located from coast to coast and involved in each of the Class III and Class IV commodities requiring make allowance determinations.

The most current plant cost data, for 2004, compiled by the California Department of Food and Agriculture should also be used. The California information, explained by Mr. Krug, and Ms. Reed, is a rigorous, state-agency-compiled data set which has inherent indicia of reliability. The presence at the hearing and the testimony of the California officials makes this data even more reliable than in the prior hearing record.

We support the weighting by volume of the available, reliable plant cost data to reach the new make allowance figures. As Dr. Cryan from the National Milk Producers Federation testified (Exh 60), the approach used in the November 7, 2002 Final Decision is a satisfactory one which should be utilized.. See Exh. 60.

C. Recommended Make Allowance for Each Product.

ADCNE supports the methodology set forth in the testimony of Dr. Roger Cryan for the National Milk Producers Federation in Exh. 60 for determination of the appropriate make allowance for each product. This methodology, Dr. Cryan explained, uses weighted averages of

the volumes included in the RBCS survey and the California plant cost data. This represents the best approach for utilizing the data available in this hearing record for product make allowances and should be adopted by the Secretary on an interim emergency basis.

ADCNE wishes to comment specifically on the need for make allowance updating for Class IV products made in butter/powder plants. Order 1 is home to the largest regional concentration of butter/powder balancing plants in the system. These plants, owned and operated by ADCNE cooperatives, give Order 1 the largest Class IV utilization in the Federal order system, 2.9 billion pounds of producer milk in 2005. Butter/powder manufacturers are tightly constrained by the Class IV prices and value, since something in excess of 90% of Class IV milk is processed into either butter or nonfat dry milk, which are commodity products with limited opportunity for product differentiation. In the federal order marketing and pricing system, butter/powder plants are the most vulnerable assets in the industry. This is true for two primary reasons: First, as noted, the products produced, nonfat dry milk and butter are much more uniform, undifferentiated and NASS-price-tied than are the cheeses.<sup>5</sup> For butter/powder plants, the circularity of NASS pricing and their costs is almost a complete tautology. (Class III has a much greater variety of products than Class IV and cheddar cheese represents a much smaller proportion of total usage than butter and NFDM to Class IV.) There is literally “no place to hide” from the NASS price “feedback” as the powder marketers of Dairy America have experienced. (Schad Tr. 366–67 (January 25) Secondly, butter-powder plants are the acknowledged balancers of the federal order Class I markets. Thus, the plant profitability is

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<sup>5</sup> While NASS cheese prices and the Class III make allowance set the minimum Class III federal order price, the NASS products are in the range of 20% of federal order Class III usage.

inherently subject to the vagaries of the fluid market and the volumes of milk made available by the interface of farm production and fluid demand.

In Order 1, there are seven cooperatively owned butter/powder plants. There was verified financial testimony in the record about three of the largest. (Schad Tr. 393, 417 (January 25); Wellington Tr. 142–44, 168–70 (January 25); Alexander Tr. 179–181 (January 26)) None of the plants showed a meaningful profit, and there were substantial losses in most cases for most years. This is data that cannot be ignored. The inadequacy of the current make allowance for Class IV products is a significant contributor to this scenario. It is quite unfair to the dairy farmers who have invested their capital in these assets to have that capital eroded solely on the basis of regulatory make allowances which have not been updated.

D. Emergency Action Should Be Taken.

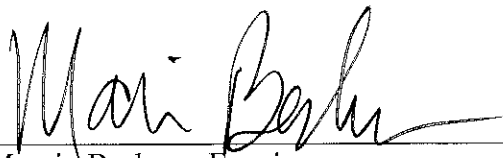
The Department should address the make allowance cost crisis with the implementation of an interim final rule at the earliest possible date. Except perhaps in the wake of a natural disaster, there could hardly be a more unanimously endorsed, nor more clearly established need for urgent action than on the present record. The objectors – Select Milk Producers, Inc., et al., and the several individual dairy farmers – had two distinct agendas. First, Select et al. advocate the potential balancing of make allowance increases with adjustments in other aspects of the price formulas. These matters will be heard and addressed in due course. The individual farmers, and their organizations, such as Pro-Ag, reflect the always present importance of balancing producer and handler interests. Their case on this particular issue is compromised, at least in part, by the fact that a large segment of their neighbors, the cooperative dairy farmer community, are paying for the current make allowance inadequacies, as well as suffering the

farm-level cost-price squeeze. Thus, updating the make allowances provides a measure of financial relief to the cooperative producer community which has been shouldering more than its share of the manufacturing losses.

**V. Conclusion**

ADCNE urges the Department to (1) reverse, and immediately cure, the ALJ ruling on Dr. Cryan's testimony to allow the adjustments to Class III and IV make allowances, as calculated by Dr. Cryan for NMPF to be adopted on an emergency basis through an interim final rule which does not impact Class I and II prices; and (2) recommend an energy cost adjuster in the make allowances to be implemented with the final rule.

Respectfully submitted,

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