UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

IN re: Docket #AO-F&V-991-A3; FV03-991-01
FR Doc. 05-03481 (70 Fed. Reg. No. 36, Page 9000)
February 24, 2005

ANHEUSER-BUSCH COMPANIES, INC.
RESPONSE TO REQUEST FOR ADDITIONAL ARGUMENT

In the February 24, 2005 Federal Register,[1] USDA sought additional argument relating to the establishment of an appropriate representative base period for the allocation of initial base under a proposed marketing agreement and order concerning hops grown in Washington, Oregon, Idaho and California.

No Evidence in Support of Representative Base Period Using More Recent Years

Anheuser-Busch must initially question the statement in the USDA communication that "[t]he hearing record also contained testimony supporting a representative base period using more recent years." We question the existence of such testimony. We believe order proponents universally supported a base period from 1997-2002. Opponents of the order, of course, universally desired no base period at all because they do not want an order. Some opponents may have testified that, hypothetically, if an order were to be imposed on them, they would want a base period that included the three most recent growing seasons. Such testimony by determined opponents to the order's very existence cannot be characterized as evidence supporting "a representative base period using more recent years." In effect, the opponents' statements were conditioned on the existence of an order they do not want to exist, and, fortunately, that condition has not been met.

Process of Seeking Additional Arguments Appears to be Questionable

Anheuser-Busch also questions the appropriateness and validity of seeking additional argument outside of the hearing process where it is not subject to rebuttal and questioning by all of the parties. It is our understanding that public hearings, along with the rebuttable post-hearing briefings, are the only appropriate methods of obtaining and hearing the evidence and arguments.[2]

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[1] Volume 70, Number 36, page 9000.

[2] The submissions being solicited are in effect a series of *ex parte* communications. See 5 U.S.C. §§ 556-557; 7 U.S.C. § 608c(3), 4; 7 C.F.R. § 900.4, 5 U.S.C. § 556(e) (transcript and exhibits constitute exclusive record for decision); 7 C.F.R. § 900.8(b) ("Factual material other than that

Function of Proposed Order

Such public hearings on the proposed hop marketing order were held October 15 through 17, 2003, in Portland, Oregon and October 20 through 24, 2003, in Yakima, Washington. As established during the hearings, the primary purpose of the proposed order would be to establish volume regulation through producer allotments and reserve pooling of excess production.[3] Under the proposed order, an eight-member hop administrative committee ("HAC") would administer the order. USDA would appoint HAC members from a list of industry-elected nominees, and USDA's Agricultural Marketing Service (AMS) would monitor the order.[4] The program would be financed by assessments, established by USDA upon recommendation by the HAC, which would be levied on hop handlers.[5]

The central feature of the proposed order would be an allotment program under which hop growers would be allocated "allotment base" established by their highest annual production in any given year during the 1997-2002 period.[6] To be eligible to receive allotment base, a grower would have to have produced hops in either the 2001 or 2002 crop year. To determine allotment base under the proposed order, production would be measured in pounds of alpha acid, rather than pounds of hops, except that production of varieties with an alpha acid content of 10 percent or less would be considered equal to 10 percent of pounds of hops produced.[7]

Each year, the HAC would determine a marketing policy for the ensuing crop year.[8] If the HAC determined that there was a need to limit the quantity of alpha acid to be sold, it would recommend to the Secretary of Agriculture a "saleable quantity", i.e., the total quantity of alpha acid permitted to be sold by the U.S. hop industry as a whole. Upon acceptance by the Secretary, the total saleable quantity would be allocated pro rata among growers holding allotment base. For example, if the saleable quantity were set at 50% of the total allotment base held by all hop growers, each grower would only be permitted to sell hops to a maximum of 50% of that grower's individual allotment base. Any additional sales would be prohibited by law.

Value of Base

This would effectively create a cartel of American growers because the amount of hops that could be marketed in a given year would be decided by the HAC (just as the amount of oil to be marketed by OPEC member countries is decided by OPEC). As even proponent committee members admit, allotment base would also become a commodity whereby growers who needed allotment base to sell their crops would have to buy or rent it from growers without demand for their crops.[9]

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adduced at the hearing or subject to official notice shall not be alluded to therein, and in any case, shall not be considered in the formulation of the marketing agreement or marketing order.")

[3] The proposal would also authorize production research, market research and development projects. USDA AMS News Release No. 210-03.

[4] Id.

[5] Id.

[6] Proposed Order § 991.53(a).

[7] Id. An alternative proposal would allocate allotment base using actual alpha acid content of the varieties produced. 68 Fed. Reg. at 44252 (proposal 9).

[8] Proposed Order § 991.50.

[9] Leslie Roy Tr. 1605, 1614-15; Stephen Carpenter Tr. 97. Other proponents who testified agreed that base would be an expense for growers needing it to sell hops. Michael Smith Tr. 336; Paul Serres Tr. 2025; Duane Desserault Tr. 2300.

Indeed, there was substantial evidence provided by proponents and opponents alike that the value of base allotments could, and probably would, be substantial.[10] Proponents acknowledged, and even asserted, that base allotments would have a substantial value, presumably because this would be a selling point for the proposed order for those growers who want to exit the industry by selling all of their base allotment, or who anticipate selling excess base as a valuable commodity.[11] Indeed, there was evidence during the hearing to the effect that the order is viewed as an "exit strategy" where exiting growers with insufficient demand for their hops will receive artificially-created value in the form of payments for base allotments needed by other growers to meet demand for their hops.[12]

Base Period Alternatives Impact a Primary Reason for Opposition and Support

Growers opposing the order appear to generally oppose it for one or more of the following reasons:

They have successfully expanded their production over the past years to meet demand; they would have to acquire base to maintain or further expand their hops production to meet their existing contract obligations or to supply new buyers.

2 Their belief in the free market and desire to retain the ability to make decisions about how much and what hops to grow outweigh any inclination or incentive they might have to attempt to collectively manipulate the market. These opinions are generally reinforced by the related conviction that an attempt to restrict production by a U.S. hop cartel producing only 22.5% of the world's hops[13] would merely result in higher sales of foreign hops.

Proponent growers appear generally to support the order for one or more of the following reasons:

1 Their production has generally (although not universally[14]) declined over the past years; they would have base to sell under the proposed order.

2. Their belief that the hops market can be collectively restricted in a manner to achieve "fair" (i.e., higher) prices outweighs any inclination or incentive they

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[10] Smith Tr. 336, 346-47 (base cost as much as $3.25 per lb. under old order; aroma hop growers could face increased costs from acquiring base); Roy Tr. 1605, 1614-15 (base will create increased costs for some growers; order would be inequitable at outset because some growers will have to buy base); Folwell Tr. 909-10 (competitive disadvantage between one American grower having to buy base and one selling base; the competitive disadvantage could be exacerbated by reinvestment of base sales by sellers of base); Annen Tr. 748 (any saleable set below 85% would require his operation to buy base); Riel Tr. 2357 (potential bidding war for base); Desmarais Tr. 2383 (potentially high cost for base); Gooding Tr. 477-78 (President of Idaho Hop Growers' Association testified order would unfairly add costs to his operation because it would have to acquire base; he had to acquire base under the previous order and it hurt his operation; cost of base was $1 per lb. in 1979); Obendorf Tr. 498 (plans to expand, but would have to acquire base which would be uneconomical).

[11] Smith Tr. 336, 346-47; Roy Tr. 1605, 1614-15; Carpenter Tr. 97, 105-06 (potential for base purchases exists; concern that substantial cut in saleable will increase cost of base); Serres 2025 (expanding producer would most likely have to buy a lot of base in the event of a drastic cut in the saleable quantity).

[12] Ex. 23 at 2. See also Charles Stauffer Tr. 1760-61 ("Why should the responsible grower pay the price for the irresponsible grower?")

[13] Dr. Ray Folwell Tr. 894 (54 million lbs. produced in the U.S. vs. 239 million lbs. worldwide).

[14] For example, a proponent who has expanded production over the past few years may still support the order because of his belief that the HAC can sufficiently raise the price of hops by restricting supply to outweigh the increased costs from acquiring base.

might have to operate under free market conditions. This belief necessarily is either grounded on the opinion that a U.S. hop cartel producing only 22.5% of the world's hops could somehow profitably restrict production (i.e., sufficiently raise price to offset reduced sales and higher costs caused by base purchases), or that they (or some association of which they are a member) can profitably operate under restricted production conditions.

For both sides, the first rationale is impacted by the base period that is chosen. Proponents whose production has declined over the years will not receive as much of a wealth transfer from expanding producers if the base period is modified to include the most recent years. Concurrently, opponents as a group presumably would not have to buy as much base under this proposal as they would have to if the base period were 1997-2002. The outcome would be "half a loaf" for proponents, and less (but still substantial) pain for opponents.[15] For these reasons, opponents should continue to be against any base period at all while most proponents would support the 1997-2002 base period. The only proponents who should be in favor of the alternative base period would be:

. Proponents who perceive this request for additional argument as a threat to a proposed order with a 1997-2002 base period and who would be willing to accept a half-loaf measure.

2. Proponents who support a hop cartel, but who might also have to buy base under the proposed order's 1997-2002 base period.

Order Would Continue to be Inequitable

The fact that there would be an inequitable distribution of wealth to "winners" (declining producers) from "losers" (expanding producers) would not change. These payments would continue to constitute a substantial extra cost for growers having to acquire base allotments, and an unfair windfall for growers with excess base to sell, growers who would receive that base for nothing.[16] In the meanwhile, the only "value" created by the proposed order would be merely the inequitable redistribution of wealth from expanding growers needing base to declining growers with excess base, with no net increase in industry wealth.[17] We continue to believe as a matter of basic fairness, that it would be inappropriate for the U.S. government to knowingly

[15] The only parties who would truly support the alternative base period would be those proponents identified in the previous footnote, i.e., those who want to restrict production, but who might also have to buy base when production is restricted. Under the alternative base period, such producers might not have to buy, or might not have to buy as much, base.

[16] Proposed Order § 991.53(a).

[17] Proponents conceded in testimony that these base transfers would be inequitable. See note 61. See also Gasseling Tr. 606-07 (Mr. Gasseling testified that he does not know of any type of mandatory program that is fair to everyone – that there are going to be "some people have a certain situation that's not going to benefit them"); Id. at 1883 (noting inequities under previous order); Carpenter Tr. 105 (would appear to be inequitable that a grower who has expanded and has been competitive would have to purchase base from another grower); Duane Desserault Tr. 2293-94, (grower down from 300 to 100 acres would receive base from production over 300 acres; might increase acreage at expense of current grower having to cut acreage; would have to think about whether that is fair; later noted that expanding grower having to buy base should have to share burden borne by Mr. Desserault for hops that he has not grown over the past 3-5 years due to his inability to find a market for those hops). Of course, opponents agreed. Annen Tr. 2166 (thinks it would be un-American to have to buy base to expand); Kerr Tr. 783 ("marketing order would force us to either reduce our acreage further or face financial hardship of acquiring more base allotment. Neither of these options would be fair . . .").

impose a system that preordains such winners and losers, particularly when the market is currently admittedly in balance.

Order Would Continue to be Ineffective

The proposed order would harm the industry because any coordinated U.S. restriction in supply would merely result in higher sales of foreign hops. As noted above, proponents' agricultural economics expert testified that only 22.5% of the world's hops were produced by U.S. growers in 2003.[18] Moreover, about 70% of U.S. growers' sales are outside the United States.[19] If the order were enacted, many efficient American growers would be less competitive and would receive decreased profits because they would be burdened with purchasing base allotments from growers without demand. As one proponent committee member acknowledged, the cost of purchasing base may drive some growers out of the business completely.[20]

Order Would Have Been Counterproductive if Enacted as Proposed

The hops oversupply cited by proponents for the proposed order has apparently evaporated. Both leading independent hop merchants (John I. Haas and S.S. Steiner) estimate that world alpha acid usage exceeded current production by over 920 metric tons (resulting in an alpha shortage), while 2005 estimates suggest a modest positive balance of 182 metric tons.[21] Restrictions on hop production would have likely resulted in an imbalanced market.

Reflecting the healthy demand for U.S. hops, both hop and alpha production are expected to expand by an estimated 10% in 2005. This suggests a vibrant industry. Conversely, reported drought conditions in Washington may now seriously affect the 2005 crop; if restrictions on production had been in effect, the negative impact would be that much greater. Finally, proponents at one time relied on the strong U.S. dollar as a reason for the order. Today, the continued strength of the euro and weakness of the dollar means that U.S. hops are now relatively inexpensive on the world market.

The result of all of these and other factors is that the U.S. hop trade surplus reached a record $103.7 million for the 2003-2004 crop year. The state of the market coincides with some of the proponents' surprising testimony that the market had already corrected in late 2003 due to market responses as well as the German crop failure.[22] In addition to confirming a healthy U.S. hop market, all of these factors demonstrate the complexity of market forces, complexities that a HAC could not address.

Proposed Order Would Go Against Bush Administration's Stated Policies

From a policy perspective, it is undisputed that the proposed order would establish a

[18] Dr. Ray Folwell Tr. 894 (54 million lbs. produced in the U.S. vs. 239 million lbs. worldwide).
[19] Ex. 23 (Henry von Eichel, The Hop Marketing Order) at 2.
[20] Tom Gasseling of the Proponents Committee testified that if base costs would rise to as much as $2.00 per pound of hops, his own operation might "go broke"; he also acknowledged that other growers hypothetically could go bankrupt as well. Gasseling Tr. 599-600; See also Smith Tr. 336 (base cost as much as $3.25 per pound under previous order).
[21] Hopsteiner 2004 Guidelines for Hop Buying; The Barth Report 2003/2004.
[22] Smith Tr. 291, 302; see also Carpenter Tr. 121-22 (free market forces are bringing current supply in line with demand).

government-mandated hop cartel, and Anheuser-Busch must reiterate its incomprehension as to how a cartel approach can possibly be reconciled with this Country's economic, agricultural and international trade philosophies and policies in the 21st century. As Dr. Don Kloth testified, this cartel approach would run counter to this Administration's stated agricultural policy that recognizes that "the marketplace is the best guide for allocating resources and provides the most objective reward for efficiency and good management."[23]

We must also reiterate that the proposed order would contravene our international trade policy agenda.[24] The United States has long advocated that its trade partners, such as the European countries, move away from the government-regulated programs of the past and allow the free market system to ensure that supply meets demand.[25] For the United States to adopt anti-free market principles domestically would undermine our credibility as well as our negotiating positions internationally, all for a program that is inequitable, strongly opposed at least by a very substantial plurality, if not a majority, of hop growers and that will shift hop market share overseas.[26]

Conclusion

Anheuser-Busch believes that there is no record evidence in favor of the alternative base period. While we remain resolutely opposed to any order, the only alternative base period with even hypothetical evidentiary support would be a base period consisting of the three most recent years prior to any vote.

We also believe that the process being followed by USDA to obtain additional information is defective. In the meanwhile, a study of the actual record by an impartial fact-finder should thoroughly establish that proponents failed to establish the proposed order would result in greater returns and market stability for U.S. growers. Because of foreign competition and additional costs that would be imposed on U.S. growers by having to purchase allotment base, the hearing testimony confirms the opposite in both respects.

Market conditions reflect a vibrant U.S. hop industry in no need of the "relief" of a marketing order. Moreover, we believe it is clear that had the proposed order been enacted in early 2004, it would have seriously restrained and damaged the industry, not helped it.

Finally, the proposed order would constitute a U.S. government-sanctioned redistribution of wealth from healthy, expanding growers, to uncompetitive, declining, and in some cases no longer existing, growers. This would be grossly inequitable. For this reason alone, we believe that the USDA should decide against sending the proposed order, in any form, to a grower referendum.

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[23] Kloth Tr. 658-59. (quoting United States Dept. of Agriculture, Food and Agricultural Policy—Taking Stock for the New Century, at 51 (Government Printing Office 2003)).
[24] Id. at 659.
[25] Id.
[26] Id.

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