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Before the Secretary
United States Department of Agriculture
Washington, D.C.

Hops Produced in Washington, Oregon, Idaho and California; Hearing on Proposed Marketing Agreement and Order No. 991	Docket AO-F&V-991-A3; FV03-991-01; 70 Fed. Reg. 9000 (Feb. 24, 2005) (request for additional argument).

Additional Comments Concerning Base Period and Request for Reopened Hearing

We appreciate the opportunity to provide additional input regarding the proposed marketing order for hops. As stated at the hearing, and in post-hearing comments, we oppose implementation of the order. If there is a proposal, the base period must not exceed three seasons immediately preceding the first season of operation under the order, and the base must reflect current bona fide production. However, the information sought by AMS in its notice can only be obtained at a noticed on-the-record hearing, followed by post-hearing argument, and not through "informal" comment. In addition to the evidence apparently sought by AMS, the hearing should be reopened to receive crucial evidence on current production and marketing

conditions and changes since the October, 2003 hearing. That "snapshot" of the industry, relied upon by proponents as the sole basis for the order, is now stale, if not obsolete, in light of the rapidly evolving economics in the industry, and must be updated in order to provide anylawful basis for decision. Accordingly, we seek a noticed re-opened hearing of approximately two days to receive evidence concerning (1) AMS's questions about base period; and (2) updated production and marketing conditions as they relate to the need for an order and the desirability of the particular provisions sought byproponents.

I. An Order Cannot Be Imposed Based Upon the Present Record.

We remain strongly opposed to this marketing order, and believe that the proponents failed in the October, 2003 administrative hearing to demonstrate either a need for this marketing order or that this proposed new system of supply controls could achieve the promised industry-wide benefits. Indeed, the record demonstrated that the proposal was not well thought out, that the proponents were unable to demonstrate, either with a hypothetical or past data, how the program would be operated, that implementation would impose severe inequities, and that operation of the

order could likely worsen the economic condition of the industry. The proponents were unable to show unreasonable fluctuations in supplies or prices, or any form of disorderly marketing conditions or market failure. The industry was experiencing an orderly adjustment to higher-alpha varieties and new production and marketing technologies. Evidence of exiting/reducing producers along with entering/expanding producers showed a healthy industry. The proponents' desire to use allotments as a "buy out" for exiting legacy growers or to protect investment in a new marketing cooperative can never justify the imposition of producer allotments. The uncertainty and artificial costs associated with producer allotments together with the relative elasticity of demand and the U.S. minority share of a fiercely competitive global market will, over time, transfer production to other more production friendly regions of the world. Finally, the divisiveness of imposing an order on this closely knit yet evenly divided industry does not augur for amicable program operation and the consensus necessary for such a rigid regulatory scheme.

II. AMS Should Reopen the Hearing.

Orders issued under the AMAA can only be based upon notice and evidence introduced at a formal on-the-record hearing governed by 5 U.S.C. §§ 556 and 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); 5 U.S.C. § 706(E) (decision must be based upon substantial record evidence). Factual material, especially including new proposals and whether or not a particular proposal is supported or opposed by specific witnesses, is not a proper subject of post-hearing argument now being sought by AMS. 7 C.F.R. § 900.8(b) ("Factual material other than that 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."). AMS chose under 5 U.S.C. § 553(b)(3) to publish the precise terms of the proposed order rather than a more general description of the subjects and issues involved, and is bound by these limitations. *See* Attorney General's Manual on the Administrative Procedure Act (1947), pp. 28-30. Accordingly, notice and a reopened hearing would be required if AMS wants to consider a base period of six years prior to any new order.

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[1] Available on the internet at http://www.oalj.dol.gov/public/apa/refrnc/agtc.htm.

See, e.g., *Public Service Comm. of Kentucky v. FERC*, 397 F.3d 1004, 1012-13 (D.C. Cir. 2005); *Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 63-64 (D.C. Cir. 1999); *Fertilizer Inst. v. EPA*, 935 F.2d 1303 (D.C. Cir. 1991), *McLouth Steel Products Corp. v. Thomas*, 838 F.2d 1317, 1323 (D.C. Cir. 988) (citing and describing a number of cases illustrating notice insufficiency); *cf. Alto Dairy v. Veneman*, 336 F.3d 560, 569-70 (7th Cir. 2003); *Wileman Bros. & Elliott v. Giannini*, 909 F.2d 332 (9th Cir. 1990) (committee members subject to suit under antitrust laws for attempting to enforce "higher" maturity standards beyond the scope of the rulemaking notice).

A. The Proponents Offered No Evidence or Argument for a Base Period of Six Years Prior to a New Order.

Given the strictures of formal on-the-record rulemaking, AMS must either accept the 1997-02 base period (which would render the order subject to immediate legal challenge for an unlawful base period), reject the proposal in its entirety, or reopen the hearing to receive evidence concerning a base period six years prior to any new order. Proposal No. 1, 68 Fed. Reg. 44244 (July 28, 2004), set forth a proposed § 991.53(a) which provided for a six-year base period of 1997-02. This was the period vehemently supported

by proponents at the hearing and in post-hearing argument.[2] No proponent testified in favor of a base period six years prior to the beginning of any order, and no post-hearing argument was offered for such a modification. Proponents were locked into this now stale base period at least in part because they wanted to punish new/expanding producers and reward exiting/reducing "legacy" growers with base as a "buy out" of their investment in hop producing facilities,[3] and actually opposed more recent base periods. For example, Ms. Brulotte said:

> Q: Would you have any objection to using more recent years for the base period, like '01, '02, and '03, instead of going all the way back to '97?
> A: Yes, I would.

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[2] See, e.g., Proponents' post-hearing comments at Ex. B, pp. ii-iii.

[3] See, e.g., Proponents' post-hearing arguments at 3, 12, 36: "Many of the HMO proponents first believed that the reductions could be accomplished through voluntary measures. Unfortunately, for every acre that was taken out by a farmer who supported the industry initiatives, an extra acre was surreptitiously by a self-interested farmer who wanted to increase his relative market share. . . . The atmosphere of cooperation and accomplishment was unfortunately short-lived. AHPA discovered that certain growers (many of whom were to become primary opponents of the HMO) had surreptitiously planted more than 1250 acres of hops after the AHPA had announced that its goal had been reached. Market signals in the fall had clearly indicated that extra production was not needed, but this small segment of self-interested entrepreneurs took it upon themselves to undo the significant accomplishments of an entire industry. There may not be another agricultural commodity in America where a minority of participants can have such a significant effect on the health of the industry. . . . At the end of the day, however, the Proponents recognize that those growers who have ignored industry efforts and who have brazenly increased production in a time of chronic oversupply, may end up having to shoulder a slightly heavier load than if they's been more responsive to the needs of the industry."

Tr. 2208. Mr. Carpenter was also adamant that even producers who had exited the industry or substantially reduced their production should have base if they produced in 1997:

> A: We have designed the order so that there should be plenty of base available on the front end. We heard from growers in certain segments of the industry that felt that '97 year was important to them. We had other growers who felt the later years [were] important to them to have that option. What we tried to do is to take a big tent approach and please as many people as possible, recognizing that we could not please everybody in terms of establishing what the base period would be. . . . In fact, subsequent to submitting our proposal, we added the 2002 year to that as well. We do not want base to have a value to speak of on the front end and that is one of the reasons why we went to the now six-year period so that there would be plenty of base available for those growers that needed it at hopefully a very low value.

Tr. 95-96. Mr. Carpenter was unable to support on behalf of the Proponents and even unwilling to support on his own theinclusion of even the '03 season in the initial base calculation:

> Q: Would you have any objection, Mr. Carpenter, to including – since the season will be over by then – '03 season production in calculation of base?
> A: Again, I can't – I don't want to speak on behalf of the committee. I think certainly if you're proposing that there would be support, additional support if the 2003 [season] were added, I think that's something the committee would consider. But I can't answer that on behalf of the committee. In terms of my personal opinion, I'd like to give that a little more thought before I answered your question.

Tr. 119-20.

Proponents may or may not support AMS's alternative, but this can only be determined with evidence presented at a reopened hearing. Opponents opposed both the six year base and determining base upon such a stale period. See, e.g., Opponents' post-hearing comments at pp. 57-61. At most, opponents favored a three-year base, inferring that this would be the three years prior to any order.

Proposal 2 provided that base would be determined by actual production for the most current season, but no testimony was offered in favor of this proposal.

AMS's "proposal" was not noticed at the original hearing. There was no testimony in support of this as a reasonable alternative. The proponents specifically opposed the idea, preferring a 97-02 base period to ensure a buy-out for legacy growers. Accordingly, if AMS wants to consider a base period of six years prior to a new order, it must reopen the hearing to receive evidence, support and opposition, and argument.

B. The Hearing Should Be Reopened to Receive Evidence and Argument on Current Production and Marketing Conditions.

Production and marketing conditions have materially changed since the October, 2003 hearing. Aside from the inequity of base allocation, we remain concerned that the supply controls at the heart of this proposal will inflict severe damage on the industry, and sacrifice not only the long-term competitiveness of US hop producers but also the recent gains the industry has achieved in expanding foreign markets and alleviating its own difficult market challenges. Indeed, the market situation facing US hop producers has changed considerably in the few short years since this marketing order was originally proposed, and while few would argue that the challenges faced by US growers have been completely eliminated, recent development clearly add to the body of evidence that supply controls are an inappropriate tool for addressing the challenges that remain.

Hop Market Situation

The market conditions faced by US hop growers today are far different from those that characterized the US hop industry when the marketing order was originally proposed. In many important aspects, conditions have improved from those highlighted in the original proposal, which only increases the skepticism that supply controls administered

through a marketing order are necessary or could be beneficial to US growers. The following developments are of key importance:

- **Burdensome US supplies have already been removed from the market.** Since 2000, US hop acreage has exhibited an orderly decline from 36,120 acres to 27,742 acres in 2004.[4] Far from evidence of a "reactionary planting cycle," the lower acreage demonstrates that farmers respond to market conditions rationally without the need for forced intervention by a central planning committee. Similarly, after reaching a peak of 7.6 million pounds in 2001, US production of alpha acid has also declined to less than 6.4 million pounds in 2004.[5] The result is that the US "surplus" of alpha acid that was prominently highlighted by marketing order proponents has largely evaporated. Both leading independent hop merchants (S.S. Steiner and John I. Hass) estimate that in 2004 world alpha acid usage *exceeded* current production (from the 2003 crop) by more than 920 metric tons (resulting in an alpha deficit), and the initial estimate for 2005 suggests only a modest worldwide alpha acid positive balance of 182 metric tons.[6]

- **The US dollar no longer places US growers at a "competitive disadvantage" in world markets.** In 2002 the Euro/$US exchange rate reached 1.14, and the effective Deutsche Mark/$US exchange rate was as high as 2.25. Proponents of a hop marketing order argued that the strong dollar makes US hops relatively expensive on the world market, and suggested that the costs of production in Germany and the United States are such that the DM/$US exchange rate should be between 1.6 and 1.8 for the US to be competitively priced on the world market while still providing a return to the grower.[7] By the end of 2004, the Euro/$US and the DM/$US exchange rate stood at 0.68 and 1.46, respectively—suggesting the US dollar has declined even further than the

[4] Source: USDA/NASS
[5] Source: USAHops 2004 Statistical Report
[6] Source: Hopsteiner 2004 Guidelines for Hop Buying; The Barth Report 2003/2004
[7] "Justification for the Proposal in Favor of a Hops Federal Marketing Order" Fall, 2002, p. 3

level hoped for by the marketing order proponents.[8] *As a result of these positive exchange rate developments, the US hop trade surplus reached a record $103.7 million for the 2003-04 crop year.*[9]

The market conditions identified above reflect an industry that is independently capable of managing its own production and marketing decisions and that looks forward to improved market prospects. Indeed, there is no evidence that a marketing order would have strengthened the industry's position over this period. In fact, given that these favorable market developments occurred despite the admonitions of marketing order proponents who testified of a US hop industry in a persistent state of crises, it is not unreasonable to consider that had a marketing order been in effect, the industry might instead be facing a far less positive outlook than it does today. Forced supply controls beyond the reductions that occurred naturally almost certainly would have eroded the strong and growing US hop trade balance, and would have simultaneously provided opportunities for expansion in China, Germany, and elsewhere. Experience clearly shows that the market remains the best guide for US producers and the most efficient mechanism for allocating industry resources.

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[8] The Deutsche Mark is no longer an official currency, but is quoted here to provide consistency with figures cited in the original hop marketing order justification document, op. cit.
[9] Source: USDA Hop Market News

The conditions claimed by the proponents to justify an order simply no longer exist, and it would be arbitrary to impose an order based upon a stale record and conditions that no longer exist. The "doom and gloom" state of the industry[10] (e.g., no contracts, declining acreage, below-cost sales, unreasonable price fluctuations, etc.) painted by proponents simply no longer exists Evidence of recent plantings (some by order proponents), higher prices, and nearly universal forward contracting renders the existing record and argument thereon stale and obsolete as a basis for an order.

Given the positive outlook that the hop industry faces today, including strong prices, nearly universal contracts, and diminished alpha surpluses, it is not surprising that the industry expects acreage to expand this year to take advantage of these favorable market forces. Such a modest expansion would have been impossible had the proposed HMO been effect (allowing for only a 1% increase in base). Had the order been in effect, the industry would have missed this unique opportunity for market expansion.

In summary, we continue to believe that a hop marketing order will be harmful to the US hop industry, will create inequitable transfers of wealth between growers, and will erode the ability of our industry to compete in

[10] See, e.g., Proponents' post-hearing comments at 14-27, 38 ("The current market dynamics simply must be corrected. . . . These simple facts illustrate that the US has not yet found its true market share. And its true market share will only be determined once it begins to regularly operate without a loss.").

today's global markets—regardless of the representative base period chosen. The market today is far different than it was under the previous failed marketing order, and recent market developments only add to our concerns that supply controls are both unnecessary and potentially very harmful to the industry.

While all growers are united in a desire to receive higher and more stable prices for hops, it is our conviction that the market remains the best mechanism to guide producer decisions. We respectfully request that based on the weight of evidence provided in the administrative hearing and evolving market conditions in the world hop market today, AMS reject the proposed hop marketing order in its entirety and allow growers to again focus their full and undivided attention on hop production and marketing.

III. Any Six-Year Base Period is Too Long and Fails to Properly Account for Current Bona Fide Production.

AMS is requesting additional comment on the representative base period for the proposed marketing order. While AMS has correctly identified the base period as an issue in need of additional discussion and definition, this is in fact just one of many concerns that the marketing order proponents were unable to resolve or properly address despite eight days

testimony in Oregon and Washington. See, e.g., Golden Gate Hop Ranches post-hearing comments; Opponents post-hearing comments at pp. 19-64.

However, despite the request for additional input, we remain concerned that neither base period under consideration by AMS (i.e. marketing years 1997, 1998, 1999, 2000, 2001, and 2002; or the six marketing years immediately preceding any eventual implementation of a marketing order) would address the fundamental problem that any base period that reaches far into the production history for individual growers would unfairly reward those whose production has declined over time, at the direct expense of those who voluntarily invested in expanding their operations—often at considerable risk to their own livelihood and future market prospects.

We reassert here without repetition all the arguments in opposition to the 1997-2002 (highest average) base period. See, e.g., Opponents' post-hearing comments at pp. 57-61; DOJ post-hearing comments at pp. 9-13. This blatantly inequitable distribution of production base is clearly documented (see hearing exhibits 30 and 32) and is not in dispute. The marketing order proponents appear willing to accept this implication as a necessary outcome of the proposed regulations. We hope that AMS is not

equally nonchalant about this inequity. A six-year base period clearly highlights the unequal treatment of different producers that is central to this marketing order, and the arbitrary nature by which this regulation could create severe economic hardship among some, while directly rewarding others. We continue to believe this is fundamentally unfair and is not the proper or intended role of government regulation. The only way to minimize this inequity would be to make the representative period as recent, and as short, as possible and account both for weather-related yield differences and current production.

AMS has never created a "buy out" program for legacy producers and has allocated base for producer allotment programs largely on the basis of current production for the season immediately preceding the new order (taking due account of yield variations due to weather or other factors). The previous order accounted for weather-related fluctuations by averaging three of the previous four seasons (1962-65) per acre yields, but then calculated initial base by multiplying that average yield by the most recent season (1965) bona fide produced acreage. See 7 C.F.R. 991.38(a) (1985). This procedure reasonably accounted for weather-related fluctuations but linked the first year's saleable to the previous season's actual bona fide production.

A grower had the option of selecting from three methods of calculating initial base under the spearmint order. 7 C.F.R. § 985.53 The representative period was limited to the three most recent seasons, 1977-79. Initial base was computed as (1) average pounds sold during any two of the three most recent seasons; (2) average pounds sold during three seasons plus 1/3 of pounds currently available for sale; or (3) pounds sold during 979 plus pounds currently available for sale. Basically, AMS followed the same concept of calculating base on the basis of most recent production, with reasonable allowance for weather-related yield changes.

A somewhat more complex method is used for cranberries, but it follows essentially the same principle of calculating base (called sales history) on the basis of most recent production, allowing for variation in weather- and planting-dependent yields. 7 C.F.R. §§ 929.49, 929.49(a)(6). AMS recently amended the order to ensure that base would be most dependent on actual production most recent to any volume limitations:

> The amendment to modify the method for calculating sales histories will provide growers with additional sales histories to compensate them for expected increases in yields on newer acres during a year of volume regulation, which would result in sales histories more reflective of actual sales. This amendment will also allow more flexibility in recommending changes to the formula and add the authority to calculate fresh and processed cranberries separately. The amendment to the sales history

> calculations will benefit a majority of growers, especially growers who planted some or all of their acreage within the previous 5 years. It will also help ensure that growers with mature acres who also have newer acreage and growers with only newer acres are treated equitably.

70 Fed. Reg. 7633, 7634 (Feb. 15, 2005).

AMS has never approved a method for calculating base that is so "generous" to legacy producers and so disregards the current production of new/expanding producers. Accordingly, if production history is used at all in a new hop order, the base must be ties to the most recent season's production. For example, take the average of two of the previous three seasons and multiply by the most recent season's production of alpha acid pounds. Such a method will ensure that base is based upon actual production, with appropriate respect for weather-related yield fluctuations, and not on the historical production of exiting/reducing producers.

Respectfully submitted,

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