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Deputy Administrator
USDA/AMS/Dairy Programs
STOP 0231, Room 2971
1400 Independence Ave. SW
Washington, DC 20250-0225

Re: Supplemental Proposal for California Milk Marketing Order

Dear Deputy Administrator:

I write on behalf of the California Producer Handlers Association (“CPHA”). CPHA is made up of four **Producer-Handlers** (also known as **Producer-Distributor**)¹ dairy farm families: Foster Dairy Farms, Inc. (“Foster Dairy”), Hollandia Dairy, Inc. (“Hollandia Dairy”), Producers Dairy Foods, Inc. (“Producers Dairy”), and Rockview Dairies, Inc. (“Rockview”). These are the only dairy **Producers**² who also process their milk for delivery to consumers. The vertical integration of these entities is unique as compared to other dairy Producers in California, and in recognition of that uniqueness they were granted a **Quota**³ that is exempt from the California Pooling Act dating back to the enactment of the Pooling Act in 1967.

For approximately 48 years, Producer-Handlers have held a Quota exemption for a limited portion of their Class 1 milk, which is exempted from being part of the California milk pool. They have structured their businesses around their exempt Quota allocations, and invested millions of dollars to obtain and maintain those exemptions. CPHA submits this proposal to

¹ Producer-Handler is defined as “[a] dairy farmer who processes and sells milk from his or her own production. A P-H may also purchase milk from other dairy farmers for processing. A producer-handler is usually exempt from minimum pricing provisions on some of his or her milk but is required to make reports, maintain records and prove this status as a producer.” California Department of Food and Agriculture, Appendix: Glossary of Dairy Terms, <http://www.cdffa.ca.gov/dairy/appendix.html> (last visited Apr. 2, 2015) (attached hereto as Exhibit A).

² Producers are “[a]ny person that produces milk from five or more cows in conformity with the applicable health regulations of the place in which it is sold, and whose bulk market milk is received, acquired, or handled by any handler or any nonprofit association of producers. In California, a cooperative is considered a single producer.” Appendix: Glossary of Dairy Terms.

³ Quota means “[p]art of a two-tiered pricing system in California. Essentially, quota is an entitlement that allows a producer to receive a price for milk that is \$1.70 per hundredweight higher than the overbase price.” Appendix: Glossary of Dairy Terms.



preserve the Producer-Handler Quota exemption in any Federal Milk Marketing Order (“FMMO”) adopted in California that also retains the California Quota system.

Background

The State of California is the largest milk-producing state in the country, representing more than 20% of national milk production. Milk and dairy products are the leading commodity group in California agriculture. The California Department of Food and Agriculture has regulated milk production in California separate and apart from the federal government for over 80 years.

The United States Department of Agriculture (“USDA”) is now considering whether to establish an FMMO for the State of California. The 2014 Farm Bill specifically permits California to keep some aspects of its unique milk marketing system, including the Quota, if any FMMO is adopted for California. The purpose of this section is to provide a general overview of milk regulation in California, which has always been different from federal milk regulation. Any FMMO for California must account for the unique history of milk regulation in California, and the multiple legislative compromises that the current Quota system embodies.

I. Legislative History of Milk Regulation in California

California has operated a milk marketing order unique from the Federal Order system since the passage of the Young Act in 1935. As with all milk market orders, the programs are designed to establish minimum prices, based on ultimate utilization, that processors must pay for market grade milk received from dairy farmers. California has maintained its own milk marketing order separate from the Federal Order, breaking the state into two sections. As described below, Producer-Handlers in California have held a portion of their milk as exempt from Pooling due to the different market and pricing relationships with the end buyer of their milk.

A. Stabilization Act

In 1934, the California Legislature enacted the California Milk Stabilization and Marketing Act, Cal. Food & Agric. Code § 61801, *et seq.* (“Stabilization Act”). The purpose of the Stabilization Act was to protect dairy farmers from drastic price fluctuations and predatory pricing while allowing consumers to purchase milk at low prices.



The Stabilization Act divided milk into four classes, each priced differently, with Class 1 having the highest price and Class 4 having the lowest.⁴ Under the Stabilization Act, Producers sold their milk by contracting individually with processors (also known as **Handlers**).⁵ Since the various classes of milk were priced differently, individual Producers fared differently depending upon the type of contracts they were able to obtain despite all having produced the exact same product. Producers who were able to obtain contracts for Class 1 milk fared quite well and were able to make a profit. However, Producers who were only able to obtain contracts for Class 2, 3, and 4 products fared less well even though they were selling the same quality milk. Since production costs were largely the same for all Producers in a given area, a Producer's financial welfare was related directly to the proportion of Class 1 milk contracts it was able to obtain. This resulted in extreme competition for Class 1 contracts, which led to many abuses by processors and distributors and distorted the market balance.

B. 1967 Milk Pooling Act

In response to the competitive abuses discussed above, the Legislature enacted the Gonsalves Milk Pooling Act, Cal. Food & Agric. Code, § 62700, *et seq.* ("Pooling Act"), in 1967. The Pooling Act, which went into effect in 1969, sought to equalize the disbursement of revenue among Producers.

Under the Pooling Act, the prices that Producers received for their milk were no longer dependent on the classification of products that their milk was used to produce. Instead, Producers were paid based on the amount of production in each of three categories: Quota, Base, and Overbase. The pooling system guaranteed that every Producer could sell a minimum

⁴ Classes of milk in California:

- Class 1 - Fluid products
- Class 2 - Heavy cream, cottage cheese, yogurt, and sterilized products
- Class 3 - Ice cream and other frozen products
- Class 4a - Butter and dry milk products, such as nonfat dry milk
- Class 4b - Cheese, other than cottage cheese, and whey products

⁵ Handler is defined as:

A person (other than a cooperative association) who operates one or more pool plants or operates any other plant from which Class 1 milk is disposed of directly or indirectly during the month in the marketing area.

....

A person who operates a milk plant located in the marketing area and receives market milk from one or more dairy ranches.



amount of milk each year at the highest market price, referred to as Quota, which was generally a higher value than the other classes of milk because it was based on the Producer's historical Class 1 milk sales. Additionally, Producers were also given another level of milk assignments that would be guaranteed to be paid at a certain formula price scheme, known as **Base**.⁶ Anything produced over the Quota and Base amounts would be paid based on a formula for pricing called the **Overbase**.⁷ When the Pooling Act went into effect, Quota and Base were assigned to each Producer based on its historical Class 1 sales and overall production sales. In order for the Pooling Act legislation to pass, it was imperative that some accommodations be made to protect the farms that had established their own production and processing businesses (Producer-Handlers). As a vertically integrated production and processing company, the Producer-Handlers had established the largest share of Class 1 milk sales prior to the enactment of the Pooling Act legislation; therefore they would become the source of at least some of the profits that would be used to eliminate the inequity in prices for the producers.

The Pooling Act created an accounting system known as **Pooling**⁸ to reconcile the prices that processing firms paid and the prices that Producers received. Under this system, a processing firm paid a price for milk based on the applicable Quota, Base, or Overbase price. If the processor made products with higher classified prices, it had to pay the difference into the pool. If the processor made products with lower classified prices, it received a refund from the pool.

The Pooling system ensured that Producers received payments based on their holdings of Quota, Base and Overbase, rather than on how their milk was used. In essence, it leveled the playing field for all Producers. The system also guaranteed that processors would not be hurt

⁶ Base is the amount of assigned milk production that is established for each Producer in which the Producer receives a higher price. Base-Excess Plan means a "pricing plan to encourage producers to adjust their production to a desirable seasonal pattern. It involves the annual (re-) assignment of a production base that reflects that producer's deliveries during a specified period of time of year when demand for milk is strong. The producer then receives a higher price for milk produced up to the amount of the production base and the 'excess' or surplus price for additional supplies. A base-excess plan typically is authorized and administered under a federal order, but it may be established by a cooperative for its members." Appendix: Glossary of Dairy Terms.

⁷ Overbase means "[o]ne price of a two-tiered pricing system in California; quota is the other price. Essentially, overbase is the basic pool price and is calculated using milk sales and usage data." *Id.*

⁸ Pooling is a "[m]ethod used in determining how funds in a market will be distributed among producers supplying the milk. While there are three methods of pooling returns to producers (individual handler pool, market-wide (statewide) pool and cooperative pool), only the statewide pool operates in California." Appendix: Glossary of Dairy Terms. Marketwide Pooling is a "[m]ethod of calculating the blend price paid to producers on the basis of the usage of all the milk received by all handlers in the market. The announced California pool prices (quota and overbase) apply to all producers, independent of how the milk was used by the handler who received it." *Id.*



financially by having to pay Quota prices if they were manufacturing a product which did not require Quota class of milk. The system was designed so that neither processor nor Producer suffered or benefitted from the other's financial position.

II. 1967 Producer-Handler Quota Exemption

The Pooling Act recognized that there was a difference between the Producer's and the Producer-Handler's relationships with their end buyers. The Producer-Handler's relationships were with the ultimate consumers, while the Producer's relationships were with its processor companies. As a result, the Pooling Act treated the Quota for dairy models differently: the Producer's Quota was all put into the milk pool, but the Producer-Handler's Quota was in part treated as exempt from the milk pool because their business was vertically integrated and created its own Class 1 markets that were not subject to the same destructive trade practices and price pressures as the Producers.

Producers who do not process their own product have a different relationship model with their customers than the Producer-Handlers. The Producer's customers are the milk processors. Prior to the enactment of the Pooling Act, Producers preferred to sell Class 1 milk because it brought the highest prices/margins; the other milk classes were priced lower. Many processors of Class 1 milk appreciated their leverage and demanded kickbacks from the Producers, or threatened that they would not accept the milk. In those instances, Producers were stuck between giving a kickback, taking a reduced price for a lower class of milk, or being left with a perishable product. The processors' destructive trade practices and disparity in bargaining power drove the Pooling of milk revenues as a way to eliminate the price inequities and processor control over the Producers. But these same risks were not at issue with Producer-Handlers who processed their own product, and that is why the Pooling Act allowed the Producer-Handlers to treat at least a portion of their Quota as exempt from the milk pool.

The Pooling Act recognized the Producer-Handler's vertical integration by allowing for a certain portion of the Quota assigned to the Producer-Handlers to be treated as exempt from the Pooling. The Producer-Handler's vertical integration works as follows: Producer-Handlers produce their milk (and sometimes purchase additional volumes), process the milk into final consumer products, and deliver the products to the customers. As Handlers, the Producer-Handlers created their own markets by establishing relationships with the customers and built up the Class 1 markets over many years. As processors for the Class 1 products, the Producer-Handlers generated their own markets by marketing and creating brand recognition of their own products, even tailoring final products to specific customer needs. There was a historical connection between their farms and the consumer that allowed the Producer-Handlers to create



and expand the Class 1 markets over time, which continues today. As a result, the Pooling Act allows the Producer-Handlers to treat some of their Quota as exempt from Pooling because the Producer-Handlers operate differently than the Producer-only dairies and were not subject to the same risk and control by processors as Producer-only farms.

In the end, all Producers received Quota for the Class 1 sales that were reflective of how they operated their businesses, reflective of their relationships with their end buyers, and based on their historical production. The Pooling Act gave Producer-Handlers Quota that was in part exempt from the milk pool prices to cover the production from their own cows. The exempt Quota was not subjected to the price dilution that the rest of the Producer's Quota would incur because the Producer-Handlers priced their own Class 1 products based on their own production, processing, branding, and customer relationships. This allowed the Producer-Handlers the opportunity to maintain the Producer-Distributor model that they had already created.

In passing the Pooling Act, California created two types of Producer-Handlers who qualify to treat some of their Quota as exempt. The first type of Producer-Handlers is referred to as Option 66 or exempt Producer-Handlers. These Producer-Handlers do not pay into the pool for any of their milk, but have significant restrictions on their production (milk production and sales must average less than 500 gallons per day, 95% of their production and sales must be disposed of to resale or wholesale outlets, and no more than 5% of their Class 1 sales can be from outside sources). The Option 66 exemption is not at issue for CPHA's proposal.

The second type of Producer-Handlers is referred to as Option 70, Producer-Handlers who hold Quota that is partially exempt. In other words, only the Quota that is permitted to be treated as exempt is not subject to the milk pool, but any other Quota or Base or Overbase production is subject to the milk pool. These Producer-Handlers can deduct the Quota treated as exempt from their Class 1 pool obligation, but must account for their non-exempt Quota to the pool in the same manner as a fully regulated Handler. The CPHA at issue in this proposal is Option 70 Producer-Handlers, who treat a portion of their Quota as exempt.

For Quota that is treated as exempt, the Producer-Handlers are permitted to pay themselves the Class 1 price (or whatever price they are able to obtain from their customers). If that Quota were non-exempt, they would instead have to pay the higher Class 1 price to the pool, and the pool would in return pay them the blended Quota price with all classes of milk combined. In the event any Quota treated as exempt no longer qualifies for the Quota exemption (see discussion below), that Quota is considered regular Quota that will once again be subject to Pooling.



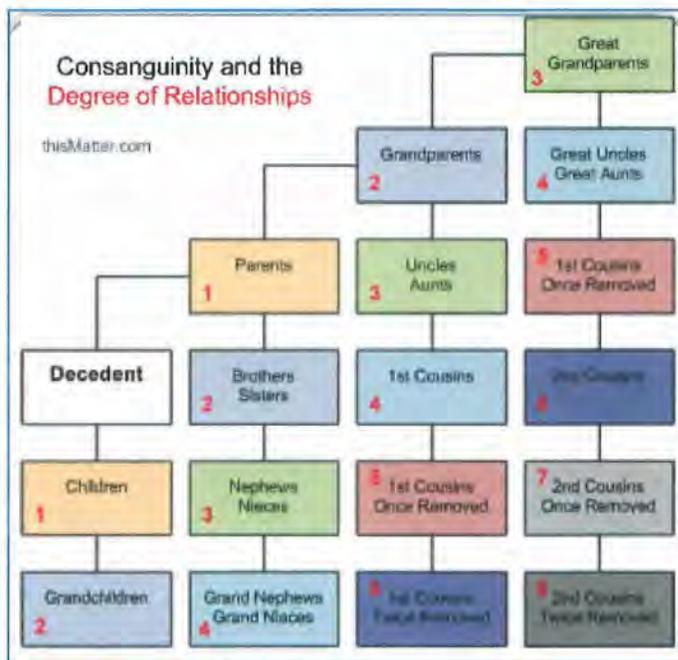
When the 1967 Pooling Act was passed, Quotas were assigned to all Producer-Handlers based on their historical production of Class 1 milk, and that assigned Quota was permitted to be treated as exempt. The Producer-Handlers were also assigned a Base number that was subject to the pool, and any Overbase production was likewise subject to the pool. Only the assigned exempt Quota was exempted from the pool.

III. Producer-Handlers Requirements to Maintain the Quota Exemption

The Producer-Handlers were only permitted to treat the Quota as exempt so long as they were complying with the statutory requirements in the Pooling Act.

Under Article 6.5 defining the Option 70 Producer-Handlers, the “ownership of the [H]andler and all of the ownership of the [P]roducer is owned by the same person or persons and their ownership in the [P]roducer or [H]andler is at least 95% identical for each person with their ownership in the [H]andler or [P]roducer.” Further, the ownership “shall not exceed ten individual persons or owners of equitable interest.” § 650. Person is defined to include spouses and those within four degrees of lineal consanguinity, adopted children, and those of half-blood lineage.⁹ § 651. This ownership structure had to exist historically when the Quota treated as

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- Note in the consanguinity diagram that all relatives depicted in the same color have the same degree of relationship (depicted in red numbers) to the decedent.
- Relatives below the common ancestor in the 2nd column are first-line collaterals, those in the 3rd are second-line collaterals, and the 4th column consists of third-line collaterals.



exempt was created, and has to be maintained so long as the Producer-Handlers treat that limited portion of their Quota as exempt. § 652. Quota treated as exempt cannot be bought or sold, while non-exempt Quota is freely transferrable. § 655. If a Producer-Handler sells any Quota that is treated as exempt to another Producer or Producer-Handler, that Quota is treated as regular Quota subject to the milk pool. *Id.*

In other words, the Producer-Handlers must maintain both arms of their business (Producer and Handler) in the same family as the original owners who owned the Producer-Handler business when the exempt Quota was established. Producer-Handlers cannot sell their businesses without losing the treatment for their exempt Quota. Producer-Handlers cannot sell their Quota without losing the treatment for their exempt Quota. Producer-Handlers cannot separate the Producer-Handler arms of their business into different owners without losing the treatment for their exempt Quota. Even transfers down family lineage become troublesome because the total ownership cannot exceed 10 and must stay within four degrees of consanguinity (first person to great-grandfather is four degrees of separation). In sum, Producer-Handlers have had to make conscious ownership structural decisions and strategic business choices over the past 48 years in order to maintain any Quota treated as exempt.

If a Producer-Handler did not comply with the requirements to maintain its exemption treatment for its Quota, it became regular Quota that would forever be subject to Pooling. Therefore, to maintain their Quota exemption treatment it is imperative for any Producer-Handler that it complies with all exemption requirements.

IV. 1978 and 1993 Legislative Amendments to the Pooling Act

When the Pooling Act was enacted, it was anticipated that new Quota would be issued in order to *equalize* Class 1 revenue among Producers. The goal of the Pooling Act was for all Producers to sell a similar percentage of their milk production as Quota milk (either as exempt or non-exempt, depending on whether the Producer also was a distributor of its milk). The Pooling Act thus provided the Department of Agriculture with the authority to create *new Quota* as Class 1 sales expanded.

In 1978, the Pooling Act was amended to allow Producers to equalize their Quota holdings at 90% of their production base. As new Quota was assigned for Class 1, it allowed the Producer-Handlers to be assigned new exempt Quota based on their continued actual production and distribution. Thus, the exempt Quotas for the Producer-Handlers grew as well as the new Quota assigned to the other Producers, but only based on the assigned Quota production allowing the lower Producers to catch up in the percentage of pooled milk they produced. Base Quotas were not increased with this amendment. But this in turn had a disproportionate effect on those



Producers who had already established themselves as Class 1 Producers because it allowed the other Producers to obtain a greater share of new Quota and the exempt Quota assigned was nominal.

During the course of negotiations with the Producers leading up to the enactment of the 1978 amendments, a compromise was reached in which Producers agreed to expand the Producer-Handlers Quota exemption to allow Option 70 Producer-Handlers to increase their Quota exemption to equal their original Quota plus any additional Quota purchased prior to 1978. Option 70 Producer-Handlers also received an additional daily Quota exemption of 150 pounds of fat and 375 pounds of solids not fat, provided they had not transferred production base and pool Quota after February 9, 1977.

In 1993, Producers drafted a Quota reform bill that they viewed as essential to their livelihood. Again, after a negotiated compromise was reached with the Producer-Handlers, the 1993 legislative amendments expanded the Producer-Handlers Quota exemption to cover all original Quota and all Quota subsequently purchased, plus the additional daily Quota exemptions of 150 pounds of fat and 375 pounds of solids not fat that were allowed as a result of the 1978 amendments. This allowed the Producer-Handlers a one-time opportunity to convert a certain amount of non-exempt Quota into exempt Quota. Additionally, for a period of only one year, the Producer-Handlers could sell or buy exempt Quota from other Producer-Handlers.

V. Current Status of Producer-Handler Quota Exemption

Following the 1993 amendments, Option 70 Producer-Handlers were allowed to purchase Quota. The number of Producer-Handlers went from 49 in 1969 to four by 2015. The Producer-Handlers who purchased Quota that would be designated as exempt paid millions of dollars and had to ensure that their business structures were set up to comply with the stringent requirements that would allow them to maintain their exempt Quotas for the years to come.

The CPHA represents the remaining Producer-Handlers with exempt Quota today. The amount of Quota that was allowed exemption treatment froze at the end of 1994, and there is no mechanism for the Producer-Handlers to increase their exempt Quota, transfer their exempt Quota, or otherwise dispose of their exempt Quota (that maintains the exemption treatment). Producer-Handlers can only lose the exemption for the Quota if they fall outside of the enumerated legislative requirements.

In January 2015, the Producer-Handler production under Option 70 represented only 3.8% of the Class 1 milk production in California, while the exempt solid non-fat exempt Quota



Producer-Handler production represented only 0.6% of the total milk production in California. *See Exhibit B.* The Producer-Handlers Quota exemption is relatively insignificant in terms of overall production and its cost, but is critical in allowing Producer-Handlers to remain economically viable.

VI. Producer-Handlers Established Business Model on Quota Exemption

Each Producer-Handler that maintains an exempt Quota today has structured its business and operations in reliance on the Pooling Act going back to 1967, and through each amendment in 1978 and 1993. They have invested millions of dollars for their exempt Quotas, and structured their businesses around maintaining those Quota exemptions for more than 48 years. While they have no way of increasing their Quota exemptions, preserving their Quota exemption is necessary for the continued viability of their dairies. The following is a more detailed overview of each Producer-Handler, how they acquired their Quota and the history of their operations.

A. Foster Dairy

Foster Dairy operates under d/b/a Crystal Creamery and Foster Farms Dairy with roots dating back as far as the 1920s. Today Foster Dairy has five separate milking sites in Hickman, California and its administrative offices and processing facilities in Modesto, California. The dairy side of the business, Foster Farms Dairy, was originally founded in 1941 by Max and Verda Foster, and the same family still owns and operates the dairy today selling branded products as Crystal Creamery.

Foster Dairy specifically structured its company as a Producer-Handler, utilizing the Quota exemptions since the inception of the Pooling Act in 1967. Foster Dairy was assigned an initial Quota and Base in 1967 with the enactment of the Pooling Act, which increased with the 1978 amendments, increased more each year or so with assigned Class 1 growth up to January 1, 1992, and increased for the final time with the purchase of Quota as allowed by the 1993 amendment.

B. Producers Dairy

Producers Dairy was founded in 1932 in Fresno, CA. For three generations the Shehadey family has owned and operated the company with a focus on nourishing lives. It places a high value on family, which is something that the company has translated into how it engages and cares for its employees. Through their hard work and commitment, the company has



consistently produced high quality products and achieved excellence in the level of service it provides to its many customers.

This has allowed Producers Dairy to continue to invest in growth and in the communities in which it operates. The consistent combination of nourishing the lives of employees, consumers and community has been at the core of Producer Dairy's success and has allowed the company to enjoy an extremely positive reputation. Today, the company distributes fresh dairy products throughout Northern California and is proud to be one of the few remaining family owned dairies.

Producers Dairy was initially issued exempt Quota in 1969, was assigned growth exempt Quota up until 1992, and then purchased additional exempt Quota under the last amendment to the Pooling Act. Producers Dairy has made conscious business decisions in order to maintain the exemption treatment for its Quota.

C. Rockview

Rockview was originally founded in 1927. Mr. DeGroot, arriving in Southern California from Holland, turned an insolvent dairy into a solvent, growing dairy, and today it remains a family-owned business. Initially operating as only a dairy producer, Rockview became a Producer-Handler prior the enactment of the Pooling Act. In 1965 when Rockview's processor declared bankruptcy, Pete DeGroot purchased the processing facility. For fifty years Rockview has operated as a Producer-Handler, making branded products it sells directly to retail accounts.

Rockview operates its fluid milk processing plant in Downey, California where it receives raw milk delivered by tanker trucks. It has a warehouse for refrigeration storage and distribution in South Gate, California. Its Producer farms are located in Chino and Corcoran, California, with one of its farms producing over 97% exempt quota milk. Rockview milks 4000 cows on two farms, employing nearly 300 individuals in California.

As with the other Producer-Handlers, Rockview was initially assigned exempt Quota in 1966. Over the years, Rockview has grown its exempt Quota through growth allocations and conversions under the Pooling Act. Hollandia has invested in its entity, and maintaining its exempt treatment for its Quota.



D. Hollandia Dairy

Hollandia Dairy began in 1949 just a year after the deJong family moved from Holland to Poway, California with \$32 in their pocket. Over the past 66 years, the deJong family has grown the Hollandia Dairy into a viable family-run business.

Hollandia's farm in Escondido produces milk picked up by its raw milk tankers and driven to its milk processing plant for its own distribution. Today, Hollandia Dairy delivers fresh milk and by-products to all of San Diego County, Orange County, and portions of Los Angeles, Riverside and San Bernardino Counties. From its processing facilities, it offers fresh Hollandia branded and private label products including milk, flavored milk, buttermilk, egg nog, half & half, whipping cream, cottage cheese, yogurt, sour cream, ice cream and ice cream novelties. Hollandia Dairy is one of the oldest independent producer and distributor dairies in the State of California and relies on its exempt Quota as part of its critical business structure.

Initially, Hollandia was assigned its exempt Quota through two separate farms and plants, that were later merged into one in 1973. Since its original assignment of exempt Quota with the enactment of the Pooling Act, Hollandia grew its exempt Quota on a regular basis until its last purchase in 1995. Hollandia received Class 1 growth assignments of exempt Quota after the 1978 amendments, and invested significant sums of money to purchase exempt Quota in 1994 and 1995. Going through a merger in 2003, Hollandia carefully structured its business entities so as to preserve and protect the investment it had made in the exempt Quota treatment.

E. Quota and Exempt Quota

Together, the four Producer-Handlers hold a total of 81,992.28 pounds per day of exempt Quota, and a total of 77,972.80 pounds per day of Base. They also produce Overbase that is not quantified by set volumes, but instead subject to whatever amount of production exceeds their Quota, exempt Quota and their allocation of Base. Compare that to the 41.06 billion pounds of milk produced in California in 2014.

While some of the exempt Quota was assigned to the Producer-Handlers based on their historical production and sales of Class 1 milk, under the 1994 amendment to the Pooling Act, the Producer-Handlers were given a short window of time within which to purchase additional Quota that could be treated as exempt. Between 1994 and March 1995, the Producer-Handlers collectively invested \$9,298,677.84 to acquire Quota that would receive the exempt treatment.



In sum, the Producer-Handlers have invested considerable sums of money to acquire the exemption treatment for their Quota. They have likewise made strategic business decisions with respect to ownership and their business models in order to preserve the treatment for the exempt Quota.

VII. California Producer-Handler's Comparison to "Producer-Handler" Definition in Proposed California Milk Marketing Order

A. Proposed California Milk Marketing Order

The Cooperative entities have proposed language for a California Milk Marketing Order (February 3, 2015 submission). Their proposal would exempt from the pool plant any "producer-handler as defined under any Federal order." § 1050.7(f)(1).

The Cooperative entities proposed the following definition for "producer-handler":

- (a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, from which total route disposition and packaged sales of fluid milk products to other plants during the month does not exceed 3 million pounds;
- (b) Receives fluid milk from own farm production or milk 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 1 milk except by increasing the nonfat milk solids content of the fluid milk products;
- (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 1 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; and

(f) Any producer-handler with Class 1 route dispositions and/or transfers of packaged fluid milk products in the marketing area described in § 1131.2 of this chapter shall be subject to § 1000.76(a) and payments into the Order 1131 administrative fund provided such dispositions are less than three million pounds in the current month and such producer-handler had total Class 1 route disposition and/or transfers of packaged fluid milk products from own farm production of three million pounds or more the previous month. If the producer-handler has Class 1 route disposition and/or transfers of packaged fluid milk products into the marketing area described in § 1131.2 of this chapter of three million pounds or more during the current month, such producer-handler shall be subject to these provisions described in § 1131.7 of this chapter or § 1000.76(a).

(Attachment A to February 3, 2015 Letter to Anne Alonzo, Administrator Agricultural Marketing Service United States Department of Agriculture, "Proposed Language for the California Milk Marketing Order." (emphasis added).)

Under this proposal, if a purported "producer-handler" produces more than 3 million pounds per month of milk, ALL of the producer-handler milk would be subject to the pool plant. It is an all or nothing determination.

B. Current California Producer-Handler Exemption Comparison

The Proposed California Milk Marketing Order for exempt "producer-handlers" proposal differs from the California Pooling Act in two key areas. First, with the proposal there is a threshold amount under which a producer-handler must stay in order to qualify as a producer-handler (3 million pounds per month). Under the current Pooling Act, without regard to the size of the Producer-Handler's overall operations, production or sales, the Producer-Handlers receive their exempt Quota treatment for all assigned volumes. Any surplus amounts are paid out as regular Quota, Base, and Overbase subject to Pooling. But they are permitted to have at least a fixed portion of their Quota treated as exempt, without risking losing it by growing their business.



Second, the California Pooling Act does not have an all-or-nothing determination. Rather, the Pooling Act allowed a certain portion of the Quota to be exempt, while other Quota is non-exempt subject to the Pool (depending on when the Quota was acquired and whether the qualifications have been met since that acquisition). In other words, Producer-Handlers have a specified amount of Quota that is treated as exempt, but they also have Quota that is subject to Pooling, and Base. The exempt Quota is a specific volume amount that does not change, cannot increase, cannot be sold, and cannot be transferred (except as regular Quota subject to the Pool). But, it can be held alongside regular Quota that is subject to Pooling.

Additionally, none of the Producer-Handlers (CPHA) would qualify as a “small business” under the Federal marketing order, as they each have gross revenues that exceed \$750,000.

In short, with the Proposed California Milk Marketing Order language, all of the current Producer-Handlers who hold exempt Quota from Pooling would be subject to Pooling eliminating nearly all of the value in the investments and strategic business decisions they made over nearly 50 years to maintain their respective exempt Quota.

Recommendation

The California Producer-Handlers urge preservation of the exempt Quotas that have become the backdrop against which the last remaining Producer-Handlers have invested and structured their businesses for the past 48 years, in addition to the current proposal for exemption for producer-handlers with production under 3 million pounds a month. In essence, this would grandfather into a new California FMMO the exempt treatment for the Producer-Handlers who have invested in this exemption with their business structure and with millions of dollars over the past 50 years. Preservation of the Producer-Handler assigned exempt Quota would also leave in place the proposed exemption for smaller producer-handlers (under 3 million pounds per month) to potentially qualify as exempt from the pool as well.

If the Quota system is to be maintained in any California FMMO, it should also preserve the Quota exemption treatment for the Producer-Handlers as these exemptions are the result of a series of years’ worth of legislative compromises and business structuring decisions. The industry has come to rely on the current pooling system, with Producers of all types structuring their businesses to best utilize the Quota system and any available Quota exemptions. Just as Producer-Handlers have benefited from their Quota exemption, Producers have benefited from increases in their allocated Quota and ability to purchase additional Quota. If the exemptions were not maintained in the new system, then the Producer-Handlers should be compensated with some type of exchange for regular Quota that recognizes the additional value that the exempt



Quota gave to the Producer-Handlers. However, if the USDA elects to recommend the establishment of an FMMO for the State of California with the preservation of the California Quota system, we urge it to preserve the exempt Quotas that have become the backdrop against which these Producer-Handlers have structured their businesses for the past 48 years.

Maintain Exempt Quota Treatment. CPHA proposes to maintain its Producer-Handler Quota exemption with the establishment of a California FMMO. The Cooperative Proposal retains the California Quota system, and the CPHA seeks to maintain its Quota exemption as a part of the preservation of the state Quota system. Maintaining the exempt treatment for the Quota honors the original intent of the Quota system, and the overall impact to the market and pricing is nominal at best as the percentage of the Producer-Handler exempt Quota production is only 0.6% of the total California market.

The Quota exemption also incentivizes the retention of these family-run Producer-Handler businesses, a rare business model in today's markets. The Quota exemption has allowed them (and required them) to run their operations as a family business, and it has allowed them to counter the pressures of giving into impersonal corporate models and predatory acquisitions. They maintain in-person customer service relationships with their customers, create brand identify around their business models, and brand equity with respect to their customer relationships. They have to produce high-quality products to compete with large corporations that have larger buying power and larger marketing budgets. Overall, the Quota exemption is woven through their entire operations and loss of exempt treatment for their Quota places their businesses at risk of demise or failure. Therefore, in the event a FMMO is implemented in California, the CPHA's proposal should be adopted whereby the Producer-Handler Quota exemption is incorporated into the FMMO.

Remove Degrees of Family Consanguinity. The CPHA further proposes that the degrees of family consanguinity be removed to allow for a continuation of transfers within the family definition. This would allow for the Producer-Handlers to continue to maintain the CPHA as a family-run organization so long as they do not transfer the entities out of the family ownership structure.

Thank you for your time in review of this proposal. If you have any questions, you can reach me at 208-387-4231 or nicole.hancock@stoel.com.

Very truly yours,

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