



101 S. Capitol Boulevard, Suite 1900
Boise, Idaho 83702
main 208.389.9000
fax 208.389.9040
www.stoel.com

NICOLE C. HANCOCK
Direct (208) 387-4231
nicole.hancock@stoel.com

May 27, 2015

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

Re: Amended 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-Handler** (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 or handle 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 as part of the overall Quota System in the Pooling Act. 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 preserve the Producer-Handler

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.cdfa.ca.gov/dairy/appendix.html> (last visited Apr. 2, 2015) (attached hereto as Exhibit A).

² A Producer is “[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.” *Id.*

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.” *Id.*



Deputy Administrator, USDA/AMS/Dairy Programs
May 27, 2015
Page 2

Quota exemption in any Federal Milk Marketing Order (“FMMO”) adopted in California as it is an integral part of the California Quota System contemplated for preservation by the 2014 Farm Bill.

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 (“CDFA”) 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 Agricultural Act of 2014 (“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, which necessarily includes both types of Quota in the Quota System.

I. Farm Bill and Authority to Maintain “Quota System”

The 1996 Federal Agriculture Improvement and Reform Act (“1996 Farm Bill”) provided the USDA with the authority to designate an FMMO for the State of California. The 1996 Farm Bill stated, in pertinent part: “Upon the petition and approval of California dairy producers . . . the Secretary shall designate the State of California as a separate Federal milk marketing order. ***The order covering California shall have the right to reblend and distribute order receipts to recognize quota value.***” 7 U.S.C. § 7253(a)(2) (emphasis added). The 1996 Farm Bill contained a deadline for the USDA to consider the designation of an FMMO for California. 7 U.S.C. § 7253(b)(2). The 2014 Farm Bill repealed the deadline that was in the 1996 Farm Bill. It thus reopened the opportunity for a party to petition the USDA to adopt an FMMO for California.

The Conference Report that accompanies the 2014 Farm Bill includes a “Joint Explanatory Statement of the Committee of Conference” that reflects the intent of the drafters. It states in pertinent part: “The Managers intend for the Secretary to conduct a hearing prior to the issuance of an order designating the State of California as a Federal milk marketing order. *The provision provides the Secretary of Agriculture with the discretion, if a California Federal milk marketing order is requested, to recognize the longstanding California quota system, [“Quota*



System”] established under state marketing regulations, in whatever manner is appropriate on the basis of a rulemaking hearing record.” (Emphasis added.)

As we understand the current proposals, the USDA, through a California FMMO, will suspend any duplicative portions of the California Pooling Act, but retain any portions of the California Pooling Act that are not duplicative and consistent with the California FMMO. For that reason, it is helpful to have a historical overview of the California Pooling Act.

II. 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 Handlers must pay for market-grade milk received from dairy farmers. California’s milk marketing order breaks the Producer-Handlers into two groups. As described below, Producer-Handlers in California have held a portion of their milk as exempt from Pooling (defined *infra* note 8) 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

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.

....



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 Handlers 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 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

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

Appendix: Glossary of Dairy Terms, *supra*.

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." *Id.*

⁷ Overbase means "[o]ne price of a two-tiered pricing system in California; quota is the other price. Essentially,



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 vertically integrated production and processing companies, 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 Handler firms paid and the prices that Producers received. Under this system, a Handler paid a price for milk based on the applicable Quota, Base, or Overbase price. If the Handler made products with higher classified prices, it had to pay the difference into the pool. If the Handler 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 Handlers would not be hurt financially by having to pay Quota prices if they were manufacturing a product that did not require Quota class of milk. The system was designed so that neither Handler nor Producer suffered or benefited from the other's financial position.

III. 1967 Producer-Handler Quota System

The Pooling Act created a Quota System that recognized the difference between the Producers' and the Producer-Handlers' relationships with their end buyers. On the one hand, the Producer-Handlers' relationships were with the ultimate consumers who purchased finished branded products, while on the other hand the Producers' relationships were with Handler companies who would process the raw milk into a variety of products.

As a result, the Pooling Act created the Quota System to address both Producers and Producer-Handlers: Regular Quota for Producers, and Exempt Quota for Producer-Handlers.

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." *Id.* 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.*



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 6

A. Regular Quota for Producers

Producers who do not process their own product have a different relationship model with their customers than the Producer-Handlers. The Producers' customers are the milk Handlers. 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 Handlers 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 Handlers' destructive trade practices and disparity in bargaining power drove the Pooling of milk revenues as a way to eliminate the price inequities and Handler 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.

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.

B. Exempt Quota for Producer-Handlers

The Pooling Act recognized Producer-Handlers' vertical integration by defining Exempt Producer-Handlers recognizing their vertical integration warrants at least some of their raw milk to be exempt from Pooling. The 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 Handlers 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 consumers that allowed the Producer-Handlers to create and expand the Class 1 markets over time, which continues today. As a result, the Pooling Act Quota System 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 Handlers as Producer-only farms.

The Pooling Act gave Producer-Handlers a 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 Producers' Quota would incur because the Producer-



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 7

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. When the 1967 Pooling Act was originally 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.

IV. CDFA Administration of Pooling Act

The CDFA is tasked with administering the California Pooling Act under the state order system. The CDFA Milk Pooling Plan (“Plan”) contains the following definitions relevant to Quota and Producer-Handlers:

- **Quota milk** is defined to mean “that amount of fact and solids not fat contained in pool milk delivered by a producer during the month which is not in excess of the pool quota of such producer computed pursuant to Section 110 multiplied by the number of quota eligible days in the month.” Plan § 115.
- **Exempt Producer-Handler** is defined to mean “any person who qualifies and continues to qualify under the appropriate options to be excluded from the pool, pursuant to the provisions of Article 6.” Plan § 121.
- **Producer-Handler** is defined for purposes of the Plan in Article 6 and Article 6.5. Plan § 129.

Here are the provisions of the Plan relating to Option 70 Producer-Handlers:

Section 650. A producer-handler, for the purposes of this article, shall also include, as a separate and distinct category of producer-handlers, any producer and any handler who purchases or handles market milk or market cream produced by such producer if they meet the requirement that all of the ownership of the handler and all of the ownership of the producer is owned by the same person or persons and their ownership in the producer or handler is at least 95 percent identical for each person with their ownership in the handler or producer. Such ownership shall not exceed ten



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 8

individual persons or owners of equitable interest in a partnership, corporation, or other legally constituted business association.

Section 651. The ownership required by this article may be through a partnership, corporation, or other legally constituted business association so long as the entities are owned by the same person or persons, and there is at least 95 percent identity of ownership for each person with their ownership in the handler or producer. For the purposes of this article, a “person” or “persons” includes the spouse, or other persons of lineal consanguinity of the first or second degree or collateral consanguinity to the fourth degree, and their spouses, and includes an adopted child the same as a natural child and kindred of the half blood equally with those of the whole blood of the owner and ownerships by persons so related shall be considered single ownership by one person. For the purpose of this article, property pledged or hypothecated in any manner to others shall be considered “owned” so long as equitable ownership with management and control remain with the producer-handler.^[9]

Section 652. Ownership, as provided in this article, shall have existed at the time of the base period selected by the producer under Section 107, and at all times thereafter.

Section 653. Any producer-handler qualified under this article may, no later than August 5, 1969, notify the secretary of the election:

- (a) To join and operate wholly within such pool; or
- (b) To have the entire original production base and pool quota determined during the base period selected as a producer, pursuant to Sections 108 and 110, established as a part of such Pooling Plan,

⁹ You will note that this section includes the consanguinity limitation that our client does *not* want the USDA to adopt as part of its proposed FMMO. This limitation comes from the Pooling Act, Cal. Food & Agric. Code § 62708.5(b). However, if the consanguinity limitation is reserved as part of the California Pooling Act and not covered under a California FMMO, then the CPHA will voluntarily withdraw this aspect of our proposal from our FMMO amended supplemental proposal.



and nevertheless elect to operate entirely outside of the pool to the extent of the provisions of Section 654.

Section 654. Any producer-handler who elects to operate outside the pool pursuant to Paragraph 653(b) shall have its quota milk deducted from its own Class 1 usage, plus a further daily deduction from such usage of 150 pounds of milk fat and 375 pounds of solids not fat, before being required to account to the pool, even though the average Class 1 usage in the pool for that month may be less than 100 percent of the quota milk in the pool.

Section 655. The fact that a producer-handler qualifies as to one of its milk production operations under this article does not prevent the producer-handler from operating on an entirely separate nonqualifying basis at other milk production facilities, and with other nonqualifying persons at such other milk production facilities. A producer-handler can neither buy nor sell the option granted under this article, but this shall not prevent the producer-handler from purchasing or selling pool quota or production base as otherwise provided in this Pooling Plan.

Section 656. If at any time, ownership, as defined in this article ceases, the producer-handler shall no longer be eligible for the option in this article and shall account to the pool as a separate handler and shall be entitled to reentry into producer participation in the pool on the same basis as a producer-handler may, under Sections 602 and 605, or the producer-handler may elect to become an exempt producer-handler provided the entity qualifies under the provisions of Section 604.5.

Section 657. Pool quota exempted under this article shall not be subject to the provisions of Article 9.1 and Article 9.2.

In other words, the above provisions pertaining to Exempt Producer-Handlers and their portion of the Quota System require the Producer-Handlers to 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



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 10

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 since the Pooling Act was enacted 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, that Quota became regular Quota that would forever be subject to Pooling. Therefore, to maintain a Quota exemption treatment, it is imperative for any Producer-Handler to comply with all exemption requirements.

V. 1978 and 1993 Legislative Amendments to the Pooling Act Expanded Quota System

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



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 11

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.

VI. 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.

VII. 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



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 12

in 1978 and 1993. The following is a more detailed overview of each Producer-Handler, how it acquired its Quota, and the history of its operations.

A. Foster Dairy

Foster Dairy has 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, California. 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.



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 13

C. Rockview

Rockview was originally founded in 1927. Pete 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 Producer, Rockview became a Producer-Handler prior to the enactment of the Pooling Act. In 1965, when Rockview's Handler declared bankruptcy, Mr. DeGroot purchased the processing facility. For 50 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 1967. Over the years, Rockview has grown its exempt Quota through growth allocations and conversions under the Pooling Act. Rockview 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 Dairy'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 and Orange County, and to 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-and-half, whipping cream, cottage cheese, yogurt, sour cream, ice cream, and ice cream novelties. Hollandia Dairy is one of the oldest independent Producer-Distributor dairies in the State of California and relies on its exempt Quota as part of its critical business structure.

Initially, Hollandia Dairy was assigned its exempt Quota through two separate farms and plants, which were later merged into one in 1973. Since its original assignment of exempt Quota with the enactment of the Pooling Act, Hollandia Dairy has grown its exempt Quota on a regular basis until its last purchase in 1995. Hollandia Dairy received Class 1 growth assignments of



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 14

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 Dairy carefully structured its business entities so as to preserve and protect the investment it had made in the exempt Quota treatment.

E. CPHA 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 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.

VIII. Comparison of Current California Producer-Handler to “Producer-Handler” Definition in Proposed FMMO

A. Proposed FMMO

The Cooperative entities have proposed language for an FMMO for California (February 3, 2015 submission).¹⁰ Their proposal would exempt from the pool plant any “producer-handler as defined under any Federal order.” Proposed FMMO § 1050.7(f)(1).

¹⁰ By letter dated April 9, 2015, the Dairy Institute of California submitted a letter to the USDA along with an alternative proposal for a California FMMO. *See* Attachment 1, *available at* <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELPRDC5111114> (last visited May 22, 2015). The Dairy Institute’s alternative proposal retains a Quota system by reference to the California Food and Agriculture Code. *See id.* § 1050.11(a) (defining “California Quota Program” to mean certain applicable provisions of the California Food and Agriculture Code). Notably, the Dairy Institute’s alternative proposal does not recognize



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 15

The Cooperatives' proposed FMMO is modeled after the California Plan with respect to regular Quota, but does not recognize exempt Producer-Handlers as part of the Quota system that currently operates under Article 6.5 of the Plan quoted above. 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

special Producer-Handlers as does the CDFA Plan, and excludes Producer-Handlers as defined in any federal order from the definition of Handlers. *Id.* § 1050.12(b). CPHA proposes that, if the Dairy Institute's proposal is adopted, it be modified to include preservation of the Pooling Act's treatment for exempt Quota.



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 16

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's 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 FMMO attempts to preserve the regular Quota but does not preserve the Exempt Producer-Handler Quota that has always been a part of the California Pooling Act Quota System. None of the current Producer-Handlers who are exempt under the California Quota system would be exempt under the proposed California FMMO.

First, the Cooperatives have not proposed preservation of the California Pooling Act definition of exempt Producer-Handlers. Instead, the Cooperatives propose a new definition of Producer-Handlers, with a threshold amount (3 million pounds per month) under which a Producer-Handler must stay in order to qualify. Under the current Pooling Act, without regard to the size of an exempt Producer-Handler's overall operations, production, or sales, the Exempt 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 allows a certain portion of the Quota to be exempt, while other Quota is non-exempt and subject to Pooling (depending on when the Quota was acquired and whether the



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 17

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 exempt Producer-Handlers (CPHA) would qualify as a “small business” under the FMMO, as they each have gross revenues that exceed \$750,000.

In short, with the proposed California FMMO language, all of the current exempt 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

CPHA urges preservation of the entire Quota System that have become the backdrop against which the last remaining Exempt Producer-Handlers have invested and structured their businesses for the past 48 years. The 2014 Farm Bill specifically contemplates preservation of a Quota System, that has always recognized both Regular Quota and Exempt Quota since the inception of the Pooling Act in 1967.

In order to accomplish this recommendation, CPHA proposes one of two methods. First, CPHA proposes preserving the California Pooling Act Plan §§ 115, 121, 129 and Article 6.5 §§ 650-657 addressing Exempt Quota, and defining Exempt Producer-Handlers, their requirements and administration under the Pooling Act by the CDFR. By preserving these sections, in addition to the Regular Quota sections proposed for preservation by the Cooperatives and Dairy Institute proposals, it will preserve the entire Quota System as is contemplated by the 2014 Farm Bill.

Second and alternatively, if the California FMMO is intending to address the Quota system in its own FMMO regulatory framework, then CPHA proposes that the FMMO adopt the Exempt Producer-Handler definition, along with the California Pooling Act sections identified in the preceding paragraph to allow CPHA to preserve its exempt Quota treatment along with the rest of the Quota System.

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



Deputy Administrator, USDA/AMS/Dairy Programs

May 27, 2015

Page 18

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. However, if the California FMMO does not suspend the California Pooling Act requirements for consanguinity, then CPHA will voluntarily withdraw this aspect of the proposal with the understanding that it will be governed by the state order system.

Proposed Language for Exempt Quota Preservation. CPHA proposes that the language of the California Pooling Act, as quoted above, pertaining to exempt Quota be preserved as part of the Quota system that was contemplated to be preserved by the 2014 Farm Bill.

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,

Nicole C. Hancock