UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE
On review of a Recommended Decision by the Administrator,
Agricultural Marketing Service (Dairy Programs)

In re: Milk in the Central	)	
Marketing Area,	)	Dkt AO 313-A48
7 C.F.R Part 1032	)	DA 04-06

COMMENTS ON AND EXCEPTIONS TO
RECOMMENDED DECISION, 71 Fed. Reg. 9015 (Feb. 22, 2006),
MATERIAL ISSUE No. 1-E: STANDARDS FOR PRODUCER MILK

On behalf of: Associated Milk Producers, Inc., Central EquityMilk Cooperative, First District Association, Foremost Farms USA, National All-Jersey, and Wells Dairy ("AMPI *et al*.")[1]

INTRODUCTION AND SUMMARY OF EXCEPTIONS

These comments and exceptions on behalf of AMPI *et al* focus on the Central Milk Order hearing proposals and issues identified in the Recommended Decision as Material Issue 1-E: "Standards for Producer Milk."[2] 71 Fed. Reg. at 9020 – 9023. The Administrator concluded that significant new restrictions are necessary (1) to discourage pooling of distant milk, (2) "to meet the Class I fluid needs of the market," and (3) to "assure that distributing plants are adequately supplied." *Id.* 9016, 9022-23. Elsewhere, however, the Administrator found that the existing "order provisions attract sufficient milk for fluid use, [and]… *the need for additional government intervention beyond what the order currently provides in meeting the market's fluid demands is not warranted*." 71 Fed. Reg. at 9031 (emphasis added). Distant milk, therefore, was the only objective problem.

These comments demonstrate that the Administrator's proposed sweeping and burdensome solution to a limited "distant milk" problem falls short of

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[1] Comments and exceptions unique to individual cooperatives may be filed separately.

[2] AMPI *et al* actively participated in the public hearing held in Kansas City during December 2004 and on February 18, 2005, and addressed these issues in their "Post-Hearing Brief on 'Pooling Standard' Proposals."

compliance with several basic standards of administrative decision-making, as prescribed by the Administrative Procedure Act, the Agricultural Marketing Agreement Act, and the Regulatory Flexibility Act. The defects of the recommended decision addressed in these Exceptions are:

(1) Failure to address "*all* the material issues of fact, law or discretion presented on the record," with a statement of findings and conclusions, including "the reasons or basis therefor," on each material issue. 7 U.S.C. §557(c)(3)(A); 7 C.F.R. §§900.12(b) and 900.13a; *Motor Vehicle Manufacturers Association v. State Farm Mutual,* 463 U.S. 28, 43 (1983)(an agency decision is arbitrary if it has failed to consider relevant factors or any "important aspect of the problem.").
(2) Failure to consider or explain the recommended choice made against less burdensome regulatory alternatives available to address the problem identified. *Id.; Motor Vehicle Manufacturers*, 463 U.S. at 54-56.
(3) Failure to describe, discuss and resolve "significant alternatives… which minimize any significant economic impact of the proposed rule on small entities," 5 U.S.C. §601(c), or provide a *fact-based* statement certifying that the proposed rule will not have a significant impact on a substantial number of small businesses. *Id.* §605(b).
(4) Failure to make rulings on each proposed finding and conclusion in the post-hearing brief submitted by AMPI *et al*. 5 U.S.C. §557(c)(3); 7 C.F.R. §900.12(b)(2).

The Rules of Practice provide for recommended decisions to be issued by the agency head of Agricultural Marketing Service, subject to review and final decision by the head of the Department of Agriculture, or his delegate. 7 C.F.R. §§ 900.12 – 900.14.[3] On review by the Secretary of the Administrator's

[3] Referring to the recommendation functions of the Administrator and review functions of the Secretary expressed in these Rules of Practice, Counsel for USDA has explained that a recommended decision "represent[s] the views of the Administrator, not those of the Secretary. The regulations specify that the Administrator's recommended decision, after expiration of the period for comments, is submitted to the Secretary who then considers the record and renders his decision. 7 C.F.R. § 900.12-13a." Defendant Secretary of Agriculture's Memorandum in Opposition to Plaintiffs' Motion for a Preliminary Injunction, at 41, *Dairymen, Inc., v. Madigan*, MD Tn, No. 3-92-0166 (1992). These rules conform to the process of "subordinate employee" recommendations and agency head final decision-making required by 5 U.S.C. §557(b) and (c).

recommendations pursuant to 7 C.F.R. 900.13a, particular attention must be given to correction of the foregoing shortcomings.

THE ADMINISTRATOR'S IDENTIFICATION OF THE DISTANT MILK PROBLEM

For purposes of these comments and exceptions, we rely on the Administrator's findings that identify and describe the problem to which the "Standards for Producer Milk" analysis is addressed (71 Fed. Reg. at 9021-9022), particularly as it relates to the proposed individual producer delivery (touch base) requirement and diversion limits. On this issue, the Administrator focused on the problem of "distant milk" and made the following findings of fact.

> The record evidence demonstrates that milk distant from the Central marketing area does not provide reasonable service to the Class I market but can be pooled on the order because of current pooling standards. This evidence shows that pooling large volumes of milk at lower class-use values has lowered the order's blend price. Specifically, the record shows that the current one-time touch-base standard and the diversion limit standard of the order does not properly identify the milk of producers who reliably and consistently serve the Class I market.
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> The record demonstrates that current pooling standards of the Central order make it the most logical order for *distant milk such as in Southern Idaho*--to be pooled.[4] The record shows that the current performance standards of the Central order are insufficient to prevent milk from qualifying for pooling while not performing service to the Class I market.
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> In addition, the record provides evidence that *milk produced in areas distant from the marketing area cannot profitably be delivered to distributing plants in the Central marketing area*. However, the current liberal touch-base and diversion limit standards make pooling on the Central order attractive while reducing the blend price of the order for those producers who actually provide service to the Class I market.

71 Fed. Reg. at 9021-22 (emphasis added, footnote supplied).

[4] The meaning of "distant milk" and context of "most logical order" is further explained by proponents' evidence of the problem as new milk pooled on the Central Order from Idaho, as summarized in the recommended decision at 71 Fed. Reg. 9020-21.

The Administrator further reinforced his view that "distant milk," in this context, means milk produced far from the market, "such as in Southern Idaho," "that will never perform service to the Class I market," *Id.* at 9022 (col. 1). It was, after all, the recent introduction of Idaho milk into the Central Market pool that stimulated proposals to amend producer milk pooling requirements even though the Central Milk Order pooling rules had been amended in 2003. *Id*. at 9020 ("those changes did not contemplate that milk from the Mountain States might seek to be pooled on the Central order."). Elaborating on the nature of the problem, the Administrator continued *Id*. (col 2) (emphasis and footnote added):

> The record indicates that milk located either inside or outside the marketing area can be reported as diverted milk by a pooled handler. This milk is eligible to receive the order's blend price. Under the current pooling provisions, this can occur after a one-time delivery to a Central marketing area pool plant. After the initial delivery, however, such milk need never again be physically delivered to a Central marketing area pool plant. The record evidence confirms that usually this milk is delivered to a nonpool plant located nearer the farms of *producers located* ***far from the marketing area*** *who cannot serve the Class I market*.[5]

THE PROPOSED SOLUTION TO CURTAIL DISTANT MILK BY REGULATORY BURDENS ON LOCAL MILK SUPPLIES

The Administrator identified and described the problem of "distant milk" that was not addressed in or contemplated by the 2003 amendments to the Central Order. He then proceeded to propose a new market-wide regulatory burden on all producers, believing that this would discourage distant milk – not part of the legitimate reserve supply for the marketing area – from associating

[5] The Administrator rejected proponents' view that distant milk includes all milk outside of the Marketing Area or New Mexico, as advocated by proposal No. 1 amendments to 7 C.F.R. §1032.13(d). Rather, the Administrator concluded that some milk outside of the marketing area may "be part of the legitimate reserve of the market." *Id.* (cols. 1-2).

milk with the Central Order revenue pool. The Administrator explained (71 Fed. Reg. at 9022 (col. 2-3)):

> It is therefore appropriate to amend the order's diversion provisions to ensure that milk pooled through the diversion process is part of the legitimate reserve supply of the pool plant from which it was diverted. It is necessary to safeguard against excessive milk supplies becoming associated with the market through the diversion process to prevent the unwarranted reduction of the order's blend price.
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> * * * * *
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> This decision finds that the touch-base standard should be amended so that at least one days' milk production of a dairy farmer is physically received at a pool plant during January, February, and August through November for the milk of the dairy farmer to be eligible for diversion to a nonpool plant. Amending the touch-base standard should reduce the ability of milk not performing a consistent and reliable service to the Class I market from being pooled.

THE IMPACT OF THE PROPOSAL ON LOCAL PRODUCERS

There is little doubt that requiring distant producers to ship milk at least one day's production per month to a pool plant would provide a significant economic disincentive to pool distant milk in the Central Marketing Order. That disincentive is now greater than at the time of the December 2004 hearing due to much higher petroleum product prices. However, the solution selected by the Administrator to address the problem does not merely curtail distant milk, it also adds an unnecessary but avoidable burden on all producers within the Central Marketing Area and its historical milkshed.

Evidence of record at the December 2004 hearing revealed that (for October 2004) about 1.2 billion pounds of milk from 5,800 producers was pooled each month on the Central Order. *Number of Producers Marketing Milk, By State, 2004, Central Marketing Area* http://www.fmmacentral.com/ (under publications, state statistician information). This included about 2 million pounds of milk from one Idaho producer. *Id*. The stated concern of DFA/Prairie Farms for Proposal No. 1 was the potential threat of up to 260 million pounds of milk per month from 196 Idaho producers, pooled as Class III and IV milk in the Upper Midwest market during 2004, shifting to the Central Market when USDA adopted distant milk pooling restrictions for the Upper Midwest market. Hearing Ex. 19 pp. 15-19; Ex. 11 p. 38; 71 Fed. Reg. at 9020. Distant milk from Idaho, therefore, could eventually represent up to 18% of the Central Market pool, although only 3% of producers. The concerns of DFA/Prairie Farms to which the touch-base proposal was addressed were restated in their February 18, 2005, post-hearing brief (at p. 8), as follows:

> "Proposal 1 is needed because the current performance standards will allow and even encourage milk from areas too distant to ever serve the market on a regular basis to become attached to the Order pool. The "once and done" standard combined with the ability to easily depool any volume can be very detrimental to the Order 32 blend price. (Hollon, TR. 264-65)"

The amendments to the Upper Midwest Order were made effective in July 2005. 70 Fed. Reg. 31321 (June 1, 2005). As expected, additional Idaho milk was associated with the Central Order, but much less than proponents anticipated. Between June and September 2005, the volume of Idaho milk pooled in the Central Market increased from 2.8 million pounds from one producer to 23 million pounds from 26 producers. For the first two months of 2006, the Idaho volume has leveled off at 20 million pounds. *Number of Producers Marketing Milk, By State, 2004 - 2005, Central Marketing Area* http://www.fmmacentral.com/ (under publications, state statistician information).[6] Compared to data at the time of hearing, it appears that 18 million pounds of Idaho milk per month is now taking advantage of opportunistic pooling without serving as part of the legitimate reserve milk supply for the Central Milk Market. This milk unnecessarily depresses the blend price received by producers in the historical Central Market milkshed.

[6] Official Notice of the foregoing updated milk volumes and producer numbers, by state, is respectfully requested.

The Administrator's recommendations, however, propose to deal with this problem by use of a chainsaw rather than a scalpel. To curb potential abuses by a few Idaho producers (26 actual, 196 projected), the rule imposes new burdens on all 5,400 Central Market producers. The Administrator's recommendation would require every producer's milk to be shipped to a pool plant during six months, whether that milk is needed or not by the pool plant, and would reduce the diverted milk volume by 25% or require a 25% increase in sales to fluid milk plants to maintain pool status for existing producer milk supplies.[7] The record shows that there is substantial milk production in the market's historical milkshed, both within and outside of the marketing area, that serves as a reserve supply to the market and is continuously shipped to nearby nonpool plants; other milk, located closer to distributing plants, is continuously shipped to such distributing plants. *See, e.g.,* Hearing Ex. 12; Ex. 32. The existing touch base provision and diversion limits allow market participants to decide what is most efficient for them where transportation is expensive and market choices may be limited by a variety of institutional factors. The Administrator's recommendations require inefficiency within the market to respond to abuse from without. For many, the solution may more burdensome

[7] Proposal No. 1, adopted by the Administrator, would reduce the percentage of milk that may be diverted by 5 points (from 80% to 75%) during August-February. A cooperative with a pooling base of 20 million pounds per month in sales to a fluid milk distributing plant, can currently pool up to 100 million pounds and divert 80 million pounds (80 = 80% of 100). Without an increase in sales to a distributing plant, the recommended rule for 75% diversions and 25% sales to distributing plants would allow only 80 million pounds of milk to be pooled, with 60 million diverted to nonpool manufacturing plants (60 = 75% of 80) – a loss of 20 million pounds of diversions, or 25% of the diverted milk volume. In order to continue pool status for 100 million pounds of milk under the Administrator's recommendation, the cooperative must increase sales to distributing plants by 5 million pounds, or 25% of current sales. 5 / 20 = 25%. With this increase in sales to 25 million pounds, the cooperative will meet the new requirement of 25% deliveries and 75% diversions, but loose 5 million of 80 million pounds in sales to a nonpool plant. To maintain its diverted sales volume, the cooperative would have to increase distributing plant sales by 34% to 26.75 million pounds, which allows 80 million additional pounds to be diverted (80 = 75% of 106.75).

than the problem; for all, the problem can be addressed with less regulatory burden.

Central Equity, for example, has two plant customers that buy member milk: the Eagle Brand manufacturing plant in Seneca, Missouri, formerly owned by Milnot, and a Wells Dairy distributing plant in Le Mars, Iowa, 494 miles north of Seneca (about the same distance as Washington, D.C. to Portsmouth, N.H., or to Columbia, S.C.), as described in the record (Testimony of Erick Metzger). Central Equity's milk is primarily marketed to the Eagle Brand plant in Seneca, close to the location of member farms. To meet the new "touch base" requirement, Central Equity would each month have to transport milk 400 to 500 miles to Wells Dairy, even though Wells doesn't need the milk. Milk from farms close to Wells, then, would be displaced and have to be transported to milk manufacturing plants at a greater distance from the farms. The cost for a comparable shipment of 456 miles prior to the hearing was $1,003, at 2.2 cents per loaded mile, or $2.09 per hundredweight of milk. Ex. 29 (and other Proposal No. 3 evidence). DFA testified to 2004 hauling costs of 3.3 cents/loaded mile. Dec. 7, 2004 Tr. p. 214.

From February 2004 to February 2006, however, diesel fuel costs have escalated 89%, and gasoline by 46%, as shown below by Producer Price Index[8]

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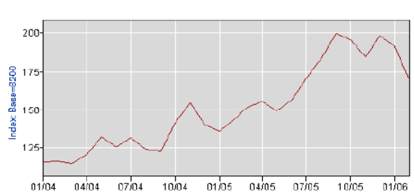
[8] PPI Commodity Data at http://www.bls.gov/data/home.htm. Official Notice requested.

Producer Price Index-Commodities

Series Id: WPS0571
Seasonally Adjusted
Group: Fuels and related products and power
Item: Gasoline
Base Date: 8200

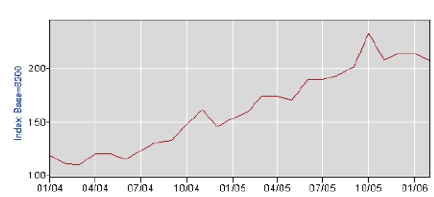


Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annua
2004	115.6	116.4	115.0	120.5	131.9	125.8	131.3	124.1	122.6	141.6	154.8	140.2	
2005	136.0	143.5	151.8	155.5	149.4	156.6	170.3	184.0	199.8	195.8	184.8 (P)	198.1 (P)	
2006	191.1 (P)	170.0 (P)											

P : Preliminary. All indexes are subject to revision four months after original publication.

Producer Price Index-Commodities

Series Id: WPS057303
Seasonally Adjusted
Group: Fuels and related products and power
Item: #2 diesel fuel
Base Date: 8200



Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
2004	118.9	110.5	110.4	119.9	120.2	115.3	123.0	130.6	132.8	147.7	161.3	145.3	
2005	153.3	159.0	174.0	173.8	170.4	189.5	189.6	194.0	201.5	232.5	208.2 (P)	214.1 (P)	
2006	213.7 (P)	208.3 (P)											

P : Preliminary. All indexes are subject to revision four months after original publication.

Bureau of Labor Statistics, data for gasoline and diesel fuel, 2004 – 2006.

The situation is not expected to improve over the next two years, according to gasoline and diesel fuel price forecasts by DOE, Energy Information Administration, as summarized in the table to the right.[9]

Price Summary

	Year				Percent Change		
	2004	2005	2006	2007	04-05	05-06	06-07
WTI Crude[a] ($/barrel)	41.44	56.49	64.65	60.63	36.3	14.4	-6.2
Gasoline[b] ($/gal)	1.85	2.27	2.50	2.40	22.7	10.1	-3.9
Diesel[c] ($/gal)	1.81	2.41	2.59	2.44	33.3	7.2	-5.6
Heating Oil[d] ($/gal)	1.54	2.04	2.28	2.18	32.8	11.6	-4.4
Natural Gas[d] ($/mcf)	10.75	12.82	13.12	13.16	19.3	2.3	0.3

[a] West Texas Intermediate. [b] Average regular pump price.
[c] On-highway retail. [d] Residential average.

Increased fuel costs, energy inefficiency, federal energy policy costs to increase silo capacity and milk handling equipment, additional man-power and salaries are all part of the mix of factors to be weighed for rational decision-making of the rule proposed against less burdensome alternatives to address the problem of distant milk. Increased fuel costs have simply added much more weight to the requirement that less burdensome alternatives be considered; and if such alternatives are rejected, they should be accompanied with a statement of facts explaining reasons for the choices made.

The increased cost for fuel to comply with the proposed regulatory requirement simply adds to the need to reexamine the Administrator's recommendations against impact on market participants. Under current fuel prices, it is estimated that increased costs resulting from the proposal to Central Equity and its 157 small business members will be $18,000 to $20,000 per month; increased costs to First District in marketing milk of 45 – 50 small business producers under the Central Order will be $18,000 to $19,000 per month; and the cost to AMPI and its small business members over $88,000 per

[9] DOE, EIA, Short Term Energy and Summer Fuels Outlook (April 11, 2006), http://www.eia.doe.gov Petroleum, Forecasts. Official Notice is requested.

month.[10] Another result could be to create more pay-to-pool arrangements in order to gain access to distributing plants that do not need the milk, but are better geographically located to a cooperative's milk supply. Although such plants are fully supplied under supply agreement contracts, the supplier's exclusive access to the plant is a valuable asset that can be peddled to other cooperatives who have little market access to fluid milk plants. The question in a market-driven economy is the buyer's cost for purchase or rent of that asset to comply with the Administrator's recommended rules.

ALTERNATIVE REMEDIES WITH LESS REGULATORY BURDEN ON LOCAL PRODUCERS AND SMALL HANDLERS ARE AVAILABLE AND SHOULD BE CONSIDERED

REQUIREMENTS OF THE REGULATORY FLEXIBILITY ACT

This brings us to the requirements of the Regulatory Flexibility Act, and the reasonableness of the Administrator's certification that the proposed rules "will not have a significant economic impact on a substantial number of small entities." 71 Fed. Reg. at 9016. This certification, contrary to the face of its representation, was not premised on a conclusion that the rules at issue would not have a significant impact, nor that a significant number of small entities would be unaffected by that impact. For some parts of the recommendations, at least, the Administrator found that "impacts on producer blend prices are *significant*." 71 Fed. Reg. 9011. Likewise, rule proponents intended that the

[10] These current additional regulatory compliance cost estimates for specific cooperatives are, quite naturally, not part of the 2004 hearing record. They may therefore not be considered on the current record to formulate the terms of an order (7 C.F.R. §900.9(b). As invited by the Recommended Decision, these comments must necessarily be considered in the Secretary's review of the economic impact of the proposed rule on small entities, the propriety of the Administrator's recommendation of no significant impact on a substantial number of small entities; and whether current circumstances, in any event, now merit a Regulatory Flexibility Analysis. See. 5 U.S.C. §§604(a)(2), 605(b), and 611. "Interested parties are invited to submit comments on the probable regulatory and informational impact of this proposed rule on small entities. Also, parties may suggest modifications of this proposal for the purpose of tailoring their applicability to small businesses." 71 Fed. Reg. at 9016.

amendments "establish *significant consequences*…" for non-compliance with the proposed amendments. 71 Fed. Reg. at 9008 (emphasis supplied).

The Administrator made his certification, instead, because pooling rules "are established without regard to the size of any dairy industry organization or entity." 71 Fed. Reg. at 9016. The Administrator's apparent conclusion that a "one size fits all" rule is exempt from RFA analysis, for reasons of its one size, is totally incompatible with the RFA. AMPI *et al* emphasized this point in its February 18, 2005 post-hearing brief to the Administrator (Pooling Standards Brief at 5-6), but without any acknowledgement in the Recommended Decision. The rule of law under the RFA was made more persuasively in a March 8, 2002, letter to USDA from the Small Business Administration on two similar, but "invalid," certifications to avoid making an RFA. The SBA letter is attached to these Exceptions, and we direct the Secretary's attention to the SBA's discussion on page 2, under the heading: "'*All Entities Affected Equally' is an Invalid Basis for Certification.*"

Other than the Administrator's invalid one-size-fits-all conclusion, the certification is not accompanied by the requisite "statement providing the factual basis for such certification." 5 U.S.C. §605(b).

Was it because the Administrator felt that the number of small entities affected was not substantial? AMPI *et al*'s hearing witness testified that the vast majority of 1,200 producer-members of the cooperatives for whom he testified were small business farmers. Metzger, Dec. 8, 2004 Tr. at 827 – 828. The proposed rule, on its face, affects all producers and the Recommended Decision found that there were 5,365 small producers pooled on the Central Order during January 2005. 71 Fed. Reg. at 9016. As further described by Mr. Metzger, the proposed rule would have a uniquely adverse impact on few remaining small cooperative handlers trying to compete in a world dominated by large cooperatives and large proprietary handlers. Tr. 829-832. There would, presumably, be some winners and some losers; but all would be impacted. Mr. Metzger's testimony asserted that the substantial adverse impact on those burdened by the proposed rules did not outweigh the *de mininimus* benefit to others. As elsewhere described in SBA's 2002 letter to USDA (page 3): "While a cost-benefit analysis might help an agency determine the degree of impact on small entities, the mere fact that the benefits outs weigh the cost is not dispostive of impact. In other words, the test for certifications is whether a rule has an impact." In any event, the Administrator did not do a cost-benefit analysis.

Was the Administrator's certification premised on a belief that the economic or regulatory impact on affected small entities was not substantial? If so, it does not appear in any statement providing the factual basis for this conclusion, and such a conclusion would run counter to the evidence, both pro an con, concerning the proposals, as well as counter to the Administrator's findings about the economic significance of conduct the rules were intended to curtail. 71 Fed. Reg. 9011. The recommended decision, moreover, fails to address burdens on small entities subject to milk order rules outside of the Central Market who will be directly affected by amendments.[11] As has occurred each time USDA has tightened pooling standards in a market, some producers shift their supply to another market, resulting in lower producer milk prices.

In short, the Secretary's final decision on review of the Administrator's recommendations should provide either the RFA analysis, or the factual basis for exemption from analysis, which is absent in the recommended decision.

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[11] The rule proposed by the Administrator and subject to the RFA is not merely a few amendments to the Central Milk Order, but rather a new milk order as amended, which in turn is part of a coordinated system of regulation having a significant economic impact on a substantial number of small entities. See 64 Fed. Reg. 16026, 16034-16042 (Apr. 2, 1999) (final RFA analysis). The economic impact of a rule must be measured with the aggregate impact of the proposal on prior burdens. The RFA does not authorize an agency to avoid RFA analysis by building a significant economic burden on small entities brick-by-brick.

LESS BURDENSOME ALTERNATIVES UNDER THE APA AND RFA

As observed in our introduction (p. 2), the RFA and the APA, as construed by federal courts, require articulate consideration of less burdensome regulatory alternatives. For the problem identified as "distant milk," the most extreme regulatory remedy on the table was part of Proposal No. 1, prohibiting the pooling of any milk diverted to a distant nonpool plant (i.e., outside of the historical Central Market milkshed plus New Mexico). 69 Fed. Reg. at 52726. The Administrator's recommended solution to the problem was to require *every* producer's milk to be delivered to a pool plant during six months, regardless of location of the farm, need for the milk, or efficiency of the transaction. There were (and are) several lesser-included alternatives, and permissible "logical outgrowths" of the proposals (*Alto Dairy v. Veneman*, 336 F.3d 560 (7th Cir. 2003); *Fertilizer Inst. v. EPA*, 935 F.2d 1303, 1312 (D.C. Cir. 1991)), that could address the "distant milk" problem with less adverse impact on small producers in the historical Central Market milkshed.[12] These include, but are not limited to: (1) a monthly delivery requirement directed only to milk that was the source (or anticipated to become the source) of the problem – milk originating outside of the historical milkshed; (2) expansion of the permissible diversion geography in Proposal No. 1 to include those areas deemed by the Administrator to constitute possible parts of the "legitimate reserve supply for the marketing area" (71 Fed. Reg. 9022); or (3) requiring distant supply sources to qualify on their own merits by state or geographical "units," as employed by the Secretary for many years in the Northeast Milk Order (7 C.F.R. §1001.13(b)(1)-(2)).

If (contrary to the record) there are other objective market conditions for which greater shipments to distributing plants may be required, such shipments can be required, as needed, without any amended rule simply by exercise of the

[12] As revealed in Ex. 32, the average producer in Idaho would not meet the definition of small business entity. Nor would the average producer in New Mexico or Colorado.

agency's *existing* authority to increase shipments and reduce diversions of milk pursuant to 7 C.F.R. §§1032.7(g) and 1032.13(d)(6). This authority to do on a temporary basis, as needed, what the Administrator now recommends as a permanent rule has not been exercised by the agency nor invoked by request of any handler on the Central Market. 71 Fed. Reg. 9030-9031. The authority of Section 1032.13(d)(6) could also be extended to the "touch base" requirement without imposing a market-wide and perpetual burden on producers.

Finally, proposed rule 1032.13(d)(3) should be eliminated, even if other aspects of the proposed "touch base" requirement can be justified under RFA or APA standards. Subsection 13(d)(2) will cause a producer to loose pool eligibility for *all* milk if the producer's milk is not shipped to a pool plant during any month of August – February (except December). That should be enough. Subsection 13(d)(3) adds to that a six-month touch base penalty period for March – July and December if the producer fails to touch base during any of the prior months of August – February (except December). If this extraordinary economic penalty is necessary for any lawful reason, the Recommended Decision does not explain it.

OTHER FACTORS NOT CONSIDERED BY THE ADMINISTRATOR

The post-hearing brief and proposed findings of AMPI *et al* specifically brought to the Administrator's attention a number of "material issues of fact, law or discretion presented on the record," in response to which the APA requires statements of findings, conclusions, reasons, and basis, 5 U.S.C. §557(c)(3)(A). AMPI *et al'*s post hearing brief also addressed other relevant factors, including important aspects of the problem and of proposed solutions, which the Supreme Court has instructed must also be addressed to avoid "arbitrary and capricious" rulemaking. *Motor Vehicle Manufacturers Association v. State Farm Mutual,* 463 U.S. 28, 43 (1983). The Administrator did not rule on AMPI *et al*'s proposed findings, nor even acknowledge the most significant aspects of the problem addressed in hearing testimony.

Market Foreclosure and Lack of Access to Fluid Milk Sales

The casual observer, hearing of the difficulties with a one-day "touch base" requirement for all producers might, quite logically but naively, question why Central Equity would transport milk 500 miles to comply with the rule when there are several milk plants nearby to which milk can be delivered more efficiently. The response to this question is that access to the relatively few pool plants in the Central Order is very limited; to most plants, pooling access is foreclosed due to institutional factors. DFA and marketing affiliates under its control supplies milk under contract to Dean Foods (which has 9 plants in the Order), Hiland Dairy plants, Roberts Dairy plants, Sinton Dairy and National Dairy Holdings. These plants are not accessible to Central Equity as an independent supplier. AMPI *et al* post-hearing brief at 11-15. Several of these plants are much closer to Central Equity's milk supply than Wells Dairy, and tanker trucks containing milk from Central Equity member farms pass some of these plants on the 500 mile journey to Wells. This is because Wells is one of the few pool plants left in the market that is willing to receive milk from an independent cooperative.

Over the course of several decades, the federal milk order program has consistently embraced policies of pool access and inclusion for dairy farmers in the milkshed, and of marketing efficiency, in creating and adjusting pooling standards as needed to assure adequate milk supplies for fluid use. This history is described in AMPI *et al*'s testimony and post-hearing brief on pooling standards. Similar evidence of market foreclosure and limited pooling access has been confronted by USDA in the past, and treated as a "disorderly marketing condition" deserving of a regulatory remedy. 41 Fed. Reg. 12436 (March 25, 1976) (relying on detailed evidence of exclusive milk supply arrangements, dominant cooperative market share, loss of fluid market access, and availability or loss of pooling base to minority producers to create a remedy). It was, after all, cutthroat competition for fluid markets, and the disorder resulting from some producers' lack of access to such markets, that caused the government to intervene in the milk pricing business in the first place, *Nebbia v New York*, 291 U.S. 502 (1934); *United States v Rock Royal Co-op*, 307 U.S. 533, 573 (1939).

The importance of limited market access as a source of market disorder, or as a good reason for regulatory intervention, is illustrated in court decisions and agricultural economics literature since the New Deal. Shortly after the Agricultural Adjustment Act of 1935 first authorized "fluid milk marketing agreements and licenses, [the Agricultural Adjustment Administration] sought to see that every dairyman had full access to the market regardless of his affiliations with the existing organizations.[13] The U.S. Court of Appeals for the District of Columbia summed it up: "…Congress authorized a price pooling arrangement in order to eliminate revenue disparities among producers due to *varying access to the fluid milk market*…" *Zuber v. Allen*, 402 F.2d 660 (DC Cir. 1968), aff'd 396 U.S. 168 (1969)(emphasis provided).

Proponents of proposal No. 1 are the major suppliers of milk to the fluid market. Like the beneficiaries of the nearby producer differential in *Zuber,* proponents believe that they deserve higher prices, or a larger slice of the blend price pie, to reward them for their market share. They proposed to do this by "reducing the milk that can be pooled and may be pooled in the future." Hollon,

[13] Nourse, Edwin G., Joseph S. Davis, and John D. Black, *Three Years of the Agricultural Adjustment Administration*, at 362 (Brookings Institution, Washington, D.C., 1937), published online at Cornell University, Albert R. Mann Library, Core Historical Literature of Agriculture (CHLA) http://chla.library.cornell.edu/c/chla/index.html (click on "Browse" and alphabetical list of book titles and authors). *See also*, Nourse, Edwin G., *Marketing Agreements Under the AAA,* at 204-09 (Brookings Institution, 1935), also published online on the CHLA website.

Tr. 257-58. Proposal No. 1, then, goes a bit farther than simply offering a smaller slice of the economic pie to producers in the milkshed who do not have ready access to fluid milk customers, as was the case in *Zuber*. The proposal at issue here would deny some producers without ready access to the fluid market even a small piece of the pie. Like intervening producers in *Zuber*, proponents "seek the best of both worlds. Having achieved the security that comes with regulation, they seek a regulatory umbrella to appropriate monopoly profits that were never secure in the unregulated market." *Zuber v. Allen*, 396 U.S. at 181.

Whatever the outcome of agency analysis, limited market access is clearly a "relevant factor" and an "important aspect of the problem" addressed in the record and briefs of the hearing. The Administrator's failure to confront this issue, and include consideration of this factor in his recommendations, constitutes arbitrary and capricious decision-making under the standards of *Motor Vehicle Manufacturers Association*.

The Recommended Decision is not Authorized by 7 U.S.C. §608c(5)(B)(ii).

In *Zuber*, the court dealt with a rule that distributed a disproportionate share of blend price revenues to producers located near major market populations, which tended to preserve nearby producer's revenue edge in an unregulated market. Although nearby producers "are logical fluid suppliers to the urban areas" (396 U.S. at 173 n. 3), and had received higher prices than producers in the outlying milkshed, the Supreme Court held that the nearby producer differential was not authorized by the AMAA. In reaching this conclusion, the Court relied on the Congressional mandate of "Section 8c (5)(B)(ii) [which] requires all uniform prices to be paid "irrespective of the uses made of such milk by the individual handler to whom it is delivered." 396 U.S. at 179-80, fn. 12. The Supreme Court referred, with approval, to the Court of Appeals opinion in *Blair v Freeman,* 370 F.2d 229 (1966)), which invalidated a producer "differential [that] was explicitly linked to the percentage of nearby milk actually supplied to the fluid market." 396 U.S. at 179-80, fn. 12.

The recommendation of the Administrator is that all producers must ship milk at least once per month during August – February to a pool plant, and that at 20 – 25% of each producer milk supply must actually be delivered to Class I (distributing) plants, to qualify for a share in the blend price. These recommendations are admittedly not due to any need of the market for fluid milk (e.g., 71 Fed. Reg. at 90310). The Administrator nevertheless believes that all producers must supply some additional milk for Class I use to share in the blend price, whether the milk is needed or not, and whether access to Class I buyers is available or not. The Administrator stated:

> "Criteria for pooling are established on the basis of performance levels that are considered adequate to meet the Class I fluid needs of the market and, by doing so, determine those producers who are eligible to share in the revenue that arises from the classified pricing of milk. 71 Fed. Reg. at 9016
>
> "only those producers who consistently bear the costs of supplying the market's fluid needs should share in the returns arising from higher-valued Class I sales." 71 Fed. Reg. at 9021
>
> "…only milk of producers who regularly and consistently serve the Class I market is pooled on the order." 71 Fed. Reg. at 9021.
>
> "The recommended amendments should more accurately identify the milk of those producers that provide a consistent and reliable supply of milk to the Class I needs of the Central marketing area…." 71 Fed. Reg. at 9022.

It is unnecessary in this case to examine the breadth of the Secretary's authority to consider Class I use of producers' milk as a condition for pool eligibility where a market is inadequately supplied and access to fluid milk buyers is not limited. That is not the case here. 71 Fed. Reg. at 9030-31.

While Congress saw fit in 7 U.S.C. §608c(5)(B)(ii) to prohibit consideration of the classified use of a producer's milk as a condition of blend price entitlement, it did not leave the Secretary without tools to assure that fluid milk requirements would be met, and to reward those who bear the costs of supplying the fluid milk market. Congress expressly authorized the Secretary to use regulated prices and "market-wide service payments" to ensure adequate milk supplies for fluid use, and to compensate suppliers of milk to the Class I market for any additional or disproportionate costs to serve that market. 7 U.S.C. §608c(18) and §608c(5)(J).[14]

When Congress considered milk marketing orders and marketwide service payment authority in the 1985 Farm Bill – the Food Security Act of 1985 – the supporting Committee Report expressly recognized that producers who incur disproportionately large transportation costs to supply the fluid needs of the market results in those producers "not receiving uniform prices." H.R. Rep. No. 271, Part I, 99th Cong., 1st Sess. 24-25 (1985), *reprinted in* 1985 U.S. Code Cong. & Admin. News 1103, *et seq*. Thus, while requiring payment of a blend price "irrespective" or without regard to classified use of a producers' milk is still "the foundation of the statutory scheme," *Zuber v. Allen,* 396 U.S. at 179, the Secretary can now serve a larger slice of the economic pie to producers who carry a heavier load in supplying the fluid market. He cannot bar other producers from the table altogether.

CONCLUSION

There is no reasoned basis for sweeping amendments that would create extraordinary new expense for a substantial number of small business dairy

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[14] The Administrator elsewhere rejected proposals under this authority for transportation and assembly credits on grounds that the market was adequately supplied, and any possible supply difficulty in the St. Louis area did not justify a market-wide solution. 71 Fed. Reg. 9028-31. A remedy limited to the St. Louis area was not considered, although St. Louis-area fluid milk sales represent over a quarter of market-wide sales, and contributes to the market-wide blend price for all producers. Hearing Exs. 10, 12.

farmers and cooperative associations who have historically been associated with the Central Milk Marketing Area, or deny to them a share of pooled blend price revenue even though their milk is held in available reserve, but not needed for fluid use. Although compulsory inefficiency or farmer exclusion may have resulted from rules where adequacy of supply for fluid use in danger, the proponents and the Administrator have not made the case for sweeping market-wide inefficiency in this case.

The Secretary should terminate these proceedings, or remand to the Administrator to (1) make a Regulatory Flexibility Analysis, with reasoned discussion of less burdensome alternatives, (2) address market access issues and other factors of record not resolved by the decision, and (3) reconcile his recommendations with the requirements of 7 U.S.C. §608c(5)(B)(ii), as construed in *Blair v Freeman* and *Zuber v Allen.*

Dated: April 24, 2006

Respectfully submitted,

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March 8, 2002

Charlie I. Harper, Jr., Chief
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Dear Mr. Harper:

As part of its statutory duty to monitor and report on the FCC's compliance with the Regulatory Flexibility Act of 1980 ("RFA"), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[i] the Office of Advocacy, U.S. Small Business Administration ("Advocacy") has reviewed the Rural Utilities Service's ("RUS") Regulatory Flexibility Act Certification for final rules in two recent proceedings[ii] and found that they do not satisfy the requirements of the RFA.

The RFA permits Federal agencies to certify that a final rule does not have a significant economic impact on a substantial number of small entities and avoid conducting a regulatory flexibility analysis. In the two actions referenced above, RUS certified the final rules pursuant to the RFA, but RUS relies on two invalid reasons for these certifications: (1) all entities are affected equally and (2) the benefit to small businesses outweighs the costs. These reasons contradict the language of the RFA and the intention of Congress. Therefore, RUS cannot base a certification on these reasons.

1. Advocacy Background

Congress established the Office of Advocacy in 1976 by Pub. L. No. 94-305[iii] to represent the views and interests of small business within the Federal government. Advocacy's statutory duties include serving as a focal point for concerns regarding the government's policies as they affect small business, developing proposals for changes in Federal agencies' policies, and communicating these proposals to the agencies.[iv] Advocacy also has a statutory duty to monitor and report to Congress on the Commission's compliance with the Regulatory Flexibility Act of 1980 (RFA),[v] as amended by the Small Business Regulatory Flexibility Act, Subtitle II of the Contract with America Advancement Act.[vi]

2. "All Entities Affected Equally" is an Invalid Basis for Certification

In the System Construction Certification, RUS certifies the rule will not have a significant economic impact on a substantial number of small entities because "Small entities are not subject to any requirements which are not applied equally to large entities."[vii] The idea that compliance with the RFA means not adding additional requirements on small businesses is a common misconception about the requirements of the RFA. Congress specifically addresses this issue in its findings in the RFA:

> "[U]niform Federal regulatory and reporting requirements have in numerous instances imposed unnecessary and disproportionately burdensome demands including legal, accounting and consulting costs upon small businesses, small organizations, and small governmental jurisdictions with limited resources."[viii]

And:

> "the failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity."[ix]

And:

> "the practice of treating all regulated businesses, organizations, and governmental jurisdictions as equivalent may lead to inefficient use of regulatory agency resources, enforcement problems, and, in some cases, to actions inconsistent with the legislative intent of health, safety, environmental, and economic welfare legislation."[x]

These three findings show that Congress knew about tendency of agencies to impose "one-size-fits-all" regulations and specifically rejected it. As Congress states, one-size-fits-all regulations are unnecessary and disproportionately burdensome to small businesses. This has been born out by a recent economic study commissioned by Advocacy.[xi] This study showed that a firm with less than 20 employees shouldered regulatory costs 60 percent greater per employee than firms with more than 500 employees. Because of the disparity of the impact of governmental regulations, the agency cannot certify a rule on the basis that all entities have the small regulatory obligations.

3. "The Benefit to Small Businesses Outweighs the Costs" is an Invalid Basis for Certification

In both the System Construction Certification and the System Installation Certification, RUS certifies the rule will not have a significant economic impact on a substantial number of small entities because the benefit to the regulated entities outweighs the costs. This is an incorrect interpretation of the certification provisions of the RFA. While a cost-benefit analysis might help an agency determine the degree of impact on small entities, the mere fact that the benefits outs weigh the cost is not dispostive of impact. In other words, the test for certifications is whether a rule has an impact.

As Congress states in the findings of the RFA, "the process by which Federal regulations are developed and adopted to should be reformed to require agencies to solicit the ideas and comments of small businesses, small organizations, and small governmental jurisdictions to examine the impact of proposed and existing rules on such entities…"[xii] Congress knew that agencies might not be aware of costs, have the wrong information, or might improperly estimate costs. Agencies cannot certify that the benefits are greater without giving small businesses a chance to comment and share information with the agency.

4. Conclusion

By certifying these two rules, RUS is depriving itself of the opportunity to learn about the rules' impact actions on small businesses. The two listed reasons, (1) that rules affect all businesses equally, and (2) that the benefit outweighs the detriment, are invalid bases for certification as they go against the spirit of the RFA and are contrary to the intention of Congress.

Sincerely,

Thomas M. Sullivan
Chief Counsel for Advocacy

Eric E. Menge
Assistant Chief Counsel for Telecommunications

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[i] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601 et seq.) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).
[ii] Telecommunications System Construction and Specifications, 66 Fed. Reg. 43,309 (2001) (to be codified at 7 CFR Part 1755)(System Construction Certification); RUS Standard for Service Installations at Customer Access Locations, 66 Fed. Reg. 43,314 (2001). (to be codified at 7 CFR Part 1755)(System Installation Certification).
[iii] Codified as amended at 15 U.S.C. §§ 634 (a)-(g), 637.
[iv] 15 U.S.C. § 634(c)(1)-(4).
[v] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (*codified at* 5 U.S.C. § 601 *et seq.*).
[vi] Pub. L. No. 104-121, 110 Stat. 857 (1996) (*codified at* 5 U.S.C. § 612(a)).
[vii] System Construction Certification, 66 Fed. Reg. at 43,309.
[viii] RFA, *supra* note 1, Findings (3).
[ix] RFA, *supra* note 1, Findings (4).
[x] RFA, *supra* note 1, Findings (6)
[xi] W. Mark Crain and Thomas D. Hopkins, *The Impact of Regulatory Costs on Small Firms* (2001).
[xii] RFA, *supra* note 1, Finding (8).