

ATTACHMENT 1

Upper Midwest Order Brief

**UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE**

IN RE:

**MILK IN THE UPPER MIDWEST
AREA; HEARING ON PROPOSED
AMENDMENTS TO TENTATIVE
MARKETING AGREEMENT
AND ORDER**

DOCKET NO. A0-361-A39;DA-04-03

POST-HEARING BRIEF

SUBMITTED BY

DEAN FOODS COMPANY

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I. INTRODUCTION

The hearing record is replete with evidence that the Upper Midwest Milk Marketing Order is facing a significant challenge to its continued vitality. At issue is whether the Secretary will take the steps necessary to comply with her mandate under the Agriculture Marketing Agreement Act of 1937, as amended, to restore equity among handlers and producers in the marketplace and to mitigate these dire circumstances.

The twin evils of depooling and paper pooling strike at the heart of fundamental fairness. Random and frequent depooling as has been observed with increasing frequency since Federal Order Reform in 2000, in particular, represents the epitome of disorderly marketing. Pooling is supposed to ensure that producers receive uniform prices for their milk. Today, pooling standards that are inadequate to handle present circumstances in the Upper Midwest are actually causing the opposite result – non-uniform pricing is per se disorderly marketing.

Under present circumstances, one group of producers and their handlers (manufacturing milk suppliers) participate in the pool when it subsidizes their milk check, but evacuate the pool when it is their turn to subsidize the milk checks of others (fluid milk suppliers). The inequity in this is made worse by the fact that the fluid milk suppliers are forced to remain in the pool by the Secretary's regulations so long as they ship to a fluid milk processor. As a result, fluid milk processors are unable to maintain a stable supply of fluid milk – they are losing producers; they are challenged in their ability to attract additional milk, and they are being forced to pay extraordinary fees to lure milk suppliers away from the prospect of what can only be described as a free lunch program known as pooling and depooling.

Fluid milk processors, particularly smaller ones, find themselves between a rock and a hard place. Pooling was designed to ensure that they can access adequate supplies of milk for

fluid purposes. In exchange, they and their producers are forced to pool. This forced pooling is backfiring and placing fluid milk processors in extremely uncompetitive situations. The Secretary simply must act now to preserve a robust fluid milk industry in the Upper Midwest.

II. ARGUMENT

A. Federal Orders Above All Are Intended To Prevent Destructive Competition Such As Depooling Of The Magnitude That Has Been Taking Place In Order 30 Over Recent Months In Order To Ensure That There Are Sufficient Supplies Of Milk For Fluid Purposes

The case law dealing with the 60-plus years of Federal milk regulation establishes that the “sufficient supply of milk” standard articulated in 7 U.S.C. 608c(5)(18) is a fluid milk measurement that requires steps to ensure that fluid milk processors can obtain milk competitively based upon uniform pricing. *See generally Schepps Dairy v. Bergland*, 628 F.2d 11, 13-16 (D.C. Cir. 1979). *See also* Tr. 467-470 [Evan Kinser]; “The Federal Milk Marketing Order Program,” Marketing Bulletin Number 27 at 7-8, 25) (Revised June 1981).

Indeed, there can be no debate that under the present day statutory framework FMMOs are supposed to ensure a sufficient supply of milk for fluid purposes at the location needed. As the Federal Court for the District of Columbia Circuit explained in *Schepps*, present day FMMOs, which are authorized by the Agricultural Agreement Act of 1937, shored up the efforts by the dairy industry and the Federal government in the first third of the 20th century to address the problems associated with serving the fluid market. In recounting these early efforts, the Seventh Circuit affirmatively recognized that the impetus for these early efforts was the need to protect dairy farmers from the vagaries of milk marketing while ensuring that processors handling milk for fluid purposes would be able to get the milk they needed year round:

(in) order to meet fluid demand which is relatively constant, sufficiently large herds must be maintained to supply winter needs. The result is oversupply in the more fruitful months. The historical

tendency prior to regulation was for milk distributors, 'handlers,' to take advantage of this surplus to obtain bargains during glut periods.

Schepps, 628 F.2d at 14 (emphasis added), *citing*, *Zuber v. Allen*, 396 U.S. 168, 173 (1969).

To correct the discrepancy created by the need to serve the Class I market, the Court explained that Congress first enacted legislation to allow for pooling by cooperatives. *Id.* This solution was unsuccessful due in part to its voluntary nature. *Id.* As a result, Congress intervened with the passage of the Agricultural Adjustment Act of 1933 and amendments in 1935, which according to the Court were adopted to shore up these earlier efforts by the power of the Federal government. *Id.* at 14-15 (the 1935 amendments "can be seen as a shoring, with the power of the Federal Government, of the classified pricing scheme initiated by the cooperatives.").

The 1935 amendments were carried forward into Section 8c of the present day statutory framework, the Agricultural Marketing Agreement Act of 1937 (the AMAA). *Id.* at 15. It follows, therefore, that the present day statutory framework, like early cooperative efforts at pooling and the 1933 Act framework referenced in *Schepps*, provide for the pricing and pooling of milk *in order to ensure that fluid milk plants are able to procure adequate supplies of milk to serve the fluid market.*

Somewhere along the way, it seems the industry has lost sight of this core principle. Instead, the testimony of Associated Milk Producers, Inc.'s (AMPI) witness, Neil Gulden, suggests that FMMOs are designed to ensure that the revenue from Class I milk subsidizes producers of Class III and Class IV milk, and when it doesn't, they somehow have the right to abandon the pool. Nothing can be further from the truth.¹ (Tr. 722:21-25 [Neil Gulden]).

¹ While it is true that participation in FMMOs is voluntary for producers, nothing in the 60-plus history of the FMMO program suggests that the Secretary is prevented from establishing standards, including a requirement to

Revenue sharing through pooling is not about Class I subsidizing Class III or Class IV. Rather, it is about preventing destructive competition among producers so that there is enough milk production year round to serve the fluid needs of the public.

Revenue sharing through pooling gives producers an incentive to supply handlers that are not paying the highest classified price by ensuring that all producers receive uniform prices. It also discourages producers from engaging in cutthroat competition and handler hopping to the handler that is paying the highest classified price. Preventing such cutthroat competition and handler hopping, as the Court indicated in *Schepps*, is important to maintaining an adequate supply of fluid milk year round.

Historically and traditionally, therefore, pooling gave producers serving handlers of manufactured milk an incentive to continue to supply their handler, even when Class I handlers were paying significantly higher classified prices. This is because those producers were assured that they would still receive in their milk check their fair share of the Class I value. It is this historical perspective that seems to cause some of the industry to conclude that Class I must subsidize Class III, and never the reverse.

However, if the Secretary is intent on maintaining marketwide pooling (as opposed to individual handler pools, which Dean Foods believes would be a better solution for a high manufacturing utilization market such as Order 30), the Secretary must remember that, at its core, pooling is intended to minimize handler hopping by producers seeking the highest

commit to shipping for a period of time, in exchange for pool participation. *See, e.g., County Line Cheese Co. v. Lyng*, 823 F.2d 1127, 1133 (7th Cir. 1987) (finding performance requirements are proper). Moreover, the core principle of maintaining adequate supplies of milk for fluid purposes actually requires that the Secretary take such a course of action under the circumstances in Order 30 today because the existing regulations are inadequate. (Tr. 482-484 [Kinser]).

classified price. Thus, the Secretary must reject the view that Class I must subsidize Class III, but not the reverse.

Today, Class I is not always above the other Class prices. As a result, the record is replete with examples of random² pooling and depooling by producers and handlers of manufacturing milk, who are pooling when Class I milk subsidizes their operations and depooling when unregulated prices are more advantageous for producers and their handlers. (Tr. 99 [Sue Beitlich]; Tr. 327, 344 [Dennis Tonak]; Tr. 431 [James Oberweis]).

This random pooling and depooling is now placing producers who supply Class I handlers in a position that is similar (but the reverse) to producers of manufacturing milk in the 1930s – they have an incentive to leave their Class I handler (which in the 1930s would have been the handler of manufactured milk) for the greener pastures of supplying a Class II, III, or IV handler (which in the 1930s would have been a Class I handler) where they can get higher prices by pooling and depooling. The record shows that in some cases they are leaving Class I handlers to do just this. (Tr. 429 [Oberweis]). In other cases, they are demanding compensation from Class I handlers for not jumping to the manufacturing market. (Tr. 356 [Tonak]; Tr. 428 [Oberweis]).

This is the epitome of disorderly marketing. Numerous witnesses testified to this very point explaining that the random and frequent pooling and depooling of producers serving the manufacturing market is disorderly marketing. In fact, such demands for compensation are the direct result of non-uniform prices when Class III or IV handlers depool milk, but pay their producers the classified price. If it is disorderly marketing for Class I handlers, in the absence of

² By random pooling and depooling, we mean it is difficult to forecast when negative PPDs will occur (Tr. 313:7-12 [Dr. Edward Jesse]) and thus when producers and handlers will have an incentive to depool. This unpredictability makes it difficult for fluid milk processors to ensure that they will have an adequate milk supply over time.

pooling, to pay more for their milk than Class III or IV handlers, then it is surely true that the mirror image must also be disorderly marketing. Numerous witnesses testified to this point.

Dr. Edward Jesse testifying as an independent observer (Tr. 305-306 [Jesse]) affirmed his conclusions in Exhibit 27, which said:

A major objective of Federal Order is to assure orderly marketing. The unrestricted ability to pool and depool milk on a monthly basis causing wildly fluctuating PPD's does not fit any definition of orderly marketing. Handlers are not treated equally, the producers do not receive uniform prices.

(Tr. 318 [Jesse]). In addition, numerous other witnesses concurred with this conclusion. (See Tr. 128-129 [James Hahn]; Tr. 154 [Adrian Pehler]; Tr. 236 [Marvin Anderson]). For example, Dennis Tonak explained that the pooling and depooling creates inequity among producers and handlers. "When there are negative PPDs, and the associated Class III depooling, it is very difficult for those supplying Class I in Order 30 to compete with cheese plants." (Tr. 355:17-21 [Tonak]). And Ms. Ledman, Dean's expert, indicated that all out evacuations of milk from the pool, as were observed during 2004, result in disorderly marketing and prevents dairy farmers from receiving uniform prices. (Tr. 620-21 [Mary Ledman]). Indeed, she indicated that depooling has gotten worse in recent years. (Tr. 616:13-25; 620 [Ledman]). These impacts go to the heart of what the Secretary's regulations are supposed to prevent.

For these various participants, the conclusion that depooling was disorderly marketing was based on their various perspectives. Some, like James Hahn were concerned that depooling did not result in uniform prices to producers. (Tr. 128-129 [Hahn]). Others, like Dean Foods were concerned that depooling did not result in uniform prices to handlers and producers. (Tr. 474-480 [Evan Kinser]). Still others, like Oberweis Dairy, were worried about their ability to attract and keep producers while maintaining profitability for their Class I operation. (Tr. 428,

431, 434 [Oberweis]). All of these concerns are legitimate and provide multiple reasons for the Secretary to act to bring Order 30 into compliance with the requirements of the AMAA. And certainly, she has an obligation under the general provisions in favor of uniform pricing for producers and handlers and against disorderly marketing conditions, to take action on an emergency basis.

Thus, the loose association requirements in Order 30 are threatening the ability of Class I processors to procure an adequate milk supply at competitive prices. If the Secretary does not take steps to discourage random pooling and depooling, the Secretary will have abdicated her responsibility to prevent destructive competition. Still further, the Secretary will have abdicated her responsibility to maintain uniform prices to producers and handlers (subject to minor adjustments). Under either scenario, the Secretary must, by law, take action to correct these deficiencies in the Order 30 regulations.

Since this is a major disorder that goes to the heart of the purpose and efficacy of FMMOs, Dean advocates strong medicine. Proposal 1 simply does not provide a remedy for depooling. Proposal 2 is not strong enough. In his testimony on behalf of the Midwest Dairy *et al.*, Mr. Tonak admitted that Proposal 2 was a modest step toward correcting the problem of depooling. (Tr. 855 [Tonak]). Yet, he admitted that the problem of depooling in Order 30 was a significant problem. *Id.* And, Ms. Ledman explained, Proposal 2 had too many loopholes to adequately address the depooling problem in Order 30. (Tr. 660:1-13 [Ledman]). It is for these reasons that Dean Foods cannot support proposals 1 or 2.

Rather, Dean supports proposal 3 as the best solution to the depooling problem in the Upper Midwest. Proposal 4 is Dean's second choice and proposal 5 is Dean's third choice. A

full discussion of these proposals and the modifications that were made to them during the hearing is attached hereto as Attachments 1 and 2 which are incorporated herein by reference.

B. Performance Requirements Must Be Enhanced To Preserve The Blend Price In Order 30

The Secretary must not only act to prevent random and frequent pooling and depooling to preserve the integrity of the Order 30 pool, but she must also take steps to preserve the blend price in Order 30 by enforcing more meaningful performance standards, such as those in Proposal 6 (*see* Attachments 1 and 2 hereto), which will ensure that those producers drawing on the pool, stand ready willing and able to serve the Class I market. (Tr. 497 [Kinser]).

The "blend price" is an integral component of market-wide pooling, which according to USDA is "one of the most important features of a Federal milk marketing order." (*See Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders*, 64 Fed. Reg. 16026, 16120 (Apr. 2, 1999)). As discussed above, it is the means by which the federal program staves off cutthroat competition among dairy farmers seeking to ship to the highest paying handler, while providing dairy farmers with adequate revenue to bring forth a dependable supply of high-quality milk to serve the fluid market. (*See "The Federal Milk Marketing Order Program," Marketing Bulletin Number 27 at 7-8, 25*) (Revised June 1981).

Indeed, when the blend price is diluted by producers participating in the pool, which do not serve the market when the milk is actually needed, but instead take a hike for their higher prices, this places a greater burden on Class I processors to make up the difference through increased premiums. In fact, the record reflects that such has been the case in Order 30. (Tr. 428, 434 [Oberweis]; Tr. 356 [Tonak]). When this happens, the requirement to administer uniform prices among handlers is violated. More importantly, it places some fluid processors in

an uneconomic position competitively. If they make up the difference, they are less profitable than their competitors in this and surrounding marketing areas. This problem is extremely troubling for any business trying to succeed in today's economy, but it is particularly acute for smaller processors. (Tr. 431:16-18 [Oberweis]).

USDA has a long history of recognizing the importance of establishing performance standards to preserve the blend price. Explaining why it is important to prevent unlimited participation in market-wide pools, USDA has justified performance standards noting:

Unlimited participation in a market-wide pool permitted surplus milk from other markets to be shifted to the regulated market. This widespread distribution of pool funds to dairy farmers not regularly associated with the market kept the proceeds from the market's fluid milk sales from serving their purpose of encouraging the production of a dependable supply of high-quality milk by producers regularly supplying the fluid market. Thus, the effectiveness of a market-wide pool in providing orderly marketing and adequate supplies was being undermined.

(See Marketing Bulletin Number 27 at 27). As recently as Federal Order Reform this policy was reinforced when the Secretary considered and rejected unlimited participation in regional milk order pools (i.e., open pooling) again stating:

A suggestion for "open pooling," where milk can be pooled anywhere, has not been adopted, principally because open pooling provides no reasonable assurance that milk will be made available in satisfying the fluid needs of a market.

64 Fed. Reg. 16026, 16130.

Although performance standards might result in additional costs to those seeking to pool their milk, the Secretary simply should not be influenced by such objections in light of the legal considerations cited herein. (Tr. 770 [John Umhoefer]). The Seventh Circuit has itself found that the Secretary is permitted to enforce performance standards to prevent open pooling, even when their enforcement results in additional transaction costs. According to that Court, it is

proper to prevent supply plants from drawing money out of the pool without a reasonable commitment to the Class I market when it cited with approval the following explanation given by the Secretary to justify a performance standard similar but not identical to the one at issue herein:

Pool plant status should not be determined solely on an occasional shipment of milk to the market...[P]lants only casually, or incidentally, associated with the market should not be subject to complete regulation. Neither should they be permitted to share on a pro rata basis the Class I utilization of the entire market without being genuinely associated with the market, then the differentials paid by users of Class I milk could be dissipated without accomplishing their intended purpose.

County Line Cheese Co., 823 F.2d at 1131-32. Recognizing that proof of and availability to service the Class I market was an appropriate prerequisite to pooling for supply plants, that plaintiff did not challenge (and the Court did not discuss) the existence or cost of the shipping requirement. *Id.* More recently, in *Alto Dairy v. Veneman*, the District Court for the Eastern District of Wisconsin was wholly unpersuaded by Alto Dairy's argument that the Secretary acted unlawfully when she increased performance requirements for out-of-area milk, which raised the cost of pooling on Order 33. *Alto Dairy v. Veneman*, Case No. 02-C-750, slip op. at 19 (E.D. Wis. Aug. 29, 2002), *aff'd*, 336 F.3d 560 (2003) (affirming dismissal, but modifying so that dismissal was based on merits and not on procedural lack of standing).

Moreover, the performance standards proposed by Dean Foods, such as a two-day touch base requirement, are reasonable.³ As Mr. Christ explained, proposal 6 will ensure that more Grade A milk remains in the Grade A system and thus is available to serve the Class I market. (Tr. 527-8 [Paul Christ]). As Mr. Christ put it, "[i]t does nothing more than insure that more

³ Note also that the 10-day shipping requirements in proposals 3 and 4, which address depooling, are only imposed if a producer's milk is depooled. No such requirement would apply to a producer that remains associated with Order 30 or another Federal Order. (Tr. 712 [Kyburz]; *see also* Attachments 1 and 2).

milk is actively engaged in the process of serving the fluid market.” (Tr. 527 [Christ]). To the extent it increases transactions costs, the record has demonstrated that these increased costs are offset by the need to address the very real problem of “sham” or “paper pooling.” (Tr. 140 [Hahn]; Tr. 762-763 [Gulden]).

Indeed, there was a general recognition by a number of interested parties that producers should not be pooled if they do not demonstrate a willingness and ability to supply the Class I market through enhanced performance standards. (Tr. 142 [Gulden]; Tr. 528 [Christ]; Tr. 327 [Tonak]). However, the differences of opinion come in because some of the proponents – proponents of proposals 1 and 2 – crafted their proposals so that they only applied to the milk of producers located outside of the Order 30 marketing area. While this is a start, there most certainly is milk from inside of the marketing area defined by Order 30 that is being pooled that is not itself demonstrating a competence to serve the Class I market. If one is going to stand on the principle that milk must demonstrate its ability to serve the Class I market, then one should ensure that this is required of all producers. It is for this reason that Dean advocates Proposal 6 (a two day touch base requirement), which would address “paper pooling” of distant milk and would, to some extent, address the broader problem of pooling without demonstrated service.

C. The Various Proposals: Dean’s Position

In general, therefore, Dean is seeking regulatory changes that prevent random and frequent depooling. Such depooling makes it difficult for Class I plants to maintain a steady supply at competitive prices. Regulatory change is needed to improve equity among producers and among handlers.

Dean’s position on the proposals evolved during the hearing as evidence was presented and has further evolved since the hearing. Indeed, during the hearing, Dean as well as

proponents of other proposals made modifications to some aspects of the various proposals. As such, Dean provides a brief summary of its views on each of the proposals below as modified. In addition, Dean includes a detailed summary of its proposals **as modified** at the hearing, along with references to the place in the transcript where such modifications took place, as attachments hereto.⁴ (See Attachments 1 and 2).

The bottom line is that with an open proceeding regarding what milk could be pooled and under what circumstances, everyone was on notice regarding the real issues. The actual proposals adopted, if any, by the Secretary in response to the evidence presented cannot be affected by when and how a modification was proposed. “Though this is gobbledygook to an outsider, insiders such as the plaintiffs would realize that the focus of the proceeding would be their eligibility to be pooled with the Mideast producers (that is what being “pooled on the [Mideast] order” means).” *Alto Dairy*, 336 F.3d at 570. All could participate and many did. The Court in *Alto* made clear that that is the rule lesson to be learned. It noted that parties could have participated. “Their choice not to do so cannot be attributed to a lack of notice.” Just so

⁴ Several of the questions by proponents of continued depooling suggested that Dean Foods had improperly modified its proposals or provided insufficient advance notice of the evidence that it intended to present in favor of the proposals to limit depooling. Should this hint carry through on brief, Dean notes the legal and practical merit of having actually thought about its positions and modified or refined them modestly in light of the evidence and other parties’ concerns. As has recently been noted by the 7th Circuit Court of appeals, a rulemaking hearing is not simply an up or down vote on existing proposals. “The purpose of a rulemaking proceeding is not merely to vote up or down the specific proposals advanced before the proceeding begins, but to refine, modify, and supplement the proposals presented in the course of the proceeding.” *Alto Dairy*, 336 F.3d at 569. Dean was thus doing precisely what the Court of Appeals noted should be done. Indeed in *Alto* the accusation was made that the Secretary had adopted a proposal that was not noticed or even discussed at the hearing. “What it is true is that none of the proposals was identical to the amendment that the Department adopted at the end of the proceeding, namely the prohibition of paper pooling with distant plants. But paper pooling was one of the principal methods by which the plaintiffs got to pool with the Mideast producers, so that they had to assume that it would be one of the issues in the proceeding and a possible target of reform.” *Id.* at 570. So the implied criticism of Dean is that it actually notified the parties of arguments it may make on brief, thus giving everyone, including the Secretary the opportunity to cross-examine as opposed to studying the modifications to the proposals for the first time on Brief. Such criticism is absurd in light of *Alto*.

As a practical matter, as was noted by Counsel for Dean (Tr. 504) during one of these exchanges, other pending deadlines in the weeks and days leading up to this proceeding, mostly from the Agricultural Marketing Services, but some from Federal courts, made it impractical for the parties to exchange proposed testimony in advance of the hearing – no such requirement exists regardless. Thus since one or more were unprepared to do so, no one did so. For the critics to later claim that Dean alone should have done so is itself incongruous.

participants presented with proposed modifications during a 4 day hearing can and do expect precisely that to occur.

With these modifications in mind, Dean Foods positions on the proposals are as follows:

Proposal 1 (Sponsored by Associated Milk Producers, Inc. (AMPI) *et al.*)

In short, proposal 1 deals with the problem of distant milk paper pooling on the Upper Midwest Order. Proposal 1 is troubling because its proponents freely admit that they are only seeking to fix the problem of paper pooling by distant milk and oppose Dean's efforts to address the problem of depooling because they seek to use depooling to enhance the profitability of their ailing manufacturing plants. (Tr. 678 [Michael Brown]). Dean Foods and other fluid milk processors do not have the luxury of improving plant profitability off the backs of producers because they do not as distributing plants have the luxury of opting out of the pool. (Tr. 469-470 [Tonak]).

Proposal 2 (Sponsored by Midwest Dairymen *et al.*)

Dean opposes proposal 2. This proposal would limit the pooling of producer milk normally associated with the market that was not pooled in a prior month. It would change the pooling requirements for producer milk originating outside of the states where the Upper Midwest marketing area is located, and would limit the transportation credits to 400 miles.

Although it is on the right track in that it seeks to address the twin evils of paper pooling and depooling, it does not go far enough. As Ms. Ledman pointed out, it contains some potentially significant loopholes through which a good procurement person could drive. (Tr. 660 [Ledman]). Indeed, a careful reading of the testimony in support of proposal 2 reveals that "this modest solution" to "a significant problem" is the product of compromise. (Tr. 849 [Tonak]).

As a result, this proposal will likely curtail these twin evils as to many industry participants, but not as to all industry participants.

**Proposal 3 - The Dairy Farmer for Other Markets Provision (Full Year Version)
(Sponsored by Dean Foods)**

For a full explanation of the purpose and mechanics of Proposal 3, as modified at the hearing, please reference Attachments 1 and 2, which are attached hereto and incorporated herein by reference.

Dean most staunchly supports Proposal 3, especially if it is adopted in conjunction with Proposal 6. Proposal 3 is the one proposal directed at the depooling problem that does not leave open gaping loopholes. Thus, it will advance the objectives of the many interested parties whom are interested in making a decision to depool a considered one. Moreover, proposal 3, by providing producer milk with instant access to the Order 30 pool during the next month if 10 days' milk production is shipped to a distributing plant, addresses the flaw in the producer for other markets provision adopted in Order 1. Unlike the Order 1 producer for other markets provision, Order 30 milk that was depooled will not be cast upon another Order's pool for some waiting period. Repooling can be immediate, so long as there is demonstrated service to the Class I market. (Tr. 492-493 [Kinser]).

**Proposal 4 - The Dairy Farmer for Other Markets Provision (Seasonal Version)
(Sponsored by Dean Foods)**

For a full explanation of the purpose and mechanics of Proposal 4, as modified at the hearing, please reference Attachments 1 and 2, which are attached hereto and incorporated herein by reference.

Dean supports Proposal 4, and while it can be adopted as a standalone provision, intends for it to be adopted in conjunction with Proposal 6, as its second choice. Proposal 4, while it

does not go as far as Proposal 3 toward addressing the depooling problem, it goes further than Proposals 1 and 2. Thus, it will also advance the objectives of the many interested parties whom are interested in making a decision to depool a considered one.

Proposal 5 – The Gradual Repooling Provision (Sponsored by Dean Foods)

For a full explanation of the purpose and mechanics of Proposal 5, as modified at the hearing, please reference Attachments 1 and 2, which are attached hereto and incorporated herein by reference.

Dean supports Proposal 5, and while it can be adopted as a standalone provision, intends for it to be adopted in conjunction with Proposal 6, as its third choice for resolving the depooling problem in Order 30. Proposal 5, while it does not go as far as Proposals 4 or 5 toward addressing the depooling problem, it goes further than Proposals 1 and 2. Thus, it will also advance the objectives of the many interested parties whom are interested in making a decision to depool a considered one.

Proposal 6 – The Touch Base Provision (Sponsored by Dean Foods)

For a full explanation of the purpose and mechanics of Proposal 6, as modified at the hearing, please reference Attachments 1 and 2, which are attached hereto and incorporated herein by reference.

Dean strongly supports the adoption of proposal 6. Dean believes that proposal 6 should be adopted in conjunction with Proposal 3 (or alternatively in conjunction with Proposals 4 or 5). Together Proposal 3 (or alternative Proposals 4 or 5) would go a long way towards addressing the problem of depooling (Proposal 3 or 4 or 5) and the problem of ensuring that milk that is pooled is actually competent to serve the fluid market if called upon. In the absence of adopting either proposal 3 or 4 or 5 Dean still strongly supports adoption of proposal 6.

Proposal 7 – Administrative Assessment Adjustment Provision (Sponsored by the Market Administrator)

Proposal 7 would give the Market Administrator the authority to increase the administrative assessment charged to handlers in exchange for services rendered by his office if a funding increase became necessary. Dean certainly would not oppose the Market Administrator's effort to adequately fund his office so that his staff can perform the many important functions they perform for handlers and producers on a daily basis. However, Dean respectfully urges the Secretary to adopt Proposal 3 as a solution to the Market Administrator's funding problem. The Market Administrator has himself recognized that the random depooling and swings in assessable volumes of milk is what is causing his office's funding shortfall. Proposal 3 (or alternatively Proposals 4 or 5) would go a long way toward discouraging frequent and random depooling. This is important to Dean Foods because if the Market Administrator is actually forced to raise the administrative assessment during months in which depooling takes place, fluid milk processors are being doubly hurt by depooling. Our supplier patrons are hurt by a diluted blend price when the producer price differential is positive, an unsupported blend price when depooling takes place, and now an additional tax that is not borne by the free riders. As indicated during the hearing, Dean asks that if the Secretary is inclined to adopt Proposal 7, that she make modifications that give the Market Administrator the discretion to insulate continuous poolers from the added assessment. (Tr. 537:10-25 – 539:1-18 [Christ & Kinser]). But the very fact that the Market Administrator has this funding problem and the fact that he felt it necessary to make this proposal demonstrates most dramatically the unfairness and disorderly marketing caused by depooling. The fact that this proposal was made and the financial consequences leading to it and resulting from it prove beyond doubt that the Secretary must take dramatic action to address the depooling issues in Order 30.

Proposal 8 - (Sponsored and now Withdrawn by Dean Foods)

Dean's support for proposal 8 as originally introduced and as modified is withdrawn. At the hearing certain participants clearly opposed proposal 8 as originally presented. In an effort to accommodate those objections (further evidence that at this rulemaking Dean was attempting to respond during the hearing to issues and concerns raised during the hearing) Dean agreed to modify proposal 8 to limit its scope and impact. Upon reflection after the hearing and in preparing this Brief, Dean does not believe that the modifications improved the proposal and in fact vitiated the desired result. However, having agreed at the hearing to the modification, the only fair and proper course at this time (as opposed to returning to Proposal 8 as originally presented) is for Dean Foods to withdraw support for the modified proposal 8.

D. The Disorderly Marketing Conditions In Order 30 Require That The Secretary Act On An Emergency Basis And Cannot Nor Should Not Await A National Hearing

The pooling problems facing the industry in Order 30 are real and substantial and should be recognized as an emergency. (Tr. 666 [Ledman]). In general, the participants that did not think the depooling problem is an emergency are those entities who wish to continue to take advantage of the pooling and depooling option so that they can fund their plants off the backs of Class I processors and/or their producers.

For instance, Mike Brown of Northwest Dairy Association testified: "[w]e are not a particularly profitable co-op as far as our manufacturing plants are concerned, and our concern is that our chance to make ourselves whole, if we don't address the margin issues, its goes away, if we regulate depooling and do not address some of our cost challenges, which haven't been

looked at since 2000.”⁵ (Tr. 678:10-17 [Brown]). Similarly, Neil Gulden of Associated Milk Producers testified against repooling restrictions because they would adversely impact cheese plant returns as well. (Tr. 722:16-25 [Gulden]).

Still worse, their motives are not even as straightforward as “we benefit from depooling and repooling.” They appear to be even more intricate and to have virtually nothing to do with the question of whether repooling restrictions are needed to prevent disorderly marketing conditions, which is and should be the issue before the Secretary. For instance, Mr. Brown of Northwest Dairy Association admitted on cross examination that his organization has other concerns relating to their manufacturing operations that the Secretary has not addressed and which might get some attention if there were a national hearing addressing “all Class III and IV issues.” (Tr. 679:1-12 [Brown]).

Similarly, the AMPI coalition seemed to have a similar motive in calling for a national hearing, although it also possible that their calls for a national hearing were more in the nature of a red herring. In particular, Mr. Gulden testified that the hearing was ill-focused. Instead of focusing on depooling he explained, the Secretary should hold a national hearing and address the causes of depooling. Specifically, he explained that negative Producer Price Differentials (PPDs) cause depooling and that negative PPDs are caused by price inversion which is caused by advanced pricing. (Tr. 718-719; 720:2-6 [Gulden]). However, Mr. Gulden’s effort to suggest that advanced pricing, which was a national issue, could and should be addressed in a national

⁵ While NDA’s margin issues may and probably do merit USDA attention, the Secretary should deal with that issue directly and perhaps expeditiously as well. However, she simply cannot let such issues stand in the way of a solution for Order 30 handlers and producers who have indicated an urgent need for help.

hearing and thus should be the basis for delaying a decision on depooling until after a national hearing completely misses the point.⁶

It is true that negative PPDs cause depooling.⁷ What is not true, however, is that advanced pricing is the only cause of negative PPDs (and thus depooling). Rather, as Ms. Ledman and Mr. Ed Jesse testified, negative PPDs are more likely to occur in markets with low Class I utilization – it is the relative prices and utilizations of Class II, III, and IV milk which can cause negative PPDs even in the absence of price inversion. (Tr. 314:11-25 – 315:1 [Jesse]; Tr. 638, 658 [Ledman]). This is an Order specific issue and does not involve national issues. Additionally, the record reflects that there are other reasons why negative PPDs occur. (Tr. 314 [Jesse]; Tr. 638, 658 [Ledman]; Tr. 847-849 [Tonak]; *see also* Tr. 765 [Gulden]: Mr. Gulden agreeing that price inversion is not the only cause of negative PPDs).

An attempt to address each of the causes of negative PPDs in a national hearing will no doubt be a massive undertaking and there is no telling if all of the causes could be corrected. However, we do know that the substantial problem of disorderly marketing conditions in the Upper Midwest could be significantly improved if depooling were discouraged by repooling limitations. Given the uncertainty that a national hearing could somehow do away with negative PPDs and the financial incentive to delay for those seeking a national hearing, the Secretary should reject such pleas.

⁶ It also belies the Secretary's finding as part of FMMO reform that advanced pricing would better serve Class I processors in their dealings with retail customers. Moreover, it belies the fact that the only concession Class I processors receive in exchange for forced pooling (Tr. 392:17-25 – 393:1-4; 408:15-17; 452:12-15 [Tonak]) is advanced pricing.

⁷ A negative PPD is simply a calculation that measures whether the blend price is higher than the Class III price. (Tr. 309 [Jesse]). When the blend price is not higher than the Class III price, the PPD is negative. *Id.* Producers look at the PPD for purposes of ascertaining whether they could get a better price by depooling. What is important for purposes of this hearing is that even though the negative PPD cannot be equated to a "loss," producers react to it as if it were. (Tr. 428-9 [Oberweis]).

Giving the opponents of repooling limitations more time to exploit the depooling problem and slowing down the process for entities that seek to bootstrap their issues in a national hearing simply is an unacceptable response to a clear and extreme case of disorderly marketing.

Moreover, the issue of performance standards is not the kind of issue that should be addressed in a national hearing. USDA acknowledged this as part of a lengthy process known as Federal Order Reform. Specifically, USDA affirmatively concluded that pooling issues, such as performance standards, were not the kind of issues that lent themselves to standardization across Orders. Thus, for example, with respect to diversion limitations, the Secretary attempted to tailor the rules to fit the needs of a particular market. 64 Fed. Reg. 16,026, 16,133.

To change course, at this time in favor of standardization of performance requirements across all Orders, when USDA has already begun the process of reviewing pooling standards in other Orders, would require a showing of substantial new evidence that would justify treating all Orders the same. *Motor Vehicle Mfrs. Assn. v. State Farm Mutual Auto Ins. Co.*, 463 U.S. 29, 57 (1983) (“...an agency changing its course must supply a reasoned analysis....”). The hearing record is devoid of such evidence. Moreover, such an action would be unwise in light of the uniqueness of the various Orders. Indeed, as Ms. Ledman testified, the problem of depooling is much more significant in the Upper Midwest than in the Southeast and Florida Orders and that one could make the case that those Orders did not need a depooling solution at this time. (Tr. 638 [Ledman]). As part of her answer, she alluded to the fact that the Orders with higher volumes of manufacturing milk, such as the Upper Midwest, were where the pressing need existed. (Tr. 638; 664 [Ledman]). Indeed, Ms. Ledman testified that depooling has been more egregious in the Upper Midwest in recent months. (Tr. 664 [Ledman]). Finally, such inaction will have wasted the resources of the hearing participants. If USDA wants meaningful

participation from the industry, they simply cannot call a hearing only to say they should have had a different hearing and thus take no action.

The record is replete with evidence that the frequency and magnitude of pooling and depooling in the Upper Midwest has created disorderly marketing conditions and that the problem is worthy of emergency treatment, the question USDA must answer is whether they wish to put a Bandaid® on the problem or solve it. Dean Foods advocates a solution, not a Bandaid®. And, in order for a solution to be meaningful, USDA should act on an expedited basis by omitting a recommended decision and implementing a rule on an interim basis.

E. Some Of The Other Concerns Raised By Opponents Of Meaningful Repooling And Performance Requirements Are Less Concerning Than They Appear At First Blush And Thus Should Not Undermine Dean's Proposals

The opponents of the meaningful repooling limitations and performance requirements proposed by Dean Foods raised concerns that ring hollow when carefully scrutinized. A few are worth mentioning.

(1) It is important to recognize that repooling would only become more rigorous if a producer's milk is depooled. Milk that maintains its association with Order 30 or any other Federal Order would never have to ship 10 days' milk production in order to participate in the Order 30 pool.⁸ (Tr. 712 [Paul Kyburz]).

Moreover, to the extent a producer that depooled from FMMOs altogether is seeking to repool on Order 30, the record reveals that finding a fluid milk processor to accept 10 days' milk production should not be as difficult as the opponents would suggest. But, before addressing this

⁸ In the interest of fairness, Dean believes that if such a rule were adopted, it should apply prospectively. Thus, it may be appropriate for the Market Administrator to provide handlers with a brief grace period within which to make adjustments. For the first month of adoption the Market Administrator should consider in place of "11" the use "1" and increase to "2" the second month and so on until the number is up to the proposed "11".

point, Dean reminds the Secretary that Dean has proposed meaningful repooling requirements precisely because the process of repooling should be costly and just difficult enough to give handlers and producers pause when they are considering whether to depool in the first place. (Tr. 566 [Christ & Kinser]).

That said, contrary to the unsupported and speculative suggestions that repooling in the Upper Midwest will be unattainable (Tr. 773 [Umhoefer]), the record reveals quite a different story. There are 23 distributing plants pooled on Order 30. (Ex. 12, Table 1). And, although some distributors, like Dean Foods have supply contracts with particular entities, they can and do receive their milk from multiple sources.⁹ (Tr. 567 [Christ & Kinser]). Moreover, handlers like Oberweis Dairy deal with independent producers directly. And, as Mr. Oberweis indicated, his plant just recently lost two suppliers reacting to the negative PPD (Tr. 429 [Oberweis]) – a block of milk seeking to repool could no doubt avail itself of the opportunity to supply Oberweis Dairy. Moreover, the record reveals that the Upper Midwest remains a competitive marketplace where producers have the luxury, in many instances, of moving from one handler to another with little or no notice. (Tr. 601:14-20 [Christ]). Still further, there is evidence that recently, when Class I handlers needed milk and attempted to procure milk from a Class III handler, they were rebuffed. (Tr. 357 [Tonak]).

It is simply incongruous to have record evidence that distributing plants are losing producers to manufacturing plants and cannot get milk when they ask for it, and to claim that it would be somehow difficult to locate a distributing plant willing to take 10 days' milk production.

⁹ Conclusions about the nature of Dean Foods' milk supply agreements simply cannot be drawn from the introduction of Exhibit 33, which comprises excerpted portions of Dean Foods 2003 annual report discussing Dean's milk supply arrangement with DFA. The references to Dean's milk supply arrangements are summaries only and as such are certainly incomplete for purposes of evaluating Dean's ability to procure milk from alternative suppliers.

(2) Opponents of Dean's proposals have expressed a concern that the Dean proposals impose a burden and a cost on individual dairy farmers when handlers are the ones making the decision of whether to pool or depool. (Tr. 591-592 [Christ]). There are some relatively straightforward ways resolve these concerns. First of all, the Upper Midwest remains a "producer's market" akin to a "seller's market" in real estate. (Tr. 601 [Christ]). As such, producers can demand hold harmless provisions. Even if they don't, it is because the Upper Midwest is such a competitive marketplace the economic reality is that a handler, if he wants to keep that producer, will pay the producer the pool price if the pool price was the competitive price. Moreover, the very fact that USDA found it appropriate to adopt a similar provision in Order 1 demonstrates that the Secretary has determined that such provisions do not unfairly burden individual producers.

(3) Finally, there was some concern expressed over Dean's proposal to define what temporary loss of Grade A status means in section 1030.13. Specifically, the major concern expressed was what happens in those situations in which a producer experiences a true catastrophe and simply cannot get his operation back up and running within 21 days. (Tr. 592 [Christ]). This concern can be resolved with some minor modifications by the Secretary.

By adding this definition, it was Dean's intention to close yet another potential loophole that might be used by a producer to depool, while avoiding the repooling ramifications that Dean is proposing in Proposals 3, 4, or 5. Currently, temporary loss of Grade A status is undefined. Dean's proposal is an attempt to give the Market Administrator a clear definition of what "temporary" should mean. (Tr. 502-503 [Tonak]). It is not Dean's objective to cause a producer that has genuinely faced a catastrophe to remain depooled if Grade A status is recovered outside of the 21 day period.

As such, Dean is supportive of a modification that would provide the market administrator with discretion to look beyond the surface to determine whether or not the producer's degrade was the result of a genuine catastrophe or was an intentional attempt to circumvent repooling requirements after depooling. In this vein, Dean would be supportive of some provision akin to section 1030(7)(i) being applicable to section 1030.13.

III. CONCLUSION

For the foregoing reasons Dean Foods urges adoption of proposals 3 and 6. Alternatively, Dean Foods urges the adoption of proposals 4 and 6 or proposals 5 and 6. If the Secretary declines to adopt proposals 3, 4 or 5 Dean Foods nevertheless urges the adoption of proposal 6. Moreover, Dean Foods urges emergency action by the Secretary in order for her to operate the Upper Midwest Order according to her statutory mandate.

Respectfully submitted,

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