

DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE
DAIRY PROGRAMS

Milk in the Northeast Marketing Areas;)	
Hearing on Proposed Amendments to)	Docket Nos.: AO-14-A-70; DA-02-01
Tentative Marketing Agreements and Orders)	Hearing September 10 – 13, 2002
)	Alexandria, Virginia
)	

BRIEF

**On behalf of
Friendship Dairies**

Friendship Dairies files this Brief and Proposed Findings of Fact and Conclusions of Law with respect to the pooling qualification standards and revenue sharing provisions of the Northeast federal milk marketing Order Number 1 (7 C.F.R. Part 1001). Pooling provisions of federal milk orders determine which producers share in the revenues from minimum pricing, and therefore most directly affect the rights of dairy producers. However, the handlers who pay for the raw milk are also affected by pooling decisions made by the United States Department of Agriculture (the "Department") because producers' access to the market revenue pool is achieved solely through marketing milk to or through regulated handlers. Producers who market milk to handlers who are unable to pool milk cannot share in the market's "uniform" producer price except by the grace of, or payment of tribute to, pool handlers who have excess qualification to offer in the market.

The Department's general charge is to establish and maintain orderly marketing conditions. 7 U.S.C. § 602(1). In order to meet this statutory obligation, the Department's specific duties in structuring federal milk orders, 7 U.S.C. § 608c(5), include: (1) to provide uniformity of treatment of handlers, subject to classification of milk use, (2) to provide uniform

prices to producers regardless whether their milk is marketed for Class I, II, III or IV use, and (3) if supplying the Class I market or disposing of surplus milk results in disproportionate service costs to market participants, to redistribute marketwide pool revenues so that the uniformity objectives of (1) and (2) are better realized.

At issue in this hearing are the rules that determine circumstances under which producers may share in milk revenues and “uniform prices” under the Northeast Order, and whether marketwide service payments should be made from the revenue pool because a disproportionate cost to service or balance the Class I market is borne by some market participants. Current pooling provisions were adopted through the process known as Federal Order Reform, an informal rulemaking process required by Congress and resulting in a significant reduction, primarily through merger, of the number of federal milk orders. 64 Fed. Reg. 16025 (Apr. 2, 1999). The reform process produced some awkward and unintended results: hardship for some producers and handlers, windfall for others, and a period of adjustment for all.

Most significantly, the reformed milk order system eliminated location adjustments to producers based on distance of the receiving plant from the primary market, and adopted instead a national pricing grid for both Class I milk (7 U.S.C. §608c(5)(A)) and for producer blend prices (7 U.S.C. § 608c(5)(B) and (5)(L)).¹ Because prices were no longer reduced to producers at distant plants based on real value to the primary market, cooperative associations soon learned to exploit reform rules by pooling milk from very distant locations.

¹ Subsection (L) states “that adjustments in payments by handlers under paragraph (A) need not be the same as adjustments to producers under paragraph (B) with regard to adjustments authorized by subparagraphs (2) and (3) of paragraph (A) and clauses (b), (c), and (d) of paragraph (B)(ii).”

At this hearing, as in prior hearings across the country, pooling provisions have been targeted as the whipping boy to address marketing problems caused by blend price distortions at locations distant to the primary market. See Schanback, Tr. 1246-47.

In each of the geographically large consolidated markets, with varying supply and demand conditions, the one-size-fits-all pooling standards have made market association easier in some regions and more difficult in others. For the former New York market, pool access for producers has sharply decreased as reform rules forced many former pool manufacturing plants off the regulated roster, aggravating shrinkage in plant numbers and handler diversity. Indeed, cooperative and handler consolidation has accelerated since federal order reform, and even since the hearing last September to a degree that the record no longer has integrity as a reflection of current marketing conditions. Post-hearing consolidation and changes in marketing practices are so significant that the hearing should be re-opened, as discussed more fully below.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Friendship Dairies proposes the following findings of fact and conclusions of law and requests that the Department make a ruling on each proposed finding under the provisions of the Administrative Procedure Act, 5 U.S.C. § 557(c), and the Rules of Practice, 7 C.F.R. §900.12(b).

1. The number of regulated handlers operating in the Northeast Federal Milk Market, and its three predecessors, has declined dramatically in the past 15 years -- 150 in 1988; 94 in 1999 (pre-reform); and 62 in 2001. FMMOS, Annual, 1989 and 2001.

2. The number of regulated distributing plants operating in the Northeast Federal Milk Market, and its three predecessors, has declined dramatically in the past 15 years -- 101 in 1988; 66 in 1999 (pre-reform); and 62 in 2001; and 60 at the time of the September hearing. FMMOS, Annual, 1989 and 2001; Hearing Exhibit 5.

3. Many of the remaining distributing plants are owned by large corporate processing companies such as Dean Foods (West Lynn, Garelick, etc.), National Dairy Holdings (Crowley Foods, etc.), HP Hood, and Parmalat. Ex. 5; see also attachments from company web sites.

4. In November 2002, HP Hood and DFA-owned National Dairy Holdings announced merger plans, and reportedly plan for exclusive supply to Hood plants by DFA, replacing its current supplier, AgriMark. See attached news article. Official notice of this commercial fact is requested.

5. Class I marketing opportunities for smaller cooperatives and independent producers were further reduced, and dramatically so, as of January 1 of this year, by the new Dean Foods and DFA alliance under which Dean Foods ceased operations as a pooling handler, releasing its procurement functions to DFA and affiliated DMS (Dairy Marketing Services) cooperatives. See Cheese Market News, "Dean Foods is using DMS to manage independent milk" (Jan. 17, 2003); Letter of January 7, 2003, from Richard Lentz, Director of Milk Procurement, Dean Foods ("Effective January 2003, Dean Foods will be outsourcing its milk procurement functions to Dairy Marketing Services.").²

² This event is, obviously, not "of record" in the Northeast Market rulemaking proceeding, but (together with the HP Hood/NDH merger) is such a significant development that the integrity of the September 2002 record as a reflection of current marketing conditions is in serious question. For this reason, among others, the hearing should therefore be reopened. The Secretary should also undertake a thorough investigation of "whether or not there has been any abuse of the privilege of exemptions from the antitrust laws" (7 U.S.C. § 608d), employing the incorporated tools of investigation under the Federal Trade Commission Act (7 U.S.C. § 610(h)).

6. The number of regulated supply/manufacturing plants operating in the Northeast Federal Milk Market, and its three predecessors, has declined dramatically in the past 15 years - 32 in 1988; 21 in 1999 (pre-reform); 12 in 2001; and 11 at the time of the September hearing. FMMOS, Annual, 1989 and 2001; Hearing Exhibit 5. This reduction in pooled market outlets for producer milk has made it difficult for producers to qualify and for distributors to find sources of supplemental milk. Buelow, Tr. 1181-82; Arms, Tr. 1296-97.³
7. One of the regulated supply plants that has been forced off the roll of regulated plants in the market, by federal order reform changes and limited Class I marketing opportunities in the western part of the market, is Friendship Dairies.
8. Friendship, a small business entity, was pooled as a supply plant for four decades prior to federal order reform, serving as a market by which its 125 producer-patrons could share in the revenue pool. Schanback, Tr. 1199-1200, Ex. 33.
9. Friendship's plant is unique in that it manufactures products that fall into every Class in Federal Market Order One. The vast majority of milk received at the plant in Friendship, New York is used as Class II to manufacture Cottage Cheese, Sour Cream and Yogurt, with much smaller quantities going into products considered Class III. Friendship also produces a significant amount of Class I Cultured Buttermilk; and Nonfat Dry Milk to balance its milk supply. *Id.* Its Class I use is of insufficient volume to qualify the plant as a pool distributing plant.
10. Friendship has long supplied milk for fluid use, when needed by other Class I plants, when there was a "call" under pre-reform procedures. Tr. 1201, 1210.

³ Testifying in favor of a 7(c) solution to a perceived 9(c) problem, Mr. Arms curiously complained that there are "fewer and fewer sources of reserve milk supply for fluid milk handlers...", but advocated making it even harder for supply plants to serve the market.

11. Under reform pooling rules, to qualify as a supply plant, Friendship would need to ship a fixed percentage of milk to a pool distributing plant, although there is no need for the milk, no demand for milk from Friendship's relatively distant location from most plants, and most distributors receive a committed supply from other suppliers.

13. Under reform pooling rules, Friendship would have to make redundant performance for its receipt of milk from cooperative associations whose milk has already qualified for the pool through the cooperative. This has the effect of pyramiding Friendship's shipments to qualify as a supply plant. Tr. 1202-06.

14. Proposal 8 cures this unreasonable performance redundancy by excluding pre-qualified cooperative milk from the volume of receipts upon which a supply plant must make shipments in order to offer a pool plant market to the region's dairy farmers. Id.

15. As written, post-reform pooling rules also require Friendship to make shipments to pool distributing plants for Class I and II use, purportedly to serve the Class I market, on the volume of milk Friendship itself uses in Class I. Pre-reform, Friendship was logically credited with serving the market's Class I needs by its own Class I use. This was apparently an oversight in the reform efforts to find a one-size-fits-all solution to pool qualification. Tr. 1206 – 09.

16. Proposal 9 would help restore equity and reason in dealing with Friendship's unique processing niche in the Northeast, and provide more efficient marketing opportunities for the regions dairy farmers. With modifications explained in testimony by Mr. Schanback (Tr. 1208 - 09), no partially regulated distributing plant that is primarily engaged in processing and packaging fluid milk products would become regulated involuntarily.

17. A very large portion of producer milk shipped to distributing plant is committed by 9(c) cooperative full supply contracts, partial supply commitments, and patrons under contract with a distributor. E.g. Gallagher, Tr. 711-18, 796-97; Fitchett, Tr. 1153-54. ADCNE and NYSDF

proponents of greater forced shipments of supply plant milk or decreased diversion limits did not disclose the volume of committed milk, or the supply shortfall (if any) in relation to Class I needs not served by committed supplies, as is their burden. (5 U.S.C. §556(d)(“...the proponent of a rule or order has the burden of proof”).

18. The volume of supply plant milk as a percentage of uncommitted reserve needed to supplement committed milk for Class I use, however, is presumably very small in relation to the market’s Class I utilization.

19. Milk shipped to qualify, when not needed (if an accommodating buyer can be found), simply displaces an existing or committed supplies to the buyer, which must then be transported for surplus disposition at great cost to market-wide efficiency. See: Gallagher, Tr. 854; Schanback, Tr. 1203; Buelow, Tr. 1174, 1187-89; Fitchett, Tr. 1156-58, 1174.

20. With fewer pool plants qualified in the post-reform market, greater diversions are needed to accommodate producer milk that must now be reported as diverted but was previously reported as a pool plant receipt, and the proposal for two days’ touch base for individual producers should be rejected. Buelow, Tr. 1179-82. Alternatively, delivery to any Grade A plant (pool or nonpool) in the Northeast, to demonstrate availability for fluid use, should qualify for touch base purposes.

21. The pre-reform New York market operated efficiently and effectively with greater diversion and pooling flexibility. It is reasonable to conclude that if there is a problem today, and that problem has not been forced by those advocating a regulated fix in order to gain market power, the problem does not lie with supply plant performance rules.

22. The standard for supply plant performance should be 5 to 10% during the late summer and fall months, with automatic qualification during other months, as proposed in Proposal 10.

A short-term genuine need for additional milk can be effectively made during any month by a “call” (administrative adjustment) of required shipments. Schanback, Tr. 1209-13.

ADDITIONAL COMMENTS

The guiding philosophy advocated by some proponents of more restrictive pooling is based on a perception that the primary purpose of federal milk orders is to secure an adequate supply of milk for fluid use, and once this is done, other milk should be excluded or at least burdened with extra costs for the privilege of market association. This philosophy has no foundation in law or history. The primary purpose of the milk order provisions of the AMAA is to share milk revenues among producers in a milkshed, whether milk is needed for Class I use or not.

The ‘grandfather’ of court decisions describing the need for government intervention is the U.S. Supreme Court case of *Nebbia v. New York*, 291 U.S. 502 (1934) which described the “milk problem” at pp. 517-518 as follows:

Close adjustment of supply to demand is hindered by several factors difficult to control. Thus surplus milk presents a serious problem, as the prices which can be realized for it for other uses are much less than those obtainable for milk sold for consumption in fluid form or as cream. A satisfactory stabilization of prices for fluid milk requires that the burden of surplus milk be shared equally by all producers and all distributors in the milk shed. So long as the surplus burden is unequally distributed the pressure to market surplus milk in fluid form will be a serious disturbing factor.

A similar explanation of the need for government intervention was made in the *Rock Royal* case four years later, the first federal milk order issue decided by the Supreme Court.

The desirability of pool eligibility for producers regardless of Class I need for their milk or share of Class I market is more than historical philosophy, it is a statutory mandate. A significant part of the statutory scheme for promoting orderly marketing is allowing producers

of surplus milk and Class I milk alike to share in a uniform blend price, no matter how great the surplus. To achieve this result the act requires:

...payment to all producers and associations of producers delivering milk to all handlers of *uniform prices* for all milk so delivered *irrespective of the uses made of such milk* by the individual handler to whom it is delivered.

7 U.S.C. §608(c)(5)(b)(ii)(emphasis supplied). Such sharing of proceeds in the form of uniform producer prices is “the foundation of the statutory scheme.” *Zuber v. Allen*, 396 U.S. 168, 179 (1969). Courts, when asked to examine provisions that discriminated between producers, have emphasized the primary objective of price uniformity is “[t]he core of the Congressional program.” *Blair v. Freeman*, 370 F.2nd 229, 237 (D.C. Cir. 1966); *see also*, *Block v. Community Nutrition Institute*, 467 U.S. 340, 341-42 (1984)(a primary purpose of the AMAA is “to assure that the benefits and burdens of the milk market are fairly and proportionately shared by all dairy farmers.”).

The 1962 “Nourse Report” (Report of the Federal Milk Order Study Committee to the Secretary of Agriculture) also addressed the need to accommodate all reasonably available milk supplies on policy and economic grounds. While noting that large surplus milk supplies could present problems, the report cautioned (at p. 67) that “the only alternative for such supplies may be the *even more disruptive status of milk without a market or at least without a share of a Class I outlet.*” The “Nourse Report,” as it became known after Committee Chairman, Dr. Edwin Nourse, has been cited as authoritative by the Secretary (*e.g.*, *In re: Borden, Inc.*, 46 Agric. Dec. 1315, 1410-1420 (1987), *aff’d, sub. nom, reported at* __ Agric. Dec. ____ (N.D. Tex., __), by the United States Court of Appeals for the District of Columbia Circuit (*Schepps*

Dairy, Inc., v. Bergland, 628 F.2d 11 n. 85 (D.C. Cir., 1979), and by the United States Supreme Court (*Zuber v. Allen*, 396 U.S. 168, 190-91 nn. 26 & 27 (1969)).⁴

Consistent with early judicial decisions, with economic analysis, and with principals of efficiency and equity in milk marketing rules, USDA's prior generation of regulators consistently resisted overt efforts of dominant cooperatives to structure pooling performance requirements to exclude or discourage available milk from participating in a market's pool due to its use in Class III where the market's Class I needs are being met. There are many examples of application of this policy. Some are as follows:

“To share in the pool proceed of the order, supply plants must demonstrate the *ability* to furnish market fluid needs by shipping milk to pool distributing plants.... Shipments should not be encouraged to a greater degree than necessary to satisfy fluid milk needs.... To do so results in uneconomic movements of milk to distributing plants solely for pooling purposes rather than to meet fluid milk needs. 43 Fed. Reg. 12695, 12699 (March 27, 1978)(New England decision).

“The existence of pool manufacturing plants should not be a basis for narrowly limiting the amount of milk which may be diverted to nonpool manufacturing plants, since it would continue to encourage inefficient milk handling by producer groups that use nonpool manufacturing plant outlets.” 46 Fed. Reg. 55876, 55888 (Nov. 12, 1981)(New England decision).

One day's production of a producer delivered to a pool plant during fall months is “sufficient to demonstrate that a producer has *some association* with the fluid market” 44 Fed. Reg. 64087, 64091 (Nov. 6, 1979)(Inland Empire decision).

The “some association” policy reflected in decisions described above, particularly for markets such as the Northeast Marketing Area with adequate supplies of milk for Class I use, is also addressed in USDA's program brochure, THE FEDERAL MILK MARKETING ORDER

⁴ See also: Alden C. Manchester and Don P. Blayney. Market and Trade Economics Division, Economic Research Service, U.S.D.A., Milk Pricing in the United States (Agriculture Information Bulletin No. 761, Feb. 2001) (<http://www.ers.usda.gov/publications/>) at 4 (hereinafter, “Manchester, Milk Pricing”); *Zuber v. Allen*, 396 U.S. 168 (1969); Dairy Division, Agricultural Marketing Service, Questions and Answers on Federal Milk Marketing Orders, (AMS-559, Revised March 1996) (“Q & A”) at 1-2 (*reproduced at* <http://cpdmp.cornell.edu/> (publications)).

PROGRAM. The FMMO Program explains (at pp. 5 and 10) that FMMO's facilitate orderly marketing by providing for "the sharing among producers of the returns from all milk uses." Further, "there has been a general lessening of pooling requirements to facilitate the efficient pooling of additional supplies of Grade A milk." *Id.*

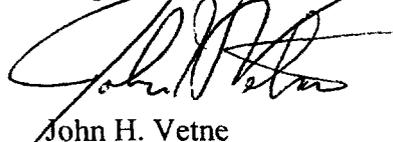
By designing rules to carefully excise substantial milk that does not have a share of committed Class I market supplies from the pool, NYSDF and ADCNE proposals seek a higher blend price accruing to a select segment of producers. A higher blend price resulting from a large and committed share of the Class I market, produced by booting less fortunate producers off the pool or requiring them to pay a tribute for market access, is simply "a disguised payment for the nearby suppliers' greater share of fluid milk sales" of the same nature as the rule criticized by the Supreme Court in *Zuber v. Allen*, 396 U.S. 168, 179-80 n.12 (1969), in violation of Section 8c (5) (B) (ii) of the AMAA. These efforts should be rejected.

CONCLUSION

The Secretary should look to 7 U.S.C. § 608c(5)(L) as the solution, in a national hearing, for any problem with "distant" milk drawing a blend at a rate higher than the value of that milk to the market in which it is pooled. The Northeast Order should be amended to promote marketing and pooling efficiency and restore equity among producers and between handlers. To this end, Proposals 8, 9 and 10 should be adopted.

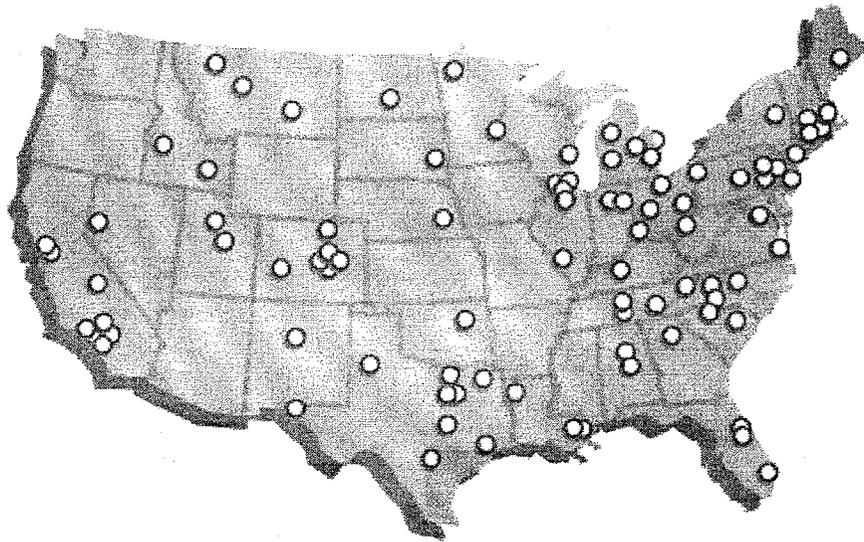
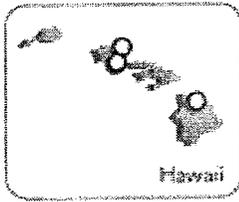
January 31, 2003

Respectfully submitted,



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1 - Dean Foods Dairy Group Plant Locations:
<http://www.deanfoods.com/company/dairygroup.asp>



2 - Crowley Foods, Subsid. National Dairy Holdings, Northeast Plant Locations:
http://www.crowleyfoods.com/corporate/business_marketing.html

Manufacturing Locations

Albany, NY – Fluid products
Arkport, NY – Cultured products
Binghamton, NY – Fluid products
Bristol, VA – Cultured products
Cleveland, OH – Fluid products
Concord, NH – Fluid products
LaFargeville, NY – Cultured products
Lancaster, PA – Fluid Products
New Paris, IN – Fluid products
Philadelphia, PA – Ultra pasteurized fluid
Sodus, NY – Cheese
York, PA – Condensed milk
Wolcott, NY – Horseradish

3 - HP Hood, Plant Locations

<http://www.hphood.com/facts/facts.htm>

Plant Locations:

Agawam, Massachusetts; Barre, Vermont; Oneida, New York; Portland, Maine; Suffield, Connecticut; Vernon, New York and Winchester, Virginia.

NEWS ARTICLE – HP HOOD / NATIONAL DAIRY HOLDINGS MERGER

Daily Hampshire Gazette <http://www.gazettenet.com/index.shtml>

Justice Department extends dairy review

Saturday, December 28, 2002 -- MONTPELIER, VT (AP)

- The U.S. Justice Department has extended its review of a proposed merger between two large dairy companies.

H.P. Hood of Chelsea, Mass., and Dallas-based National Dairy Holdings announced last month they planned to join forces to become the nation's second largest dairy processor. The merger would create a company with \$3 billion a year in sales. H.P. Hood has bottling plants in six states. National Dairy Holdings has 33 plants around the country and is half owned by Dairy Farmers of America, the nation's largest dairy cooperative.

Vermont officials and the U.S. Justice Department are reviewing the impact of the deal on farmers and consumers. Michael Duane, an assistant attorney general who represents the Vermont Department of Agriculture, said the Justice Department recently told the state that it has extended its investigation.

He said state regulators want to know if the merger will result in higher prices for consumers, and questions whether the new company would leave farmers with fewer places to market their product.

"We're looking at whether there will be a lessening of options for farmers to be able to sell their milk and if there it will have any negative impact of them," Duane told Vermont Public Radio. "It may not, it may; we don't know. We're gathering information right now."

Ten U.S. senators, including the two from Vermont, asked the Justice Department to look into the deal. The senators said they're concerned the merger would allow one company to control 90 percent of the region's fluid milk supply.

Pete Hardin, the editor of a Wisconsin newspaper that tracks the milk industry, said the new company could force farmers in New England to sell their milk to just one buyer.

"Farmers do best when there's honest competition among milk buyers for their milk," he said. "I would suspect that the power grab by Dairy Farmers of America to try to control the flow of New England milk to fluid bottlers is what the biggest concerns are."

National Dairy Holdings was itself born of an earlier merger in the milk industry. When Texas-based Suiza Foods merged with Dean Foods last year, the Justice Department required them to sell off 11 processing plants. Those plants were then bought by the newly formed National Dairy Holdings.

Lynne Bohan, a spokeswoman for H.P. Hood, said the merger would create more competition, not less. She added the new company would continue to buy milk from New England cooperatives and independent farmers in Vermont.

"The combined operations of both National Dairy Holdings and Hood complement each other very well geographically and with very little overlap, and the combined operations also complement each other very well in terms of product mix," she said. "So we think that again combining these companies will put this newly merged company into a position to better compete with Dean Foods nationally."

As a condition of the sale, Dairy Farmers of America will have an exclusive right to supply milk to all H.P. Hood plants, including those supplied by the Agri-Mark Inc. cooperative in Massachusetts, according to the office of U.S. Sen. Patrick Leahy of Vermont.

H.P. Hood has plants in Barre; Agawam, Mass.; Oneida and Vernon, N.Y.; Portland, Maine; Suffield, Conn.; and Winchester, Va.