

UNITED STATES DEPARTMENT OF AGRICULTURE
Agricultural Marketing Service
(Dairy Programs)

Milk in the Upper Midwest)	
Marketing Area)	
)	Dkt AO 361-A39
Hearing on Proposals to Limit)	DA 04-03
Repooling of Depooled Milk)	7 C.F.R Part 1030
And Otherwise Amend Pooling)	
Standards)	

POST-HEARING BRIEF ON BEHALF OF:

Associated Milk Producers, Inc., Bongards' Creameries, Ellsworth
Cooperative Creamery, Family Dairies USA, First District Association,
Davisco Foods, Valley Queen Cheese Company, and
Wisconsin Cheese Makers Association (“AMPI, et al.” or “AMPI Group”)

INTRODUCTION

Three groups of rulemaking proposals are before the Secretary: (1) A number of proposals to limit depooling of manufacturing use milk, designed to require a contribution or compensating payment to the pool when the current value of milk used for manufacturing is greater than the market’s producer blend price; (2) A series of proposals by Dean Foods intended to severely limit pool access, edging towards Dean’s “ideal” regulatory policy of individual handler pooling;¹ and (3) Proposals to restrict “distant” milk from participating in the Upper Midwest pool. As acknowledged by interested

¹ Testimony of Evan Kinser, Dean Foods, Transcript (“Tr.”) 488. Transcript pages in four volumes for the four days of hearing, August 16 – 19, 2004, are numbered consecutively. It is therefore unnecessary to refer herein to the date of the testimony of a witness.

parties and in prior decisions of USDA, all proposals are of national interest, respond to conditions experienced in several markets, and would have national impact if adopted. This brief on behalf of AMPI, et al., is submitted in opposition to proposals in the first two groups.

The producer cooperatives and milk handlers of the AMPI Group (including Alto Dairy, which has filed its own separate brief) market or purchase milk from 11,250, or 71.3 percent of the producers on the Order, representing 1.34 billion pounds or 62.9 percent of the producer milk on the Upper Midwest Order. Gulden, Tr. 717. The cooperatives alone represent 37% of producers and one-third of pool milk in the Upper Midwest Market. Id., Tr. 822-23. The producer-members of the cooperatives are small businesses, as are 29 of 31 members of the Wisconsin Cheese Makers Association. (Tr. 755, 768)

PART ONE – DEPOOLING RESTRICTIONS

Proposal 2 (part 1 - Sec. 1030.13(f) amendments) by Dairy Farmers of America and other cooperatives (“DFA Group”), along with elements of Dean Foods’ Proposals 3 through 5, are designed to discourage depooling of milk when regulated prices are out of sync by restricting repooling of such milk in subsequent months. The questions of fact and policy raised by these proposals, as we see them, and answers, are:

1. Does depooling in response to price inversions cause competitive problems between producers or between handlers? Yes.
2. Is it necessary for USDA to interfere with market-oriented response to manufactured product prices to address these problems? No.
3. Does depooling increase dairy farm revenue? Yes.
4. Would the proposals, if adopted, reduce farm revenue? Yes.
5. Are there alternative, less burdensome, remedies that would reduce or eliminate price inversions? Yes, as described by several witnesses and as previously identified by the Secretary in the 1999 National Milk Order Reform Decision.
6. Is depooling local phenomenon for which a remedy should be sought only in the Upper Midwest Order should? No.
7. Will amendment to the Upper Midwest Marketing Order cause marketing disorder and disruption in other markets? Yes.
8. Do the proposals represent a major change in Federal Milk Order regulatory policy? Yes.
9. Does an “emergency” exist within the meaning of 5 U.S.C. §557(b)(2) and 7 C.F.R. §900.12(d), justifying omission of a recommended decision? No.

I. Summary of Facts and Regulatory History.

There is, we believe, little dispute concerning the salient economic and marketing facts underlying the depooling proposals.

1. For reasons of supply and inelastic consumer demand, milk used for Class I or fluid purposes commands a higher price than milk used for manufactured products. In an unregulated market, Class I handlers will outbid milk manufacturers for milk supplies. The federal order program incorporates this economic fact in classified prices. Christ, Tr. 544-45; 64 Fed. Reg. 16026, 16102 (April 2, 1999).

2. Revenue sharing among producers in a market-wide pool was designed to allow producers to share in Class I revenue and avoid cutthroat competition for sales to fluid milk plants. As recently summarized by a federal appeals court panel in Chicago:

“...the history of the milk-marketing regime evidences primary concern with producer competition to make sales to the fluid milk market, not the manufacturing market. See Zuber, 396 U.S. at 180-81 (discussing AMAA purpose "to remove ruinous and self-defeating competition" among producers for sales in the fluid milk market); see also Block v. Cmty. Nutrition Inst., 467 U.S. 340, 343 (1984) (discussing pooling requirements as means "[t]o discourage destabilizing competition among producers for the more desirable fluid milk sales"); United States v. Rock Royal CoOp., Inc., 307 U.S. 533, 572 (1939) (characterizing system of compensating payments under the settlement fund as "reasonably adapted" device "designed... to foster, protect and encourage interstate commerce by smoothing out the difficulties of the surplus and cut-throat competition which burdened" the fluid milk market).

Lamers Dairy Incorporated v. United States Department of Agriculture, 379 F.3d 466 (7th Cir. 2004)(text at fn. 9-10).

3. The Secretary of Agriculture in the *Lamers* litigation more succinctly explained that Congress intended by revenue pooling “to share a portion of revenue from *fluid milk* sales with all farmers in the pool.” *Lamers Dairy v. U.S. Dept. of Agriculture*, 7th Cir. Nos. Nos. 03-2308 & 03-2661, Secretary’s Brief at 30 (November 2003), reproduced at <http://www.ca7.uscourts.gov> (emphasis supplied). Continuing, the Secretary emphasized: “the statute is principally intended to prevent destabilizing competition among farmers for sales to the fluid market, and it achieves this objective by establishing a mechanism to ensure that *revenues from the fluid milk market* are pooled and equitably shared among all the market's producers.” *Id.* At 33, emphasis supplied.

4. USDA’s 1999 Milk Order Reform Decision reaffirmed that the purpose of market wide pooling was to redistribute Class I revenue:

It is the Class I pricing structure that provides additional revenue above the basic value for milk to producers. Because of this, Class I pricing is often viewed as the cornerstone of the milk order program’s pricing policy. This is so because the Class I fluid use of milk commands the highest-valued use in the marketplace and is the preferred outlet for milk by producers. It is also this use of milk that has the greatest effect on determining the location value of all milk and in determining the differences in blend prices that are received by producers.

64 Fed. Reg. 16026, 16101-102 (April 2, 1999).

5. The order regulations continue to provide “pooling standards ...to provide the criteria for identifying those who are reasonably associated with the market for *sharing in the Class I proceeds.*” 68 Fed. Reg. 37674, 37684 (June 24, 2003)(Final Decision, Upper Midwest Milk Marketing Order).
6. It is axiomatic that when Class I prices are *not higher* than competitive values of milk used to manufacture dairy products, as happens on occasion, there are no pooled Class I proceeds to share. Fluid milk suppliers in such event may retain the full and exclusive benefit of higher competitive premiums generated due to price inversion.
7. Until the late 1960’s, federal order Class I prices were announced on the 5th day of the month to which they applied, and manufacturing prices were announced the same day for the previous month. *American Dairy of Evansville v. Bergland*, 627 F.2d 1252 (DC Cir. 1980)(text of dissenting opinion by Wilkey at fn. 3-9). Thereafter, the Class I price announcement was moved forward by one month, and made on the 5th day of the month for the following month to improve the fluid milk “handlers' ability to respond to class I price fluctuations.” *Id.* Advance pricing of Class I milk, now announced on the 23rd of each month, continues for the primary benefit of and at the request of fluid milk processors. 64 Fed. Reg. at 16102; 69 Fed. Reg. 19292, 19300 (April 12, 2004)(summarizing concurring views of DFA).

8. In the Federal Milk Order Reform Decision, USDA acknowledged that “since 1988, the volatility in the manufactured dairy product market has caused problems with the advance pricing of Class I milk.” *Id.* Since at least 1989, handlers have depooled milk used in manufactured products when market prices have been out of sync with (higher than) federal order blend prices at the plant. Exs. 41A, 41H; Gulden, Tr. 718, 725. Depooling is a national phenomenon, as it was prior to Federal Milk Order reform. Ledman, Tr. 637; Brown, Tr. 669-70; Ex. 38; Gulden, Tr. 718-21; Exs. 41A, 41C – 41F;

9. The cause of price inversion is advance pricing of Class I milk: “Class price inversion occurs when a markets's [sic] regulated price for milk used in manufacturing exceeds the Class I (fluid) milk price in a given month, and causes serious competitive inequities among dairy farmers and regulated handlers. Advanced pricing of Class I milk actually causes this situation when manufactured product prices are increasing rapidly.” *Lamers Dairy*, supra (quoting National Federal Milk Order reform Decision, 64 Fed. Reg. 16026, 16102 (Apr. 2, 1999)); Ledman, Tr. 616-17; Ex. 27 (Dr. Ed Jesse); Tonak, Tr. 373-74; Gulden, Tr. 719; Umhoefer, Tr. 769.

10. In early years of the Federal Milk Order Program, producers relied on price regulation to respond to changed conditions. In recent decades, producers have adjusted to changes by greater reliance on negotiated market

prices in excess of minimum federal order prices. “Cooperatives have relied more on over-order charges in recent years as a way of fine-tuning order prices promptly to changed conditions and supplementing the minimum prices established under the orders.” AMS, USDA, The Federal Milk Marketing Order Program Marketing Bulletin No. 27 (Rev. 1981, Updated 1989) at 35. Over-order price adjustments have also been the marketplace response to depooling.

11. When milk is depooled due to price inversion or other out-of-sync relationship between regulated prices and market prices, producers delivering milk to manufacturers receive more revenue than they would if pooled.

Gulden, Tr. 727-30, 747, 758. Class I handlers must frequently pay more in over-order premiums to compete for milk supplies with market value of milk used in cheese, butter or powder. *Lamers Dairy, supra*; Ledman, Tr. 624-25 (observing that over-order Class I prices increased from \$1.80 to \$3.72 from March to May 2004), *id.* 634-35.

12. The Secretary of Agriculture has, in fact, similarly observed that...

“...the administrative exemption from these [pooling] requirements that may be accorded cheese processors during the occasional "inversion" of class prices *merely permits additional competition among handlers for the available milk supply*. It does not in anyway detract from the statute's central purpose of preventing ruinous competition among dairy farmers for the *fluid* milk market.²

² *Lamers Dairy v. U.S. Dept. of Agriculture*, 7th Cir. Nos. Nos. 03-2308 & 03-2661, Brief of the Secretary of Agriculture at 17 (November 2003), reproduced at <http://www.ca7.uscourts.gov> (emphasis supplied in part).

13. If the proposals are adopted, net farm income will decline as manufacturing class milk will pay into the pool, diluting these revenues, and Class I handlers will be relieved of bidding for milk based on milk's current value. *Id.* For April 2004, for example, dairy farmers marketing milk to cheese plants would have lost \$ 0.86/cwt in income if handlers had been forced to pool 75% of their Class III milk. Gulden Tr. 729-30. Class I buyers would simultaneously have been relieved of paying additional premiums to compete against the current value of milk.

14. It has been USDA's position "that the different treatment of Class I and Class III handlers is rationally based because of the purposes of regulation and the differing marketing conditions faced by fluid milk and cheese producers." As a matter of regulatory policy and law, the 7th Circuit has confirmed that "the Secretary reasonably can require that milk used to produce fluid products be pooled while exempting other handlers from obligatory pooling. Indeed, the AMAA is premised on obligatory pooling of Class I milk, so that all producers may partake of its economic benefits." *Lamers Dairy, supra.*

15. It was USDA's view in the course of federal order reform that depooling due to price inversion and volatility is a national problem causing disorder, and should be addressed with a national remedy directed at the regulatory *cause* of price inversion rather than handlers' marketplace response to price inversion. "Since volatility in the manufactured product markets is

expected to continue, the Class I price mover developed as part of this Federal milk order reform process should address this disorderly marketing situation.”

64 Fed. Reg. at 16102 – 03. The national remedy was a shorter lag between the Class I price announcement and the following marketing month (64 Fed. Reg. at 16103):

The advanced pricing procedure provided in this final decision results in a Class I price that is based on a more recent manufacturing use price, thus reducing (but not eliminating) the time lag that contributes to class price inversion.... ..
[R]educing the time period for which Class I pricing is advanced should reduce the potential [of price inversions] considerably, allowing Class I handlers to compete more effectively with manufacturing plants for fluid milk.

16. The shorter lag time between the Class I price announcement and the marketing month was facilitated in the Milk Order Reform process by use of NASS survey reports of prices paid to dairy manufacturers for dairy products, from which milk values could be imputed and computed. When NASS survey was adopted in 1999 as the Class I price mover, USDA believed the incidence of price inversions would be reduced by basing the “*prospectively determined Class I prices on the most recent market statistics available.*” Secretary’s Brief in *Lamers Dairy v. USDA, supra*, at 26.

17. The national remedy in 1999 did not cure the problem, as the Secretary projected and as is evident in this proceeding. The reform remedy, however, left room for additional rule amendments to further close the pricing lag, or to eliminate it altogether.

18. The existing (post-reform) lag between the advance Class I price announcement on the 23rd of each month and marketplace reality, as reflected in milk product prices at the end of the following month, is six weeks.

Gulden, Tr. 721. The most recent reliable and current market data available, however, is no longer produced by NASS surveys, but by dairy product and futures trading on the Chicago Mercantile Exchange, as the Secretary presaged in the Federal Milk Order Reform Decision. 64 Fed. Reg. 16103. There is an additional lag of two to three weeks between current marketplace activity, as reported by the CME, and price survey results as compiled and reported by NASS. Ledman, Tr. 657, 665.

19. These pricing lags exacerbate the price inversion/depooling problem, and provide a ready place to continue a market-oriented reform process.

Simply switching from NASS survey to CME prices, without affecting the timing of Class I price announcements would bring Class I prices three weeks closer to marketplace reality. CME trading has matured, proven reliable, and been accepted by the dairy industry in a half-decade of trading since the FMMO Reform Decision. California's system has demonstrated that CME price reports can readily function as a Class I price mover. Ledman, Tr. 648-649.

20. If, in a departure from policy and remedy expressed in the National Federal Milk Order Reform Decision, depooling as a consequence of price

inversion results in a piecemeal remedy only for the Upper Midwest – a remedy that targets marketplace response to the problem rather than the underlying cause – there will clearly result “some pain...some disorderly marketing and chaos.” Ledman, Tr. 637.

21. A rational (but disruptive) economic response to repooling limits on depooled milk has been demonstrated very recently. Milk depooled from the Northeast Order last spring was associated with the Mideast milk pool because of repooling limitations in the Northeast Order. This activity was undertaken at expense of Northeast producers when the milk was depooled, and at the expense of Mideast producers when it was repooled. Ex. 13; Kinser, Tr. 491-92; Northeast Milk Marketing Order Uniform Price Announcement (April 2004)(Official Notice taken, Tr. 857).

22. Though other markets in which DFA and other proponents operate have been affected by depooling and price inversion, a proposal is pending in only one – the Central Order market. Several witnesses who favored a piecemeal approach to depooling conditioned their support on the assumption that similar remedies would be adopted nationally, in a series of hearings. Kinser, Tr. 493-94; Ledman, Tr. 638. These assumptions are naïve. As long as economic self-interest is served for national or regional milk suppliers by foreclosing repooling in some markets, but leaving the door open to their own repooled milk in others, a coordinated and national remedy is unlikely unless

the Secretary takes the initiative. The absence of a pending proposal to address these issues in the Mideast Market, for example, may be explained by DFA's public position opposing a price inversion remedy for the Mideast Market for many of the same reasons AMPI et al. oppose DFA's contrary position in this one. 69 Fed. Reg. 19291, 19300 (April 12, 2004).³

23. Although price inversion and depooling have been a feature of Federal Milk Order Markets since at least 1989, proponents ask for "emergency" relief. This request is in apparent response to the extraordinary increase in Class III prices last spring. That cow is already through the barn door.

Proponents' apparent argument for emergency action is that the events of last spring are likely to occur in the near future. There is no evidence supporting this contention. The Secretary's recent denial of any remedy for price inversion/depooling in the Mideast Market, let alone an emergency remedy, argues persuasively against emergency procedures to avoid any moderate price inversion/depooling that may take place pending fully informed rulemaking.

24. Last spring's Class III price spike followed a period of low milk prices to which producers slowly responded by reducing milk cow numbers. From a peak of 9.166 million milk cows in June 2002 (in response to earlier high milk

³ The April 2004 final Mideast Order Decision, at 19300, describes DFA's stated position in opposition to depooling limitations: "The DFA witness is of the opinion that penalizing supply plants, often cooperative owned, may cause financial damage to be borne by the manufacturing sectors of the market. Additionally, DFA does not endorse the notion that producers should incur any penalty because of price outcomes which, they conclude, are the result of the order program providing for the advance pricing of Class I and II milk that serves the interest of handlers."

prices), the number of milk cows declined nationally for nearly two years, bottoming at 8.987 million cows in March 2004. NASS, USDA, *Milk Production* (October 2003 and 2004).

25. Since March, milking cow numbers have steadily increased, with 9.038 million cows as of September 2004. *Id.* This increase in milk cows, in predictable (but delayed) response to higher milk prices, is expected to continue. USDA's Economic Research Service projects that "milk production is expected to expand during the second half of 2004, but large increases are not projected until next year." ERS, USDA, *Livestock, Dairy and Poultry Outlook*, (Sept 04 LDP-M-123)(www.ers.usda.gov).

26. There is therefore no substantial evidence to suggest that a Class III price spike, as experienced last spring at the end of a long period of declining production and cow numbers, will reoccur before the Secretary has the opportunity to issue a recommended decision (if any) and receive comments and exceptions.

II. ARGUMENT

The proposals to require Class III or IV milk to pool and make compensating payments to the producer settlement fund in times of price inversion, subject to disqualification from sharing in Class I revenues if milk is depooled, tests the edges of Congressional authority in the AMAA.

Congress clearly intended that a portion of higher Class I revenues be shared with all producers.

Congress, however, was not similarly concerned with pooling the revenues that could be derived by farmers competing for sales to the cheese market. Thus, the fact that cheese processors are permitted to "de-pool" their milk and to avoid an obligation to share revenues through the producer settlement fund does not give rise to a species of competitive harm that was of concern to Congress. This may well subject milk bottlers to more competition for the milk supply, and thus drive up the prices they must pay to dairy farmers. But Congress did not enact the statute to protect *handlers* from the risks of such competition.

Brief of the Secretary of Agriculture in *Lamers Dairy v. USDA*, *supra*, at 33.

As to the complaints of milk processors that depooling unfairly requires payment of higher competitive premiums to dairy farmers, USDA further observed: "Congress has not indicated that it even regards the competitive position of milk bottlers as a 'problem' warranting a legislative response." *Id.* at 29.

While AMPI, et al., perceive no acute problem in marketplace conditions by the fact that processors sometimes pay higher premiums to dairy farmers, particularly when the cause of the problem is advance pricing advocated by the processors (69 Fed. Reg. at 19300), we agree that price inversion and depooling are issues that may reasonably be addressed in rulemaking amendment as they were addressed in the Federal Milk Order Reform Decision – on a national basis.

The Department's entertainment of proposals by DFA et al. and Dean to limit consideration of depooling issues to a single-market hearing in the Upper Midwest, where it is so apparent that the issues transcend one market and that a single market remedy would shift disorder to others, is a unexplained departure from long-standing agency policy. Although now more than ten years old, the agency's brochure, *The Federal Milk Marketing Order Program* (Marketing Bulletin No. 27), explained:

The net effect of changes in the milk order program over the past 40 years has been a shift from market orders geared to local conditions to a system of orders geared to regional and national conditions. Wider use of regional and national hearing has been made to adopt these changes.

Similarly, the publication *Questions and Answers on Federal Milk Marketing Orders* (AMS — 559) at 12 affirms:

[A] change in one order -- particularly a change in price -- affects supply-demand balance in other markets unless related changes are made in the other orders. Many of today's marketing problems must be viewed in the perspective of the national milk supply and the total demand for milk in the country.

The wisdom, economic necessity and regulatory imperative that milk marketing issues of multi-market importance be addressed in a multi-market hearing is reinforced by guidance of the 1962 *Report to the Secretary of Agriculture by the Federal Milk Order Study Committee* (known as the "Nourse Report"), considered by the Secretary to express the philosophical and economic foundation for Federal Milk Orders during the past four

decades. *See In re Borden, Inc., et al.*, 46 Agric. Dec. 1315, 1408, 1411-19 (1987). Concluding its discussion on the principles of “orderly marketing,” The Nourse Report (at 9-10) cautions that orderly marketing “includes a recognition that the outlook of the Secretary of Agriculture and his aides should not be parochial but industrywide in its scope.” This powerful statement has application to current industry conditions and policies. It means that orderliness is to be viewed in the context of both the short run and the long-run effects of milk order provisions. It also means that decisions should consider the effects on the whole industry and avoid short-run expediency.

Concluding its discussions on p. 101, with almost prescient reference to this proceeding and current tensions between fluid and manufacturing users of milk, the Nourse Report emphasizes the Secretary’s responsibilities as a steward of the dairy industry:

We believe that the Secretary must exercise care to avoid short-run partisan positions in the interests of fluid milk producers as may run counter to other dairy interests of the general economy, or the long-run interests of the fluid milk producer himself. The growing interrelationships between the market milk and manufacturing milk segments now mandated extreme care to avoid arbitrary decisions in the market milk sector which may work hardship on the manufacturing sector. Moreover, modern marketing conditions bring handler problems more and more often to the core of orderly marketing issues. The Secretary is empowered and entrusted to develop a system of orders, integrated as to their relations with each other and to all the uses into which milk goes, not merely as to their internal housekeeping. He is cabinet minister to the nation’s agriculture, with equal obligation to all farmers.

With these principals in mind, the Secretary has in the past had the courage and integrity to declare “*mea culpa*” and to terminate local or regional market hearings when it became clear that the issues were of broader interest or the proposed remedies would have serious extra-territorial consequence. *See*, 52 Fed. Reg. 15951 (May 1, 1987)(terminating consideration of marketwide service proposals for southeast markets because, if adopted, “inter-market milk movements throughout this broad area ...would result in producers in the [markets subject to the hearing notice] bearing the burden of balancing milk supplies for [other markets]....”)). In a Texas Order proceeding, the Secretary terminated consideration of a proposal to reduce Class III prices in part because the problem addressed involved “the sale and processing of milk over a broad region that extends well beyond the Texas marketing area.” 49 Fed. Reg. 20825, 20828 (May 17, 1984):

Furthermore, consideration of the long term manufacturing efficiency issue has implications to the level of Class III pricing throughout the Federal order system and the national market for manufactured dairy products. Thus, it is preferable that the issue not be addressed on the basis of a record that is limited to ... one market.”

Id., at 20830.

The Secretary should follow the wise example of her predecessors and either terminate the proceeding, with an invitation to submit multi-market or

national proposals on the depooling/price inversion issues,⁴ or reopen the hearing to include other markets in the Notice of Hearing.

In a national hearing USDA may want to consider use of CME reported prices as a mover of Class I prices to address the national price inversion problem, as the next logical step in the reform process, as an alternative to piecemeal control of marketplace response in the Upper Midwest to price inversion. A national inquiry into this national problem may also consider whether any advance pricing for the benefit of Class I handlers continues to be justified today. In the course of 35 years of Class I price announcements before the marketing month, the quantity and quality of market information available to handlers has improved immensely, as has the economic sophistication of handlers who have survived to this point. Handlers now have previously unavailable forecasting tools such as daily reports from the CME providing current cash prices, industry opinion of future prices of dairy products and milk values in CME futures markets (See Christ, Tr. 545-46; 64 Fed. Reg. at 16103), as well as price forecasting experts for hire (Ledman, Tr. 612, 650-51). Handlers also have a number of risk management tools, through CME trading and other sources, to help mitigate the effects of volatility and to

⁴ The Secretary's Notice of Hearing for the Upper Midwest has preempted and foreclosed the ability of handlers and producers in other markets to engage in frank dialogue with USDA officials on the merits of proposals to address depooling/price inversion problems. From June 16, 2004, forward, all USDA personnel with whom such discussions might otherwise take place are precluded from *ex parte* discussion or communication. 69 Fed. Reg. 34963, 34966 (June 23, 2004). The inequitable and unfortunate result is that only the DFA Group and other proponents of Upper Midwest amendments, who had such discussions with USDA personnel (Hollon, Tr. 283 – 85), will enjoy the benefit and instruction of pre-hearing dialogue with agency officials on the merits of such proposals.

stabilize handler costs. Is it not appropriate in these circumstances to consider whether Class I handlers have also matured sufficiently to compete for milk based on current market value in the same manner as milk product manufacturers?

The Federal Milk Order Reform Decision of 1999 suggested that the time for Class I handlers to assume more responsibility to estimate market prices, and to be weaned from reliance on a regulatory crutch, was not far off:

[A]s more NASS product price survey observations become available, basis differences from earlier traded/issued product price surveys such as those from the Chicago Mercantile Exchange or Dairy Market News will be more predictable and, therefore, should provide for more accurate predictions of future price levels. In addition, futures markets have been established for the four dairy products in the NASS price surveys. While trading to date in these contracts has not been large, interest in these markets may increase as the industry learns to use them as effective hedges to the component values determined under this final decision. These markets also will assist handlers in estimating the Class I price.

64 Fed. Reg. at 16103. A hearing in which reasonable alternative remedies to the supposed problems are not disregarded or artificially constrained is a fundamental requirement of “reasoned decision making.” *Motor Vehicle Manufacturers Association v. State Farm Mutual*, 463 U.S. 28, 48 (1983). Even limited to the Upper Midwest hearing, the issues and remedies as unnecessarily narrowed by the Secretary’s Notice of Hearing, fail the *Motor Vehicle* test. A national hearing to bring Class I and Class III/IV prices into greater symmetry, if a remedy is needed, is now in order.

PART II – THE DEAN PROPOSALS TO LIMIT POOL MARKET ACCESS

While Dean Foods’ proposals 3 – 5 are claimed to advocate a remedy for the same depooling/price inversion problems as proposal 2, all of the Dean Proposals are designed to limit (or shrink) the volume of milk that may be pooled on the Order. Dean unabashedly comes to these proposals with an institutional bias in favor of individual handler pooling (Kinser, Tr. 488) – a regulatory option authorized by Congress but disavowed by USDA as inequitable. 64 Fed. Reg. at 16130.

Dean’s proposals also incorporate a view of federal milk order policy colored by an uninformed (or, perhaps, just wishful) perception of Congressional intent in the AMAA. Dean maintains that...

1. “The only milk of concern to the Order is distributing plants. The milk supply of other plants is a residual concern of the Order.” Kinser, Tr. 467. The Order's main concern must be with distributing plants' milk supply. *Id.* at 470.
2. “The purpose of the Order is to ensure distributing plants have a sufficient supply of milk.” *Id.* at 468.
3. There is an ample -- indeed too large – supply of Grade A milk for distributing plant needs. *Id.* Tr. 472. The Order shouldn’t provide pool access to all Grade A milk; it should only concern itself with a sufficient supply of milk for distributing plants. *Id.* Tr. 487

When challenged to document these views by reference to the statute, Dean could not do so. Kinser and Christ, Tr. 546 – 551.

Dean’s misperception of statutory purpose is, unfortunately, not unique. As is commonly the case with oft-repeated falsehoods, Dean’s view has come to be accepted by many (even some policy-makers) as the truth.

The Secretary’s authority to regulate milk and its products, 7 U.S.C. §608c(5), derives from the Agricultural Adjustment Act of 1933, as amended in 1935, c. 641, Title I, Sec. 5 (49 Stat. 753). Two years later Congress added section 18, 7 U.S.C. §608c(18), providing guidance to the Secretary in setting the *level* of milk classified prices authorized to be regulated in Section 5. 50 Stat. 246, 247. It is this ancillary section, providing direction for milk price levels, that has been confused and misused as constituting the mainframe of milk regulation. The limited purpose of Section 18 was accurately explained by USDA in the Federal Milk Order Reform Decision: “The purpose of the minimum Class I differential is to generate enough revenue to assure that the fluid market is adequately supplied.” 64 Fed. Reg. at 16102.

As to individual fluid milk handlers who wish to get milk cheaply, to limit competition, or to gerrymander pool access regulations to create a buyers market, Congress had little concern. As explained somewhat brusquely by the Secretary of Agriculture: “Congress has not indicated that it even regards the

competitive position of milk bottlers as a ‘problem’ warranting a legislative response.” Brief of the Secretary in *Lamers v USDA*, *supra*, at 29.

Lest there be any doubt, it has been and continues to be the interpretation of the Secretary that “the statute is principally intended to prevent destabilizing competition among farmers for sales to the fluid market, and it achieves this objective by establishing a mechanism to ensure that revenues from the fluid milk market are pooled and equitably shared among all the market's producers.” *Id.* at 33. It would be difficult for the Secretary to contend otherwise, because the Supreme Court has unequivocally declared that 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).

Dean’s objectives to create smaller milk pools, and reintroduce cutthroat competition among producers for sale of milk to its plants in order to gain access to the pool, is understandable. Dean is supplied under contract by cooperatives, primarily DFA and its affiliates in common marketing agencies such as DMS. Dean is the largest fluid milk processor in the country. DFA, with milk marketings of 56.5 billion pounds of milk in 2003 (Hollon, Tr. 259), representing one-third of the nation’s entire milk production of 170 billion pounds (NASS, USDA, Milk Production Disposition and Income (April 2004)), is the nation’s largest raw milk supplier. Although Dean declined to produce or disclose its relevant supply agreement(s) for the hearing record, it

is a matter of public record that Dean is required by contract to buy milk from DFA until the year 2021, and Dean faces liquidated damages of up to \$96 million for material breach of this agreement. Ex. 33. To the extent that Dean is able to buy some milk from third parties, its bottom line would be improved if those third parties form an eager line at its plants. To the extent that Dean is locked into purchases from DFA, or must look to DFA for permission to buy third party milk, it would also help Dean's bottom line for producers to be denied pool access unless they join DFA or agree to pay tribute to DFA for pool access. These facts frame the economic incentive and regulatory philosophy of the Dean proposals.

It is, however, difficult at this point to decipher exactly what Dean has proposed. In the course of hearing, Dean amended its proposals in complicated detail, and later proceeded to further amend, withdraw, or abandon its proposals or amendments to proposals.

True to its misguided view of Congressional intent, Dean amended its proposals 3 – 5 for pool re-association of depooled milk by demanding that producer access to the pool could only be reacquired through delivery to a distributing plant rather than any pool plant, as appeared in the published notice of hearing.⁵ (Kinser, Tr. 490, ; Christ, Tr. 520). With few fluid milk processors having a lion's share of the market's fluid milk disposition

⁵ These amendments to Dean proposals were apparently made without heed to the legislative prohibition against rules that would punish or reward producers in their pool participation based upon the use to which milk is put by handlers. 7 U.S.C. Sec. 608c(5)(B)(ii); *Blair v. Freeman*, 370 F.2nd 229, 237 (D.C. Cir. 1966); 41 Fed Reg 12436, 12453 (March 25, 1976).

(Gulden, Tr. 820-21; Ex. 12 t. 1; Ex. 44B), and processors commonly limited by existing full supply agreements, it is clear that the Dean proposals (as intended) will saddle some producers with the disadvantage of a buyer's market, and others with the greater burden of no pool market.

To the same end, Dean amended its proposal No. 6 to prohibit any supply plant milk from making qualifying shipments directly from farms to the distributing plant, requiring instead that all milk be received at a supply plant silo, unloaded, reloaded, and then shipped to a distributing plant for qualification. Christ, Tr. 530-31. This amendment would introduce mandatory handling practices that the court in *Alto Dairy v. Veneman*, 336 F.3d 560 (7th Cir. 2003), went out of its way to declare a “great waste,” and which USDA has for many years avoided because of transportation inefficiency and handling costs, as well as deterioration of milk quality and enhanced bacterial growth that may result from such practices.⁶ After these facts and policies were brought to Dean's attention in the public hearing (Gulden, Tr. at 820), Dean amended its amendment to avoid the unloading-reloading element for local supply plants. Christ, Tr. 832.

Each of Dean's proposals, to a large degree or a very large degree, would add greatly and unfairly to handling costs of select handlers in a market

⁶ E.g. 52 Fed. Reg. 43315-16 (Nov. 12, 1987); 58 Fed. Reg. 33347 (June 17, 1993); 49 Fed. Reg. 35101, 35107 (Sept. 6, 1984). The 7th Circuit's caution in *Alto Dairy* that mandating such costly and burdensome practices would constitute a “great waste” was not necessary to resolve the legal issue before it.

of intense competition for milk supplies, and would also add greatly to transportation and energy costs at a time when fuel and energy costs are high and rational social policy demands conservation. The Dean proposals, in their various mutations, would also require new costs and capital expense by cooperatives and other handlers.

For example, proposals 3, 4 and 6 would require individual producers' milk to "touch base" at a pool plant more frequently. If adopted, handlers would have to segregate milk of Grade A and Grade B producers that are now picked up from farms in a single truck in the most efficient manner. Although Grade B production is small and scattered, 70% of AMPI Grade A member milk is commingled with some Grade B milk on farm pick-up routes. De-commingling of these routes, including new routes for Grade B only, would cost AMPI members \$3.6 million per year in additional transportation costs and force some individual producers to go out of business. Gulden, Tr. 818-19.

Dean proposals 3 – 6, as published and/or mutated in the course of hearing, would also require more milk to be received into supply plant silos. A large problem with this, apart from handling costs, is that there is insufficient silo capacity at many plants. The cost to supply plant handlers to install silos, merely to comply with the regulatory ritual proposed by Dean, is

conservatively estimated at \$50,000 to \$100,000. And the victims of these new cost requirements would be small businesses. Umhoefer, Tr. 771-72.

There is, unfortunately, no practical way to assess or brief the Dean proposals in all their permutations, nor of logical extensions thereof that could conceivably be derived from this record under the liberal notice of hearing standards that have been approved on judicial review. *Alto Dairy v. Veneman*, 336 F.3d 560 (7th Cir. 2003). There is, however, no emergency underlying the Dean proposals. To the extent any recommended amendments may relate to depooling/price inversion issues, current milk production and price data and ERS projections, as described above, reveal that there should be plenty of time for a recommended decision without risk of price inversions as experienced last spring. To the extent recommendations may relate to other issues in pursuit of Dean's view that its distributing plants are intended by Congress to be the principal beneficiaries of Federal Milk Order regulation – and we believe all of Dean's proposals are designed with this objective in mind – there is even greater need for a recommended decision and responsive comments on any element of the Dean proposals that may survive the Secretary's initial scrutiny.⁷

⁷ Many of the policies and objectives of Federal Milk Order regulation discussed earlier were applied by the Secretary when the Upper Midwest Marketing Order was created by the merger of small orders in 1976. 41 Fed Reg 12436 (March 25, 1976). It is interesting to observe that many regulatory or institutional factors deemed undesirable to orderly marketing and remedied by that Decision (*id* at 12440-41) are now espoused, expressly or implicitly by Dean Foods as virtues; and regulatory remedies deemed desirable by the Secretary in that decision are disavowed by Dean as economic evils.

CONCLUSION

For the foregoing reasons, as detailed in hearing testimony, cross-examination of witnesses, testimony, and officially-noticed data, the dairy farmers and handlers represented by AMPI et al. respectfully request the Secretary to reject all Dean Foods proposals and proposals limiting depooling. If any issue merits further rulemaking consideration, the Secretary should issue a new invitation to submit proposals for hearings on multiple markets or all markets.

Respectfully submitted,
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