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

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In re: Milk in California

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Docket No. 15-0071

POST-HEARING BRIEF OF SELECT MILK PRODUCERS, INC.

- I. Select has an interest in this hearing both as the marketing agent for its members and as the owner of manufacturing facilities producing dairy products across all four federal order classes and supports the adoption of the Cooperatives' Proposal.**

Select Milk Producers, Inc. ("Select") is a New Mexico agricultural marketing association. Select has member producers in Indiana, Michigan, New Mexico, Ohio, Oklahoma, and Texas. Select also markets the milk of nonmember shippers in additional states. Milk of Select's dairy producer members is regularly pooled in the Appalachian, Mideast, Southeast, and Southwest milk marketing orders. Additionally, milk marketed by Select is delivered to plants in the Central, Upper Midwest, and Pacific Northwest milk marketing areas. Select does not currently deliver any milk to California plants, but has supplied milk to such plants in the past. In aggregate, Select

markets in excess of 6.5 billion pounds of milk each year, ranking it as the sixth largest dairy cooperative in the nation.

In addition to its interest as a nationwide marketer of milk, Select has an interest in this proceeding by virtue of its processing interests. Select holds an ownership interest in Southwest Cheese, LLC (manufacturer of cheddar cheese and whey products), Portales Dairy Products, LLC (manufacturer of dried dairy ingredients), and fairlife, LLC (manufacturer of fluid filtered milk products). Select is also the sole owner of Continental Dairy Products, LLC (manufacturer of dried dairy ingredients and condensed milks) and Continental Dairy Products Southwest, LLC (a Class IV manufacturer scheduled to begin operations in 2018). The dairy products manufactured at the identified plants each compete with products manufactured in California from milk produced and priced under the current California state order.

It is with this somewhat unique perspective as a national cooperative that has no California members that Select offers its comments relative to the various proposals to establish a federal milk marketing order for California.

Select supports the inclusion of California in the federal milk marketing order system. The maintenance of a separate and parochial system of milk

pricing provides for economic inefficiency. In addition, the existence of a separate pricing system for manufactured products creates real disadvantages for companies producing manufactured products that compete in a national (and increasingly international) marketplace. Select has long advocated bringing California into the FMMOs, and supported efforts during the 1996-1999 order reform process to establish a California federal order. Later, Select opposed efforts to legislate solutions to the interplay between the federal order system and the California state order. Accordingly, Select is pleased to support the efforts of California dairy producers to join the FMMO system.

Rather than submit a post-hearing brief that addresses the entirety of the questions and issues involved in this proceeding, this brief is narrowly focused on topics of key importance to Select as an association of producers operating in the broader federal milk marketing order program that California might become a part of. Those topics, more broadly examined herein, are as follows: (1) The inclusion of California in the FMMO system will provide greater market order and price uniformity; (2) The existing California State Order creates artificial economic advantages to product

manufacturers whose products compete with those produced by manufacturers in other areas of the country, including plants owned in part or in full by Select; (3) Any discussion regarding the retirement of California quota should be addressed outside of this hearing; (4) Proposal One should be modified to include a provision paying a uniform price for producers outside of California before the payment of quota; and (5) Inclusive or Mandatory pooling is a unique feature which the cooperatives have testified is necessary for the California Order and not one for consideration in other federal milk marketing areas.

II. The inclusion of California in the FMMO system will provide greater market order and price uniformity.

As seems to frequently be the case in milk marketing order hearings, a great deal of testimony was focused on the concept of “disorderly marketing,” its definition, and whether it exists in the current California market. To no one’s surprise, those in favor of a federal order argued that there are disorderly marketing conditions while those opposed asserted that there are none. What does seem to be undisputed is that there is no statutory definition (or regulatory definition) of the term. *See* Christ, Tr. Vol. XII at 2473, Schiek, Tr. Vol. XXI at 4116; Suever, Tr. Vol. XXI at 4184. Instead, various witnesses

have pointed to past decisions, reports, and studies that, they hope, will carry the day for them.

Select believes that the opening statement from the cooperatives and testimony from their key economic witnesses establish the case that the current economic situation is untenable. In the opening statements, counsel for the cooperatives explained:

The dysfunction in the state system, which has meant that California dairy farmers where milk has received minimum prices substantially less than those applicable to basically the rest of the country through the Federal Milk Marketing Order system, it has cost California dairy farm families millions and millions of dollars.

Tr. Vol. IV at 764.

The cooperative's expert in Agricultural Economics, Agricultural Policy, Dairy Policy, Regulation, and Dairy Marketing, explained his view of orderly marketing:

One of the primary goals specified in the Act is to "establish and maintain orderly marketing conditions." "Orderly marketing" is not specifically defined in the act; furthermore, the term "disorderly marketing" does not appear in the law. However, the Act does explicitly give the Secretary of Agriculture tools to create "orderly marketing conditions" in FMMO's.

Paul Christ, Tr. Vol. XII at 2473. Mr. Christ further tied the price discrepancy that currently exists between California and the rest of the nation to the

concept of orderly marketing and testified that orderly marketing was premised on the underlying aspects of “stability” and “efficiency” *Id.* at 2474. His ultimate conclusion, which Select agrees with, is that, “there will be more order if prices are, there's greater harmony in prices paid by processors in California and processors under the Federal Milk Order system.” *Id.* at 2492.

The lack of harmony between prices in California and the FMMOs impacts both producers and processors. Rob Vandenhuevel, General Manager of Milk Producers Council, testified specifically about the price inequality impacts on producers. Mr. Vandenhuevel described what had been referred to throughout the hearing as the “California Discount, ” the difference between California's Class 4b price and the FMMO Class III price. He explained that:

...applying that difference to the actual milk production figures in California, the milk production that is sold to cheese manufacturers in the State of California. And so what that figure per hundredweight equates to in dollars to the California pool. And through July of this year we had calculated that since 2010, that calculation had added up to more than \$1.8 billion over that five-year period, five and a half year period.

Vandenhuevel, Tr. Vol. X at 2044.

While producers feel the weight of the California Discount, processors in the FMMOs, such as Select, experience unfair and disorderly competition for its manufacturing plants, as explained below.

III. The existing California State Order creates artificial economic advantages to product manufacturers whose products compete with those produced by manufacturers in other areas of the country, including plants owned in part or in full by Select.

Testimony from Cooperative witness Elvin Hollon concisely explains the existing and stated policy of the Department with respect to manufacturing prices. Mr. Hollon explained that FMMO minimum manufacturing prices are national in nature “because the markets they compete in are national in nature . . . [and] [b]ased on the NASS dairy product production data, there are clear regional differences where dairy products are produced. Regional population density does not match production density, and thus product must move between regions to satisfy demand. Hollon, Tr. Vol. IV, 826. *See, also*, 64 Fed. Reg. 16096 (April 2, 1999).

Similarly, Mr. Hollon explained how this difference in manufacturing prices impacts a dairy producer:

Said another way, a dairy farm operator with two facilities, one in California priced at Class 4b and one in a Federal Milk Marketing Order area priced at Class III, would have experienced two vastly

different regulatory minimum prices for milk used to produce similar cheese and whey products. On average, this difference would be \$1.89 per hundredweight lower for milk from the California dairy than milk from a dairy operating in the Federal Milk Marketing Order for the period August 2012 through July 2015.

Hollon, Tr. Vol. IV at 839. But this negative impact on the producer located in California has an equally detrimental negative impact on manufactured product processors located in federal order areas.

The hearing record is replete with testimony establishing that California cheese manufacturers can and do transport their finished products across the nation, competing with cheeses manufactured in more local markets. Leprino's witness testified that nearly half of Leprino's California cheese production sold domestically is shipped East of the Mississippi. The witness also testified that the cost of trucking cheese from California plants to the Midwest is in excess of ten cents per pound and the cost of trucking to the Northeast and Southeast is approximately fifteen cents per pound. Taylor, Tr. Vol. XXXI at 6164-65.

Witnesses from Marquez Brothers International testified that their cheeses are regularly transported to markets including Chicago, Houston, and Dallas. Maldonado, Tr. Vol. XXIII at 4676. Similar testimony was offered by

Cacique, Inc. explaining that cheese is shipped to Central and Eastern Texas, even the East Coast. de Cardenas, Tr. Vol. XXIV at 4844, 67. Testimony in the hearing record pegged the transportation costs for these types of deliveries to range from 8 to 12 cents for deliveries to distant Texas and the Midwest, even higher for the East Coast. But tellingly, the Cacique witness explained that it would simply pass along higher milk costs to its customers if required to pay the same Class III prices as a hypothetical plant located in Texas. *Id.* at 4871.

Additional testimony from a DFA board member sets forth the practical concerns for the national market resulting from lower raw milk prices paid by California manufacturers:

As a member of the western area council, and as the board member of DFA, I have a shared responsibility for the company. What we see when we look across the national scope of the market, we see this as a disruption in the market, where lower priced product is able to travel long distances to the east and interfere with other plants that the coop owns in those markets. So we see this as a problem for DFA as a nationwide cooperative.

Olsen, Tr. Vol. VI, at 1220. Select, like DFA has national operations, and shares in these concerns. Imposing the same classified pricing requirements on California processors would address these disorderly conditions.

Dairy Institute's proposal to establish a whey factor based on the price of liquid whey should be rejected. Record evidence on the costs associated with

the handling of whey and the manufacturing of whey products is conflicting at best. But perhaps the most telling evidence on the matter of whey processing costs comes from the testimony of DIC member, Marquez Brothers International. In that testimony, the witness patently acknowledged that his plant was profitable even before installing its whey manufacturing capacity. Maldonado, Tr. Vol. XXIII at 4665. It can be inferred that the profitability of the plant only improved after its whey plant operations began. It is also important to note that this plant was constructed in 2004 -- a time when the California 4b price and the FMMO Class III price were in closer alignment.

Similarly, the witness representing Hilmar Cheese refused to provide information on the manufacturing costs for Hilmar's whey products, while simultaneously arguing that Federal Class III pricing formula should not be implemented in California. De Jong, Tr. Vol XXIII at 4550-52. One can draw the negative inference from Mr. De Jong's refusal to disclose evidence within his control that the evidence would be detrimental to his stated interests. *See, e.g.,* Exhibit 78 (arguing that the failure of the cooperatives to introduce certain evidence creates a negative inference with respect to that evidence).

Even if there were reliable evidence regarding whey processing costs and impacts, the Secretary has a long-standing policy regarding the manufacturing price formulas; they are national in scope reflecting the national market for manufactured products. A change of this magnitude to a policy as important as a single manufacturing price formula applicable across all federal orders should be undertaken only in the context of a national hearing.

IV. Any discussion regarding the retirement of California quota should be addressed outside of this hearing.

The CDFA witness, Don Shippelhoute, provided testimony and data with respect to California's quota system. Describing CDFA's Data Set I, Mr. Shippelhoute testified: "Milk in the pool is allocated quota, base and overbase. Quota milk is entitled to a higher revenue than other milk. The premium is based on pound to solids not fat. Quota solids receive 19 and a half cents per pound more out of the pool than non-quota solids. This quota premium simply is the amount of money needed to set aside off the top of the pool to finance that additional \$1.70, or 19 and a half cents per pound of solids not fat paid on quota milk." Tr. Vol XIII at 2622. Dr. Erba testified that the Cooperative Proposal would maintain two aspects of the current quota

system under the auspices of CDFA: the current \$1.70 quota differential and the current regional quota adjusters (RQAs) both of which are authorized under California state law and both of which require a public hearing process to modify. Tr. Vol. XI at 2201-02.

Although Select has concerns about the continued operation of a quota system that benefits only California producers and not other producers subject to the FMMOs, Select supports the implementation of a California FMMO that retains a quota system over the only probable alternative of allowing California to remain a separate state order, altogether outside of the FMMOs. In fact, witnesses testifying on behalf of the Cooperative Proposal testified that a California FMMO will not be approved in a producer referendum unless California's current quota system remains in place. Hollon, Tr. Vol. XV at 3017 ("Q. the quota program was described as a non-negotiable aspect of Proposal 1, correct? A. True.").

Moreover, the Processor Proponents at least initially seemed to agree, noting that if a FMMO was established in California, a key provision would be that: "The California quota system will remain intact and will be administered by CDFA. That operation of the FMMO traditional pool and the California

quota program will be jointly administered pursuant to a memorandum of understanding between USDA and CDFA and consistent with the authority of each under their respective programs.” DIC Response and Alternative Proposal for a CA FMMO, April 9, 2015, at 5, para. 2.

The Processor Proponents, over objection from the Cooperative Proponents, encouraged the Department to consider phasing out the California quota system over a period of years through an annuity payment program that would still recognize and pay quota holders in California the value of quota but provide for a strategy whereby quota could be eliminated in fewer than 10 years. Schiek, Tr. Vol. XXXIII at 6658-61. DIC stated that it was not endorsing that particular strategy at this time but was using it merely to illustrate that “there are solutions that recognize quota value without unending perpetuation of non-uniform blend prices to producers.” *Id.* at 6661. Select believes this alternative is not properly before the Department for consideration at this time.

V. Proposal One should be modified to include a provision paying a uniform price for producers outside of California before the payment of quota.

The treatment of out-of-state milk in a California FMMO is a critical issue for Select. CDFA’s witness, Don Shippelhoue, explained that out-of-

state milk production received by a handler located in California is not currently calculated in the California pool. Tr. Vol. XIII at 2700 (“The milk pounds are not included in our pool, nor is the revenue.”). Although out-of-state milk is reported to CDFA, “it goes through our system and it goes through the computations, that at the end of all those computations, it gets kicked out or left out of the pool.” *Id.* at 2701.

Select’s concerns are shared by the Processor Proponents. Dr. Schiek, testifying on behalf of the Processor Proponents, summarized the concern for out-of-state producers as follows: “When we examined the Cooperative proposal, we first concluded that the non-quota blend price concept, that is, setting aside the quota premium payment first from overall Producer Settlement Fund proceeds, does not properly address the issue of out-of-state dairy farmer milk that will end up being part of any FMMO pool. Historically, all out-of-state dairy farmers’ milk was credited at the plant blend under the California State Order (CSO). Those farmers could not, and did not, own any quota, and the plant blend they received compensated them for the fact that they did not have the opportunity to receive a quota price. It is, of course, the case that FMMO’s have the right to pool out-of-state milk, unlike the CSO.

However, we believe that the out-of-state milk must receive the traditional FMMO blend price without subtraction of the quota premium.” Tr. Vol. XXXIII at 6635.

The Cooperative Proponents apparently do not disagree and repeatedly admitted that their proposal will impact out-of-state producers and will result in those producers receiving the non-quota blend. Elvin Hollon agreed that implementation of the Cooperative Proposal would change the treatment of out-of-state milk as follows: “to the extent that one or more Arizona plants that are presently regulated under the Arizona Order would become regulated under the California Federal Order under . . . Proposal 1, and to the extent that those plants, that one or more plants receive milk from Arizona dairy farmers who cannot own quota, their price or the credit the handler would receive for their milk would be now under the Federal Order . . . equal to the non-quota blend price . . .” Tr. Vol. XIV at 2853.

Dr. Erba also acknowledged that although the implementation of a California FMMO would achieve handler equity as it relates to out-of-state milk coming into California (Tr. Vol. X at 2139) it would not achieve producer equity because the out-of-state producer would receive “the uniform non-

quota price” which he acknowledged would result in disparate treatment for out-of-state producers since they are not eligible to own quota. *Id.* at 2141.

Dr. Schiek, explained that the Processor Proponents considered several alternatives for accomplishing their goal of making sure that out-of-state producers are paid a traditional blend price. Tr. Vol. XXXIII at 6636. The Processor Proponents considered a system that would have two pool calculations, wherein the first would first pay the full order blend price to out-of-state producers and the remaining funds would be calculated after the payments to the out-of-state producers were made and distributed among all California producers in the pool, on the basis of quota and non-quota pounds. *Id.* Although the Processor Proponents have moved away from that approach, Select believes it remains a viable alternative.

Charles Turner, testified on behalf of Desert Hills Dairy, a producer located in Yerington, Nevada. Mr. Turner offered testimony because his dairy has been shipping milk into California since the 1990s. Tr. Vol. XXI at 4080. Desert Hills Dairy currently receives a plant blend price for milk it delivers into California. *Id.* at 4082. He testified that it was not fair for out-of-state dairies shipping milk into California to be paid a non-quota federal order

blend price because his dairy is ineligible to own quota or receive transportation allowances. *Id.* at 4082-83, 4089. Of the alternatives being considered by the Department, Mr. Turner testified that the proposal offered by the Cooperative Proponents would be the “worst scenario” for dairies in Northern Nevada that historically and currently are shipping into California. *Id.* at 4085. The disparate treatment of farms like his is based solely on the fact that his dairy is located outside of the state of California. *Id.* at 4090.

Another DIC witness explained his concern that not affording out-of-state producers access to a pre-quota uniform price might run afoul of the AMAA’S prohibition against trade barriers. “Proposal 1 would make a second, or I say third class citizen of any producer from out-of-state who wants to market into California if there's a proposed Federal Order. It would provide the worst possible price available to that producer and treat in-state producers better in many ways. That would be intention (sic, in tension) I think, with 8c(5)(G).” *Vetne, Tr. XXVI at 5169.*

The solution to this inequity can be remedied by providing a mechanism for the payment of a uniform price to out-of-state producers pooled on the California Order before calculating the payment to California

quota holders. Milk Producers Council agreed that if the FMMOs will regulate milk that crosses over a state line, it should be done in a “fair and equitable manner.” Vandenheuvel, Tr. Vol. X at 2072.

VI. Inclusive or Mandatory pooling is a unique feature which the cooperatives have testified is necessary for the California Order and not one for consideration in other federal milk marketing areas.

The Cooperative Proposal introduces, for the first time in a FMMO, the concept of mandatory, or inclusive, pooling. Hollon, Tr. Vol. XIII at 2737. If the Department determines that mandatory pooling should be included in a proposed California FMMO, the decision to do so should be based on factors unique to California alone and should not be viewed as a precedent for similar regulation in other FMMOs that do not have the same market conditions as California currently has.

Even the Cooperative witnesses acknowledged that it is California’s unique marketing conditions that led to the request for the adoption of mandatory pooling. Hollon, Tr. Vol. XII at 2736 (“The combination of low FMMO Class I and II use, and the very high and near equal volumes of Class III and IV use, and the unique presence of the quota system, combine for very different market conditions that calls for specific and unique solutions.”).

Paul Christ also noted factors that make California unique from other FMMOs, including: (1) The CSO currently pools all Grade A milk so a handler gains no advantage from depooling milk, therefore the concept of mandatory pooling is not new to California; and (2) Because of the quota program, if depooling were to occur, it would reduce revenues from the higher valued manufacturing uses, and reduce the uniform price for milk remaining in the pool and would have a bigger relative impact on residual milk. Tr. Vol. XII at 2549, 2452.

Issues with depooling have been successfully managed in other FMMOs without resorting to mandatory pooling. Erick Metzger testified: "When depooling became a problem six, eight, ten years ago, amendments to the Orders were made so that yes, you could still depool your manufactured milk, but the process to get it reassociated with the pool was limited to like 115 percent of your previous month's pooling. So if you saw a "windfall", by depooling milk in a particular month with a large negative PPD, you had to temper your decision with potential that you would be foregoing positive PPD's in the ensuing months because of the restrictions on the amount of milk you could reassociate with the pool." Tr. Vol. XIX at 3733-34. The

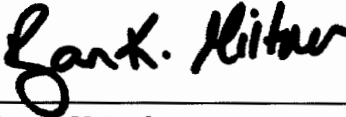
pooling provisions associated with a particular Order must continue to reflect the unique conditions within that market.

VII. Conclusion

Select supports the establishment of a federal milk marketing order for California. The hearing record clearly establishes that bringing California into alignment with the federal minimum price formulas will provide greater market order. In the specific area of manufactured products, the application of federal prices to California will eliminate raw product discrepancies between plants under different regulatory schemes that now allow products manufactured in California to compete in distant markets unfairly.

Select supports the adoption of Proposal One because it more directly ties the California market to the rest of the FMMO system. The treatment of out-of-state milk under Proposal One, however, must be changed by providing for a pre-quota uniform price provision.

Respectfully Submitted,



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