

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

In re:	) Docket Nos.
Milk in the Northeast, Appalachian,	) AO-14-A78, AO-388-A23,
Florida, Southeast, Upper Midwest,	) AO-356-A44, AO-366-A52, AO-361-A44,
Central, Mideast, Pacific Northwest,	) AO-313-A53, AO-166-A73, AO-368-A40,
Southwest, and Arizona Marketing	) AO-231-A72 and AO-271-A44,
Areas	) DA-09-02, AMS-DA-09-0007

**POST-HEARING BRIEF OF**  
**THE INTERNATIONAL DAIRY FOODS ASSOCIATION**

This post hearing brief is submitted on behalf of the International Dairy Foods Association (IDFA). IDFA represents the nation’s dairy manufacturing and marketing industries and their suppliers, an industry whose retail value of production exceeds \$100 billion annually. IDFA is composed of three constituent organizations: the Milk Industry Foundation (MIF), the National Cheese Institute (NCI) and the International Ice Cream Association (IICA). IDFA’s 220 dairy processing members run more than 600 plant operations that range from large multi-national organizations to single-plant companies. Together they represent more than 80 percent of the fluid milk, cultured dairy products, cheeses and frozen dairy desserts produced and marketed in the United States.

As buyers and processors of milk, IDFA members have a critical interest in this hearing. Most of the milk bought and handled by IDFA members is regulated under the federal milk marketing orders (FMMO) promulgated pursuant to the Agricultural Marketing Agreement Act of 1937 (AMAA).

This hearing was called to consider proposals to modify federal order regulations in all marketing areas with respect to producer-handlers and exempt handlers. IDFA urges USDA to adopt Proposals 1 and 2 as they -- and only they -- best address the issues

cited by witnesses for the National Milk Producers Federation (NMPF), IDFA and others at the hearing.

**The hearing record clearly supports the adoption by USDA of Proposal 1.**

Federal orders establish the minimum price that handlers must pay dairy farmers and their cooperatives. The minimum price established for Class I (fluid) milk is intended by design to be the highest of these regulated prices. However, the regulated minimum price actually received by dairy farmers and cooperatives from handlers is the uniform or blend price, which reflects each federal order's utilization of each class of milk and the minimum price for each class. Because the regulated minimum price for classes other than Class I are intended by design to be lower than the Class I price, the uniform price is nearly always lower than the Class I price (Yonkers, Tr. page 2434).

Producer-handlers currently are entirely exempted from the obligation to pay minimum class prices in eight of the ten federal order milk marketing areas, and are exempted in the other two marketing areas if their Class I use remains below 3,000,000 pounds per month (Yonkers, Tr. pages 2434-5). With respect to Class I milk, this means a producer-handler can, in effect, pay the uniform price for their own farm milk rather than the Class I price. The testimony of NMPF's Dr. Cryan (Tr. pages 406-8; Exhibit 23 page 23) demonstrates how this provides a producer-handler a very substantial advantage in the cost of farm milk as compared to the cost incurred by regulated plants processing and marketing Class I fluid milk products solely as a result of this regulatory exemption.

**A number of witnesses described how having some, but not all, fluid milk plants subject to the Class I minimum price has created disorderly marketing conditions.** Mr. Berthiaume of St. Albans Cooperative located in Vermont noted that in

recent years a producer-handler exempt from pricing and pooling regulations and located outside the northeastern U.S. has gained Class I sales at the expense of regulated dairy handlers and their dairy farmer suppliers in his region (Tr. Pages 647-8). Similarly, Mr. Segalla (Tr. Pages 1750-2) and Ms. Arnold (Tr. Pages 1756-9), who were part of a panel of organic dairy farmers, both testified about the loss of organic fluid milk sales to the same out-of-region organic producer-handler by the regulated plants they ship to. Mr Daniels, a dairy farmer and testifying on behalf of the Michigan Milk Producers Association, noted that regulated handlers and their dairy farmer suppliers had lost business to producer-handlers in recent years (Tr. Pages 799-800). Mr. Lee of Prairie Farms Dairy, Inc. described instances when his cooperative's regulated fluid milk processing operations lost fluid milk sales to an exempt producer-handler or been forced to significantly lower prices in recent years to remain competitive with an exempt producer-handler (Tr. Pages 945-7). Mr. Krueger of Shamrock Foods described the impact on the Arizona marketplace of a new producer-handler several years ago, and noted that despite claims at that time that removing the producer-handler exemption would lead to it ceasing operations, the entity in question continues to operate following regulatory changes adopted in 2005 (Tr. Pages 1362-7). In fact, Mr Carrejo of Dean Foods testified that the same owner of that producer-handler in Arizona has entered the El Paso market with a new exempt Texas producer-handler farm and processing plant and has had a major impact on that marketplace in recent months (Tr. Pages 1446-51). Mr. Wermet of Bareman Dairy, a regulated handler in Michigan, noted that his firm competes for business with an exempt producer-handler (Tr. Pages 2307-11) Mr. Hollon, testifying for the Dairy Farmers of America, detailed several examples of market impacts

of exempt producer-handlers in regions where his cooperative supplies regulated handlers (Tr. Pages 3774-5).

Handlers not subject to such regulations can use their artificial cost advantage to offer customers lower-priced processed milk to offer increased customer services, to invest additional funds in their plant operations or to engage in a combination of these business strategies (Yonkers, Tr. 2435-6). Dr. Schiek testified at the request of NMPF regarding instances in California where producer-handlers acted to use their regulatory cost advantage to take fluid sales away from regulated handlers (Tr. Pages 2139-41). All of these opportunities stem from the increased profits artificially created by the producer-handler regulatory exemption.

**Examples of the importance of this competitive advantage were provided by a number of witnesses, who currently operate as producer-handlers, who testified in opposition to Proposal 1.** Mr. Hatch described the advantage of being an exempt producer-handler for his operation in New Hampshire as 50 cents per gallon (Tr. Pages 317-8). Mr Dunajski, a producer-handler in Massachusetts, wants the flexibility for the exemption to grow larger in the future even though his current production is well below the size-based exemption proposed by IDFA and NMPF in Proposal 2 This is a clear demonstration that he wants the option to increase his exempt Class I sales substantially (Tr. Pages 345-6). Mr Brunton, a producer-handler from Pennsylvania, noted in his testimony that he did not disagree with the estimate of a 15 cent per gallon competitive advantage due to the current producer-handler exemption (Tr. Pages 3246-7), and further noted that while his business would remain exempt if Proposal 2 were adopted, the combination of the adoption of Proposals 1 and 2 may actually help their business grow

by allowing them to purchase milk from other farms and remain below the 450,000 size-based exemption limit in Proposal 2 (Tr. Page 3261).

In addition, many of the existing producer-handlers and others who testified in opposition to Proposal 1 also supported some limit on the Class I volumes to be exempted from pricing and pooling by existing and/or future producer-handlers. This is a demonstration of the fear that even existing producer-handlers have of a future where large farms become producer-handlers and further disrupt the marketplace not only for regulated handlers but also for smaller producer-handlers.

**Other examples of the importance of the producer-handler exemption were provided by the witnesses who have designed their business hoping to become exempt producer-handlers.** Mr. Dakin, a dairy producer from Florida who built a fluid milk processing facility and began marketing fluid milk products in March 2009, wants to become a producer-handler in order to be exempt from paying into the pool (Tr. Page 885). Messer's Bower and Montgomery, relatives who each own dairy farms with a fluid milk processing plant owned by only one of them, would like to be exempted from pricing and pooling as a producer-handler (Tr. Pages 1585-1600). Finally, Mr. Docheff, a Colorado dairy producer who built a fluid milk plant and began selling fluid milk products in March 2008, is merely waiting for increased fluid product sales to reach 60 to 65 percent of his farm production before seeking producer-handler exempt status (Tr. Page 2594).

**Exempting producer-handlers creates disorderly marketing by excluding from the order pool the funds representing the difference between the Class I and uniform price with respect to the producer-handler's sales volumes.** This denies

other dairy farmers and their cooperatives a uniform price, because the exempt producer-handler can derive and keep a price in excess of the uniform price by selling its fluid milk products to customers based on a farm milk price above the uniform price but still below the Class I minimum price (Yonkers, Tr. page 2436). Dr. Cryan from NMPF testified about the loss of pool revenue from producer-handler Class I sales (Tr. pages 408-410). Mr. Tonak, testifying for Mid-West Dairymen's Co. and Lakeshore Federated Dairy Cooperative, said: "Since the producer-handler does not contribute to the pool the net effect is to reduce the revenue for all pooled producers." (Tr. Page 516). Mr. Asbury of Maryland-Virginia Milk Producers testified that "limits on a producer-handler's ability to take Class I sales from the market-wide pool must be adopted" (Tr. page 574). Mr. Newell, a dairy producer and member of DFA, said: "The prices my neighbor and I receive for milk will be lower when producer-handler Class I sales are excluded from the pool." (Tr. page 690). Similar comments were made by fellow dairy producer and DFA member witnesses Ms. Damm (Tr. Page 697) and Mr. Traweek (Tr. Pages 702-3).

**The hearing record also demonstrates that fluid milk customers such as large retail grocery chains are very aware of this cost advantage enjoyed by producer-handlers and have actively sought out opportunities for producers and/or processors to become producer-handlers.** Extensive testimony on this topic came from Mr. Wilcox on behalf of a group of fluid milk handlers (Prairie Farms Dairy, Dairy Institute of California, Northeast Dairy Farmers Association, Anderson-Erickson Dairy Company, Pennsylvania Association of Milk Dealer's, Dean Foods Company, National Dairy Holdings, LP, Shamrock Food Company, Shamrock Farms, and Partner Farms). He noted that large grocery and food service chains are very aware of the producer-

handler exemption and described how the structure of the fluid milk market has changed so that retailers are able to use multiple suppliers of fluid milk products. This includes exempt producer-handlers and regulated handlers as suppliers, thereby providing a mechanism to balance the producer-handler supply with other regulated suppliers and overcoming any disadvantage a producer-handler may have in not being able to match their fluid milk production with a customer's variable demand for fluid milk products (Wilcox Tr. 1302-6). In fact, Mr. Wilcox described in detail an example from his personal experience when a large purchaser of fluid milk products approached the owners of Wilcox Dairy Farms LLC seeking their re-organization as a exempt producer-handler in order to reduce the wholesale cost of fluid milk product (Tr. Pages 1304-5). Mr. Krueger of Sharmrock Foods in Arizona submitted similar testimony, noting the "reality that none of the relatively few players in the retailer supermarket business and the mass merchandiser business can afford to allow any of their competitors to gain a significant competitive advantage" (Tr. Page 1358). Testifying on behalf of Country Dairy, an exempt producer-handler in Michigan, Mr. Arkema noted that other regulated handlers were supplying the same customers served by his company (Tr. Pages 3682 and 3685). Mr. Lee, testifying on behalf of Prairie Farms, noted that the concept of exempt producer-handlers as a supplier of fluid milk products "intrigues large national retailers" (Tr. Page 948).

**Whatever historical justification may have once existed for the producer-handler exemption, it clearly no longer applies in light of the significant structural changes which have occurred at all levels of the dairy product marketing chain.** Not only has the average farm size increased, whether measured in terms of number of milk

cows or total farm milk volume, but the share of total U.S. farm milk production from the largest farm size categories has also grown substantially. USDA reports that in 2008 the 730 dairy farms in the U.S. with 2000 or more milk cows accounted for 30.5 percent of all U.S. milk production. This is a significant increase from 1998, the first year USDA began reporting the 2,000 or more milk cow's category. Then 235 such farms accounted for only 8.4 percent of milk production. Farms with more than 500 milk cows accounted for 58.5 percent of U.S. milk production in 2008. To put this in perspective, the top five states ranked by milk production per cow had an average of more than 23,000 pounds produced per cow. This means that a farm located in these states with 500 milk cows produced on average 11.5 million pound of milk per year, nearly 1,000,000 per month. A 2,000 cow herd with a 23,000 pound per cow average would produce 46,000,000 pounds per year, or nearly 4,000,000 pounds per month. Very large farms, with levels of total milk production never contemplated during the decades when the producer-handlers were exempt from pricing and pooling regulations of federal orders, are a fact of life in the marketplace today. The pernicious impact of broad exemptions for producer-handlers has simply grown too large to ignore any longer (Yonkers, Tr. Pages 2436-37). NMPF's Dr. Cryan also testified to the rapidly changing structure of the dairy farm sector and the volumes of milk produced by large farms that could become producer-handlers (Tr. Pages 404-5)

**The hearing record also clearly supports the adoption of Proposal 2 by USDA.** This proposal will preserve the exemption from regulation for those plants too small to cause material market disruption, including those small plants previously exempted as producer-handlers (Yonkers, Tr. Page 2438).



As Dr. Cryan of NMPF noted in his testimony, the current 150,000 pounds per month threshold was adopted in all federal milk marketing areas beginning January 1, 2000 as part of what is known as federal order reform. In the final decision to implement that provision, USDA noted that this was the highest volume threshold then in existence in federal order marketing areas prior to 2000. Dr. Cryan added that this limit first was adopted in the West Texas - New Mexico marketing area in 1991 (Tr. Pages 413-5).

The average volume of fluid milk products produced by U.S. fluid milk bottling plants operated by commercial processors in the West Texas - New Mexico marketing area has roughly doubled, from 93.9 million pounds annually in 1990 to 189.8 million pounds in 2007 (the most recent data available). While this might suggest the current threshold should also be doubled, IDFA and NMPF support tripling it. The data clearly show that average fluid milk bottling plant volumes continue to increase over time. Proposal 2 allows for future growth while keeping the limit in line with the industry structure at the time the threshold was first adopted in the early 1990's (Yonkers, Tr. Page 2439).

Proposal 2 also requires that an exempt plant sell its fluid milk products using unique labels, to prevent this exemption from being abused through the establishment of numerous small plants and linking them together to market their milk jointly, garnering the advantages of a large plant without being subjected to minimum price regulations. This is not intended to prevent an exempt plant from marketing packaged fluid milk under more than one label. For example, an exempt plant could have its own label, another for a local home delivery distributor solely supplied by that exempt plant, and even a third label for a local grocery store solely supplied by that exempt plant. This

provision of Proposal 2 is intended to prevent a large distributor, retailer or other entity from coordinating the production of fluid milk products from a number of smaller, exempt plants under the same label. As an example only, an exempt plant under this proposal should not be able to distribute a fluid milk product under the name "IDFA Milk Company" if any other handler also distributes a fluid milk product using that same label name (Yonkers, Tr. 2439-40).

**While a number of other proposals were submitted by other parties and included in the hearing notice, IDFA urges USDA to reject those and only adopt Proposals 1 and 2.** While the proposals that seek to continue the producer-handler exemption from pricing and pooling provisions with some volume limit appear to support the position of NMPF and IDFA -- that exempt producer-handlers at some point become disruptive to the marketplace -- their adoption by USDA would in effect continue the problem of disorderly marketing created by this exemption. In particular, Proposals 23 and 24 would create new incentives for existing regulated handlers to invest in dairy farms and/or retail stores for the sole purpose of gaining a new exemption from pricing and pooling regulations on at least a portion of their Class I sales (Yonkers, Tr. 2440-1). Proposal 25, rather than being innovative, instead proposes going back many years when such a provision existed in federal orders. There were many hearings over many years in which this type of provision was found to contribute to disorderly marketing, and IDFA urges USDA to reject its adoption today (Yonkers, Tr. 2441).

Many of the witnesses testifying in opposition to Proposal 1 spent considerable time during the hearing describing a variety of unique characteristics of their farm operation, their milk processing facility, their milk quality, their packaging, their

distribution methods or some combination of one or more of these. These characteristics are not unique to producer-handlers. There were no proposals in the notice of hearing -- indeed none submitted to USDA after its request for comments and additional proposals prior to the issuance of the notice of the hearing -- that would create an exemption for all farms, or all handlers, or all distributors which share those unique characteristics. For example, witnesses testifying for producer-handlers and others noted their farm milk or fluid milk products met certain standards like USDA's organic certification or kosher certification, but there was no noticed proposal to exempt Class I milk that meets such certifications. Witnesses for both producer-handlers and other dairy producers presented testimony about farm costs of producing milk, but there is not a proposal to create an exemption for all farm milk with a farm cost of producing milk above a certain threshold.