

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

In Re:

GH DAIRY, a partnership,
Petitioner.

Docket No. AMA M 10-0283

**PETITIONER'S MERIT BRIEF IN SUPPORT OF
PETITION UNDER 7 U.S.C. §608(15)(A)**

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II. Introduction and Background

A. Introduction

Petitioner, GH Dairy, challenges as contrary to law the definition of “producer-handler” as amended by the Secretary’s Final Decision¹ and Final Rule.² Before the amendment, GH Dairy operated as a producer-handler under the Southwest Milk Marketing Order.³ GH Dairy, as part of the American Independent Dairy Alliance (“AIDA”), a coalition of producer-handlers and exempt handlers, participated in the formal rulemaking proceeding, which led to the Final Decision and Final Rule.

GH Dairy seeks review of the underlying rulemaking pursuant to the Agricultural Marketing Agreement Act (“AMAA”)⁴ and the Administrative Procedure Act.⁵ GH Dairy raises three principal challenges to the Final Decision and the Final Rule. (1) The Final Decision and Final Rule exceed the limited authority delegated to the Secretary by Congress in the AMAA. (2) The Final Decision and the Final Rule are not supported by substantial evidence, are arbitrary and capricious, and are otherwise contrary to law. (3) The Final Decision and Final Rule do not comport with the AMAA because the Secretary has failed to comply with the statutory requirement to make a factually supported determination that the amendment of the producer-handler definition in all marketing orders is the only practical means to effectuate the AMAA and the amended producer-handler definition results in unequal minimum prices for producer-handlers and regulated handlers at source.

¹ 75 Fed. Reg. 10122 (March 4, 2010).

² 75 Fed. Reg. 21157 (April 23, 2010).

³ 7 C.F.R. Part 1126.

⁴ 7 U.S.C. §§ 601, *et seq.*, and specifically 7 U.S.C. § 608c(15)(A).

⁵ 5 U.S.C. §§ 501, *et seq.*

B. Background

The formal hearing centered on the question of whether the United States Department of Agriculture should eliminate the long standing right of a dairy farmer to own his or her own cows, process the milk from those cows and sell it independent of the regulated pool. A fundamental issue in answering that question was whether producer-handlers, who purchase no milk, must be subjected to minimum classified prices, coupled with mandatory compensatory payments to the regulated pool, without regard for the producer-handler's cost of production.

The Final Decision and Final Rule emanated from proposals offered by the principal trade association for dairy cooperatives, the National Milk Producers Federation ("NMPF") and the principal trade association for milk handlers, the International Dairy Foods Association ("IDFA"). Following an evidentiary hearing held in Cincinnati, Ohio, interested parties, including AIDA filed proposed findings and conclusions. The Secretary then issued a Recommended Decision, which was followed by Exceptions and Comments filed pursuant to the Department's Rules of Practice. The Secretary issued his Final Decision, which tracked the Recommended Decision, followed by the Final Rule.

The Final Decision and Final Rule limit producer-handlers to 3,000,000 pounds per month of Class I route disposition in all marketing areas. Producer-handlers exceeding the 3,000,000 pound limitation are fully subjected to minimum pricing and pooling of revenues. Because producer-handlers do not purchase milk, the Secretary accepted the theoretical "transfer price" theories of NMPF and IDFA and now assesses producer-handlers which exceed 3,000,000 pounds of Class I disposition per month a compensatory payment equal to the difference between the Class I minimum price and the order's blend price.

The AMAA does not, however, provide the Secretary with the legal authority to impose

the minimum pricing and pooling provisions of the milk marketing orders on producer-handlers who do not purchase milk nor may the Secretary alter the regulatory status of producer-handlers. The AMAA only authorizes the establishment of minimum prices and pool obligations on milk purchased from producers. The Department has long maintained this position by exempting producer-handlers from such regulations. Congress has on multiple occasions not only ratified that interpretation but legislated that the “legal status of producer-handlers” (exemption from pricing and pooling) must remain unchanged. Congress has not amended or repealed these permanent statutes expressly or implicitly, a fact which the Department acknowledged and accepted in order reform. And in the passage of the Milk Regulatory Equity Act of 2005 (“MREA”), Congress specifically carved out one marketing area for change while reiterating that the Secretary’s authority as to all other marketing areas remained unaltered.

In the Final Decision, the Secretary also accepted the theoretical constructs of NMPF and IDFA that producer-handlers could possibly cause a “disorderly marketing” condition in the future. The Secretary also accepted the theory that producer-handlers have a raw-milk cost advantage over regulated handlers.

But the actual evidence in the hearing record does not support the Secretary’s findings– it unequivocally disproves them. The linchpin of the Final Decision is theoretical - producer-handlers purportedly secure their raw milk at the regulatory blend price and do not have to account to the pool for the difference between the blend price and their Class I milk sales, as regulated handlers do. The evidence unequivocally demonstrates as a matter of economic fact, however, that the producer-handler raw milk cost is the cost of production on the farm. USDA’s own statistics demonstrate that this cost of production exceeds both the blend and Class I price.

The producer-handler is thus already incurring costs of milk greater than the minimum blend and Class I prices.

Therefore, there is no “unfair cost advantage” to producer-handlers, as the Final Decision and Final Rule conclude. Nor is there currently any “disorderly marketing condition” that would justify such an extraordinary change in national policy. Instead, the Final Decision and Final Rule further increase producer-handlers’ raw milk cost and exacerbate the spread between their costs and those of regulated handlers. Payment systems that create such price inequities and which do not reflect the actual costs of the handlers involved are impermissible under the AMAA. Moreover, and most importantly, as noted above and further explained in the following section, the Secretary lacks the legal authority to impose price regulations on producer-handlers where no purchase of milk occurs. This has been the case since the passage of the AMAA and remains so today. Therefore, the amendment to the producer-handler definition is contrary to law and must be reversed.

III. The Final Rule is contrary to the Secretary’s statutory authority.

To determine whether the Secretary’s Final Rule exceeded the limited authority in the AMAA, the Administrative Law Judge must begin with first principles. “An agency literally has no power to act * * * unless and until Congress confers power upon it.”⁶ Because an agency’s power to promulgate regulations is limited to the authority delegated by Congress, a tribunal reviewing regulations promulgated pursuant to a statutory mandate must “reasonably be able to

⁶ *La. Pub. Serv. Commn. v. FCC*, 476 U.S. 355, 374 (1986).

conclude that the grant of authority contemplates the regulations issued.”⁷ Agency actions beyond delegated authority are *ultra vires* and must be held invalid.⁸

When asked to decide whether an agency has exceeded the authority granted to it by statute, the two-part test laid down by the Supreme Court in *Chevron U.S.A., Inc. v. NRDC*⁹ is applied. First, the Administrative Law Judge must determine “whether Congress has directly spoken to the precise question at issue,”¹⁰ by examining “the particular statutory language at issue, as well as the language and design of the statute as a whole.”¹¹ If Congress’s intent is clear, the ALJ must give it effect.¹² If the statute is ambiguous, the agency’s interpretation of the statute is entitled to deference only if it is reasonable and consistent with the statutory purpose.¹³

This is a *Chevron* step one case. The AMAA specifically defines the provisions that may be included in a milk marketing order, and prohibits any provisions beyond those specifically enumerated. Thus, under *Chevron* step one, the Secretary’s regulatory authority is limited to those provisions listed in 7 U.S.C. §608c(5).

In those sections, the AMAA requires that there be a purchase of milk by a handler from a producer in order to trigger the imposition of minimum prices. Because no such purchase

⁷ *Chrysler Corp. v. Brown*, 441 U.S. 281, 308 (1979).

⁸ *TransOhio Sav. Bank v. Dir., Off. of Thrift Supervision*, 967 F.2d 598, 621 (D.C. Cir. 1992); see also 5 U.S.C. § 706(2)(C).

⁹ *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984).

¹⁰ *Id.* at 842.

¹¹ *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291 (1988).

¹² *Chevron*, 467 U.S. at 842-843.

¹³ *GTE Serv. Corp. v. FCC*, 205 F.3d 416, 421 (D.C. Cir. 2000).

occurs in the instance of a producer-handler, the Final Rule contradicts express Congressional language.

A. The Secretary's authority under the AMAA is limited to the regulation of handlers who purchase milk from producers.

Under the plain language of the AMAA, milk marketing orders may only set minimum prices paid when handlers purchase milk from a producer:

In the case of milk and its products, orders issued pursuant to this section shall contain one or more of the following terms and conditions and . . . no others: . . . Classifying milk in accordance with the form in which or the purpose for which it is used, and fixing . . . minimum prices for each such use classification which all handlers shall pay . . . for milk purchased from producers or associations of producers.¹⁴

The statutory prerequisites to the regulation of minimum prices are (1) a purchase, (2) by a handler, (3) from a producer or association of producers.

The word “purchase” is defined as to obtain something, “in exchange for paying money or its equivalent; [to] buy.”¹⁵ No such purchase occurs within an integrated producer-handler entity. Producer-handlers do not “purchase” their own product, they produce it.¹⁶ There is no exchange, no transfer of ownership, and no payment of money. Therefore, the statutory predicate for minimum price regulation is lacking with respect to producer-handlers in the Final Rule.

¹⁴ 7 U.S.C. § 608c(5)(emphasis added).

¹⁵ American Heritage Dictionary of the English Language, p. 1061 (1969).

¹⁶ Gibson, Tr. 640 (transcript references in this brief are to the transcript of the underlying rulemaking hearing, the pages of which are numbered sequentially for the course of the multi-day hearing.).

If the plain language of Section 608(c)(5) is not plain enough, the totality of the statutory text confirms that the Secretary's authority is tied to the occurrence of a "purchase" by a handler and a transfer for value from one entity to another:

- Section 608c(5)(B) authorizes uniform payments to all producers delivering milk to handlers, regardless of use, subject to adjustment "to encourage seasonal adjustments in the production of milk through equitable apportionment of the total value of milk purchased by any handler, or all handlers, among producers on the basis of their marketings of milk . . . and . . . a further adjustment, equitably to apportion the total value of milk purchased by any handler," based on milk components.
- Section 608c(5)(C) authorizes USDA to provide "a method for making adjustments in payments, as among handlers (including producers who are also handlers), to the end that the total sums paid by each handler shall equal the value of the milk purchased by him at the prices fixed in accordance with paragraph (A) of this subsection."
- Section 608c(5)(D) provides for determination of the price to be paid for "all milk purchased by handlers from any producer who did not regularly sell milk" during the prior 30 days.
- Section 608c(5)(E) provides for the assurance of, and security for, "the payment by handlers for milk purchased." (Emphasis added).

In each provision of Section 608c(5), the Secretary's authority is expressly tied to a "purchase." The introductory language of Section 608c(5) states that a FMMO may contain no other provisions other than those authorized by these Subsections. Congress' explicit and repeated use of the term "purchased" is not inadvertent but is a deliberate manifestation of its intent to limit federal price controls to the occurrence of a "purchase."

Congressional intent is also evident in the use of the word “price.” The ordinary meaning of “price[]” is “the sum of money or goods asked or given for something” or “the cost at which something is obtained.”¹⁷ The statutory text reinforces the ordinary meaning of “price” by providing that section 608c(18) applies to all terms that, “fix minimum prices to be paid to producers.”¹⁸ This further supports the conclusion that Congress intended that there be an arms-length transaction between separate and distinct entities for the transfer of milk, coupled with an exchange of money or value.

Certainly, Congress knew how to regulate agricultural products if it had intended to accomplish minimum price application to producer-handlers. Congress could have directed that the producers of all fluid milk sold within a marketing area would receive the same price for their product, regardless of whether they sold milk directly to customers or sold milk to a handler. Congress also could have provided USDA authority to limit the total quantity of milk produced, as it did within the AMAA for agricultural products other than milk,¹⁹ or more broadly outlined the Secretary’s authority to regulate handling of covered commodities.

For example, in the case of raisins, a commodity regulated under Section 608c(6) rather than Section 608c(5), the Secretary is authorized to regulate the first handler of raisins, regardless of whether title transfer occurs.²⁰ When one packer of raisins engaged in a “shell game” to evade his responsibilities under the raisin order, the Judicial Officer rejected the

¹⁷ American Heritage Dictionary of the English Language, p.1038 (1969).

¹⁸ 7 U.S.C. § 608c(18).

¹⁹ 7 U.S.C. § 608c(6).

²⁰ See 7 C.F.R. § 989.13 (defining “processor” as “any person who receives or acquires natural condition raisins . . .”), § 989.15(a) (defining “handler” as “[a]ny processor or packer”) and § 989.55 (authorizing the Secretary to establish reserve and free percentage of raisins “acquired by handlers during the crop year.”).

argument that in the absence of a purchase, the packer did not implicate the terms of the raisin order, “Under the Raisin Order, the term ‘acquire’ is a term of art that does not encompass an ownership interest but rather physical possession. Mr. Horne and partners obtained physical possession of - thus they “acquired” - raisins when a grower brought raisins to the facility.”²¹

In moving for summary judgment in the 15(B) proceeding following the Judicial Officer’s decision in *Horne*, the Secretary explained:

The term “acquire” is specifically defined by the regulations, and the definition makes clear that physical possession at a packing plant, not transfer of title, is the triggering event. * * *

A person who has or obtains physical possession of raisins at a packing facility is therefore a “handler” whether or not he has legal title to the raisins. In order to accept Plaintiffs’ construction of the term, the Court would have to ignore the plain terms of the regulation and insert language about legal title where none exists.²²

Milk, regulated under 7 U.S.C. § 608c(5), is different from raisins, regulated under 7 U.S.C. §608c(6). For milk, Congress authorized USDA to impose price controls only upon milk “purchased” by a handler from a producer. For commodities other than milk, including raisins, the Secretary is not limited to price regulation triggered by a purchase. The Secretary, in his arguments in the *Horne* case, explicitly recognizes the distinction between purchase and acquisition and the fact that the meaning of purchase is not the same as the definition for acquire. The Secretary also recognizes that the plain language of a statute or regulation controls and that additional language cannot be added to change the meaning of a provision.

The analysis here is similar; to accept the Secretary’s Final Rule, the plain terms of § 608c(5) would have to be ignored, inserting language authorizing minimum price and pooling

²¹ *In re Horne, et al.*, 67 Agric. Dec. 18, 35 (2009).

²² USDA Motion for Summary Judgment in *Horne v. USDA*, Docket 1:08-CV-01549, E.D. Calif, 2009 at p. 15. (Excerpted and attached hereto as Exhibit A).

regulation in the absence of a purchase where none exists.

Congress understood that producer-handlers who did not sell their milk to middlemen, but sold directly to customers, were important participants in many markets.²³ Congress nonetheless decided to establish a system in which the pricing and pooling regulations would apply only to transactions in which a handler “purchased” milk from a producer. Accordingly, there is a presumption that Congress deliberately and knowingly made the language choices it did in the AMAA.

Taking the language of the AMAA into account, the consistent references to purchases throughout § 608c(5) relating to milk, the distinction between the terms that the Secretary is authorized to employ for commodities other than milk in § 608c(6), and the Congressional knowledge that the language choices it made would have an impact on the scope of the Secretary’s authority, shows there is no legal predicate for the application of the pricing and pooling requirements for milk produced by an integrated producer-handler that sells only milk that is produced by its own cows.

1. The law does not support the regulation of producer-handlers.

Petitioner anticipates that the Secretary and *Amici* will attempt to rely upon *United States v. Rock Royal Co-operative, Inc.*²⁴ for the proposition that the AMAA provides the Secretary with authority to regulate producer-handlers. Any argument which permits the regulation of producer-handlers necessarily involves a finding that the word “purchase” in the AMAA is ambiguous, and that the Secretary has authority to resolve that ambiguity, thereby implicating

²³ See, e.g., “Early Development of Milk Marketing Plans in the Kansas City, Missouri Area,” Marketing Research Report No. 14 (USDA May 1952), Official Notice taken, Tr. 455.

²⁴ *U.S. v. Rock Royal Coop., Inc.*, 307 U.S. 533 (1939).

Step Two of a *Chevron* analysis. Under such an instance, the ambiguity in the statute may be resolved by the Secretary, but any such resolution must be objectively reasonable.

Because *Rock Royal* does not reference producer-handlers, is not controlling, and is by its own language limited to agency cooperatives, any attempt to rely on *Rock Royal* to support the imposition of minimum prices on producer-handlers is not supported by a fair reading of *Rock Royal*, nor is it reasonable under *Chevron* Step Two.

In *Rock Royal*, the Supreme Court considered whether the AMAA created a difference in treatment between “sale” cooperatives, which technically purchased milk from their producer members before reselling it, and “agency” cooperatives, in which title technically did not pass to the cooperative before sale.²⁵

Applying Section 608c(5)(F), which explicitly defined the treatment of milk cooperatives, the Supreme Court held that Congress had not differentiated between the two types of cooperatives and that both were required to comply with the pricing and pooling provisions of a FMMO.

It is obvious that the use of the word ‘purchased’ in the Act, Section 8c(5) (A) and (C), would not exclude the ‘sale’ type of cooperative. When 8c(5)(F) was drawn, however, it was made to apply to both the ‘sale’ and ‘agency’ type without distinction. This would indicate there had been no intention to distinguish between the two types by (A) and (C). The section which authorizes all orders, Section 8c(1), makes no distinction. The orders are to be applicable to ‘processors, associations of producers, and others engaged in the handling of commodities. The reports on the bill show no effort to differentiate. Neither do the debates in Congress. The statutory provisions for equalization of the burdens of surplus would be rendered nugatory by the exception of ‘agency’ cooperatives. The administrative construction has been to include such organizations as handlers. With this we agree. As here used the word ‘purchased’ means ‘acquired for marketing.’ Subsection (A) cannot be construed as freeing agents, cooperative

²⁵ *Id.* at U.S. 579-80.

or proprietary, from the requirement to account at the minimum prices for milk handled.²⁶

Rock Royal dealt with cooperatives which sold milk on behalf of its members. *Rock Royal* did not deal with producer-handlers, at all; nor does its reasoning apply to instances where there is no transfer of milk from one's own farm. Instead, the key distinction in the Supreme Court's reasoning was that the cooperative did not have its own milk production.

The cooperative argues that as its members, farmers, would not need to account to the pool for their personal sales to consumers, the cooperative, being utilized as an agent to market the farmers' milk, is under no obligation to contribute to equalization. **As the cooperative does not have its own farm but is itself a handler under the Act**, it must pay into the producer settlement fund.²⁷

Of course, producer-handlers utilize only their own-farm milk, and the Supreme Court's discussion above demonstrates that utilizing one's own produced milk does not permit the Secretary to mandate a payment to the producer settlement fund.

In reality, *Rock Royal* dealt with a fiction aimed at avoiding the pooling requirements. If the producers who were members of the cooperative had sold their milk directly to the handler, the handler would have had to account to the pool. The Court held that the result must be the same if the producers inserted between themselves and the handlers an agent that shared in the revenue flows from the sale. No such avoidance device is involved in the case of an integrated producer-handler. However, the conclusion reached by the Supreme Court, that "purchase" "[a]s here used" (that is, in the context of an agency cooperative) "means 'acquired for marketing,'"²⁸ has been incorrectly relied upon by some Courts to justify the application of minimum price requirements to producer-handlers.

²⁶ *Id.*

²⁷ *Id.* at 581. (emphasis added).

²⁸ *Id.* at 580.

2. “Acquired for marketing,” regardless of its meaning, does not apply to producer-handlers that produce their own milk.

Even if “purchased” could be interpreted to mean “acquired for marketing” in the context of an agency cooperative, milk produced by producer-handler dairies would not be covered, because it is not “acquired” from any other entity. The agent cooperatives involved in *Rock Royal* obtained their milk from one entity (a producer member) and caused its sale and delivery to another entity (the processor) and shared in the revenue. No such “acquisition” or transfer occurs in the case of a producer-handler.

In *Ideal Farms v. Benson*,²⁹ USDA was found to have authority to refuse a handler with both own-farm production and purchases from pool sources “to exempt . . . own-produced milk in the calculation of [] net pool obligations.”³⁰ In *Freeman v. Vance*,³¹ the Fifth Circuit held that an entity that produced some, but not all, of its own milk was subject to the pricing and pooling requirements of a FMMO, based on the Third Circuit decision in *Ideal Farms*.³²

²⁹ *Ideal Farms v. Benson*, 288 F.2d 608 (3rd Cir. 1961).

³⁰ *Ideal Farms, Inc. v. Benson*, 181 F. Supp. 62, 73 (D.N.J. 1960). In that case, the two plaintiffs that produced some of their own milk were: (1) Ideal Farms, which “does handle and sell milk produced on farms which it rents, and also buys milk from other milk plants”; and (2) Franklin Lakes, which owned a plant “where it collects milk from dairy farms owned by others, together with milk produced on its own farms, and thereafter sells to other handlers.” 181 F. Supp. at 64.

³¹ *Freeman v. Vance*, (5th Cir. 1963).

³² In *Vance*, USDA amended the Central Mississippi FMMO to define “producer-handler” as an entity that “received no other source milk (except own production)” *In re L.B. Vance*, 18 Agric. Dec. 563, 567 (USDA 1959). The decision was challenged by entities that produced some of their own milk but also purchased “a relatively large volume of milk from pool plants [separately owned handlers] for processing and sale as well as producing milk.” *Id.* The district court invalidated the agency action. The Fifth Circuit reversed in a brief opinion that simply noted its agreement “with the reasoning and conclusion of the Third Circuit [in *Ideal Farms*].” 319 F.2d at 842.

In both *Vance* and *Ideal Farms*, the entities involved purchased and marketed substantial quantities of milk from third parties. Thus, those decisions do not support the regulation of a producer-handler, as the term is used in today’s regulatory context, where there is no purchase and no “acquisition for marketing.” Later, another Third Circuit decision confirmed that *Ideal Farms* is limited to handlers that purchase at least some milk produced by other parties, “This Court long ago held that producers who also function as handlers, even those who deal *partially in milk produced at their own facilities*, are subject to regulation under [the AMAA].”³³

B. Repeated Congressional statements, culminating in the Milk Regulatory Equity Act, confirmed that the Secretary has no authority to change the regulatory status of producer-handlers.

In seven laws enacted beginning in 1965 that amended or reauthorized the AMAA, Congress repeatedly and explicitly provided that the “legal status” of producer-handlers “shall be the same” after enactment of the law as it had been previously.³⁴

³³ *U.S. v. United Dairy Farmers Coop. Assn.*, 611 F.2d 488, 491 n.7 (3rd Cir. 1979) (emphasis added).

³⁴ The first law in this series, Section 104 of the Food and Agriculture Act of 1965, Pub. L. No. 89-321, 79 Stat. 1187, § 104, (Nov. 3, 1965), as amended by Pub. L. No. 90-559, § 1(3), 82 Stat. 996 (Oct. 11, 1968), provided:

The legal status of producer handlers of milk under provisions of the Agricultural Adjustment Act, as reenacted and amended by the Agricultural Marketing Agreement Act of 1937, as amended, shall be the same subsequent to the adoption of the amendments made by this title as it was prior thereto.

Similar provisions were enacted in 1970 (Pub. L. No. 91-524, § 201(b), 84 Stat. 1358 (Nov. 30, 1970)); 1973 (Pub. L. No. 93-86, 87 Stat. 221 (Aug. 10, 1973)); 1977 (Pub. L. No. 95-113, § 202, 91 Stat. 913 (Sept. 29, 1977)); 1981 (Pub. L. No. 97-98, § 102, 95 Stat. 1213 (Dec. 22, 1981)); 1985 (Pub. L. No. 99-198, § 134, 99 Stat. 1354 (Dec. 23, 1985)); and 1990 (Pub. L. No. 101-624, § 115, 104 Stat. 3359 (Nov. 28, 1990)).

In 1996, Congress directed the Secretary to undertake a major revision of the FMMOs.³⁵ The statute expressly directed the Secretary to establish the new principles through an informal rulemaking. This was a significant development because, prior to passage of this statute, the rules governing FMMOs had been established in formal rulemakings, where the agency's ability to establish policy was limited to the facts submitted by the parties. The FAIR process thus afforded the Secretary an opportunity to exercise his own policy judgment as to the appropriate content of FMMOs.

In the course of order reform, USDA was asked to abolish or severely limit the longstanding exemption of producer-handlers from the pricing and pooling provisions. The Secretary rejected that proposal on the ground that Congress had manifested its intention that producer-handlers must remain exempt:³⁶

Public comments were received regarding the extent of regulation that should apply to producer-handlers. The majority of public comments supported the status-quo regarding the regulatory treatment of producer-handlers, emphasizing that they should remain exempt from regulation in accordance with current order provisions and that the provisions should be regional in nature so as not to affect

³⁵ Federal Agriculture Improvement and Reform Act of 1996 ("FAIR"), 7 U.S.C. § 7253(a) (Supp. 1999).

³⁶ In the Final Rule concerning the Pacific Northwest and Arizona marketing areas, however, USDA changed its legal interpretation that producer-handlers are exempt without mentioning its prior, contrary construction of the statutes. "[A]n agency must cogently explain why it has exercised its discretion in a given manner." *Motor Vehicle Mfrs. Assn. of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48-49 (1983). USDA did not acknowledge its prior legal interpretation, nor try to explain why it had changed its construction of the law. This "unexplained inconsistency" in the agency interpretation of the law on which its action is based makes the Final Rule arbitrary and capricious. See *Natl. Cable & Telecomm. Assn. v. Brand X Internet Serv.*, 545 U.S. 967, 981(2005) ("Unexplained inconsistency is . . . a reason for holding an interpretation to be an arbitrary and capricious change from agency practices under the Administrative Procedure Act.") Since no Court has reviewed the Department's failure to explain its policy departure, it is incumbent on the Department to explain its reasoning for departing from its 1999 position in this Final Decision and Final Rule.

or change the current regulatory status of producer-handlers.

One of the public comments received proposed that the exemption of producer-handlers from the regulatory plan of milk orders be eliminated. **This proposal is denied.** In the legislative actions taken by the Congress to amend the AMAA since 1965, the legislation has consistently and specifically exempted producer-handlers from regulation. The 1996 Farm Bill, unlike previous legislation, did not amend the AMAA and was silent on continuing to preserve the exemption of producer-handlers from regulation. However, past legislative history is replete with the specific intent of Congress to exempt producer-handlers from regulation. If it had been the intent of Congress to remove the exemption, Congress would likely have spoken directly to the issue rather than through omission of language that had, for over 30 years, specifically addressed the regulatory treatment of producer-handlers.³⁷

The only Congressional statement on producer-handlers since the Department's correct assessment in 1999 came in the form of the Milk Regulatory Equity Act of 2005.³⁸ That statute enacted a cap on the size of producer-handlers in the Arizona marketing area only. Importantly, it contained a "Rule of Construction" that made it clear to the Secretary that his authority with respect to all other marketing areas was not altered by the MREA.³⁹ Accordingly, it necessarily follows that if the Secretary did not have authority to change producer-handler regulations in 1999 based on Congressional instruction and Congress has not altered those instructions for any marketing area save Arizona, no restriction or change to the status of producer-handlers in this Final Rule is valid.⁴⁰

³⁷ 64 Fed. Reg. 16135 (April 2, 1999) (emphasis added).

³⁸ The MREA is currently being challenged by Hein and Ellen Hettinga and GH Dairy as an unconstitutional act.

³⁹ 7 U.S.C. § 608c(5)(O) ("Subparagraphs (M) and (N) shall not be construed as affecting, expanding, or contracting the treatment of producer-handlers under this subsection except as provided in such subparagraphs.")

⁴⁰In fact, Rep. Frank Lucas of Oklahoma, current Chairman of the House Agriculture Committee submitted a letter to the Secretary making this exact point that restricting producer-handlers would be contrary to the intent of Congress. Letter from Rep. Lucas to Secretary Vilsack dated

IV. The Secretary’s Decision is unsupported by substantial record evidence, disregarded critical evidence, and fails to provide a rational connection between the facts found and the choices made.

The Secretary apparently concluded that producer-handlers have a competitive advantage over regulated handlers reasonably estimated to be equal to the difference between Class I and blend prices (75 Fed. Reg. at 10147); that producer-handlers and regulated handlers are “similarly situated” for purposes of regulatory or competitive analysis (id. at 10146, 10150); that producer handlers with more than three million pounds of monthly sales “enjoy significant competitive sales advantages because they do not pay the Class I price for raw milk” (id. at 10151); and that marketing disorder does not currently exist but may occur as a result.

The foregoing conclusions are: (a) unsupported by factual findings, (b) unsupported by substantial record evidence, (c) made in deliberate disregard of relevant evidence of risks and costs incurred by producer-handlers to produce and process milk, (d) made without necessary findings concerning the risks and costs incurred by producer-handlers to produce and process milk, (e) made without reference to the controlling standards for “orderly” or disorderly marketing conditions contained in 7 U.S.C. §602(4), and are further (f) irrationally inconsistent with prior determinations that fully-integrated producer-handlers who assume all production and processing risks “have neither an advantage in their capacity as producers or as handlers.”

March 26, 2009; posted to the USDA website for the underlying hearing,
<http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELPRDC5076248>.

A. The standard of review for failure to conform the Final Decision to record evidence.

The “substantial evidence” standard of the APA requires the reviewer to “hold unlawful and set aside agency action, findings, and conclusions found to be unsupported by substantial evidence” resulting from formal rulemaking.⁴¹ In operation, the standard of review under the substantial evidence test is comparable to the familiar “arbitrary and capricious” standard applicable to informal rulemaking challenges under § 706(2)(A).⁴² As the United States District Court for the District of Columbia explained:

Challenges under § 706(2)(C)-which follow the test set forth in *Chevron*-are directed primarily at the decision of the agency, whereas § 706(2)(A) actions focus mainly on the decision-making process and rationale behind the agency's action. While the standards of review for these types of challenges overlap, they are not identical; an agency's interpretation may survive analysis under *Chevron*, but it can still be struck down as arbitrary and capricious.⁴³

Review of agency action under § 706(2)(A), requires a “thorough, probing, in-depth review,”⁴⁴ to determine whether the agencies have “examine[d] the relevant data and articulate[d] a satisfactory explanation for its action...”⁴⁵ “In thoroughly reviewing the agency's actions, the [reviewer] considers whether the agency acted within the scope of its legal authority, whether the agency has explained its decision, whether the facts on which the agency purports to

⁴¹ 5 U.S.C. § 706(2)(E).

⁴² See Lubbers, Jeffrey, “A Guide to Federal Agency Rulemaking” American Bar Association, Publisher, Fourth Edition, 2006, 531-52.

⁴³ *Natl. Mining Assn. v. Slater*, 167 F. Supp. 2d 265, 280 (D.D.C. 2001) (internal citations omitted).

⁴⁴ *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 415 (1971).

⁴⁵ *Motor Vehicle Mfr. Assn. v. State Farm Mut. Ins. Co.*, 463 U.S. 29, 43 (1983).

have relied have some basis in the record, and whether the agency considered the relevant factors.”⁴⁶

Conclusory statements are insufficient to meet this requirement.⁴⁷ “Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress had not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.”⁴⁸

B. The Final Rule contains myriad findings and conclusions which are not supported by substantial evidence.

Here, the Final Rule is based upon conclusions, presumptions, or theoretical constructs that the cost of production for producer-handlers should be irrebuttably presumed to be the blend price; that that presumption is economically justifiable; that producer-handlers have a cost of production advantage when compared to the Class I price; that producer-handlers do not balance their operations; that speculation about growth of producer-handlers in the future justifies their elimination based on size; that producer-handlers’ impact on the pool is significant; and that producer-handlers are not small businesses. The record facts demonstrate otherwise. In addition, the Secretary excluded and ignored critical probative evidence from one producer-handler that would contradict all the above conclusions.

⁴⁶ *Fund for Animals v. Babbitt*, 903 F. Supp. 96, 105 (D.D.C.1995) (internal citations omitted).

⁴⁷ *Dickson v. Secretary of Defense*, 68 F.3d 1396, 1405 (D.C.Cir.1995).

⁴⁸ *Motor Vehicle Mfrs. Assn.*, 463 U.S. at 43.

1. Producer-handlers' cost of milk is the cost of production, not a theoretical transfer price or regulatory statistical reference.

Producer-handlers are dairy farmers who process milk from their own cows in their own plants and market their packaged fluid milk and other dairy products themselves.⁴⁹ While regulated handlers purchase milk from farmers, each producer-handler produces its milk supply from its own-farm production, as part of a single integrated operation.

Regulated handlers must pay a USDA established minimum price for the milk purchased and used at the plant. That price is defined with certainty. But the producer-handler incurs the actual economic cost of producing its milk. The differences in price are noted in the following formulae.

$\begin{aligned} \text{Cost of Milk to a Producer-Handler Plant} &= \text{Cost of Production at the Farm} \\ \text{Cost of Milk to a Regulated Handler} &= \text{Producer Payment} + \text{Pool Payment} = \text{Class I Price} \end{aligned}$
--

The regulated price and the actual cost of production do not correlate over time. While the Final Decision accepted the Hearing Proponents' non-peer-reviewed, non-evidentiary theory that a producer-handler has an advantage in the cost of milk, determining whether any advantage actually exists cannot be based on a theoretical "transfer price," but must be premised on real facts as to whether the cost of milk for the producer-handler plant exceeds the regulated Class I price.

2. The arbitrary assignment of a transfer price at the blend price does not reflect the economic reality of any producer-handler's operation.

The Final Decision concludes without evidentiary foundation, that the producer-handler's

⁴⁹ USDA-AMS-Dairy Programs website, <http://www.ams.usda.gov/AMSV1.0/ams.fetchTemplateData.do?template=TemplateD&navID=IndustryMarketingandPromotion&leftNav=IndustryMarketingandPromotion&page=ProducerHandlers&description=Producer-Handlers&acct=dmktord>.

cost of milk is the federal order blend price.⁵⁰ This conclusion flows from the hearing proponents' invented notion that the blend price is "the appropriate transfer price" for a producer-handler, and therefore should be the basis for the calculation of a compensatory payment that would be assessed to producer-handlers.⁵¹ This dual fallacy, that the producer-handler's milk cost is the blend price and that there is an actual commensurate cost advantage that accrues to the producer-handler, is a key linchpin to the Secretary's "conclusion" that producer-handlers enjoy a pricing advantage over fully regulated handlers.⁵² But that does not reflect the economic reality of what is actually happening within the business. Instead, such a theoretical notion is antithetical to the actual economic evidence which must be the basis of the Final Rule.⁵³

The economic evidence supplied by AIDA's university expert economists established: (1) that transfer prices are not based on nonexistent regulatory prices, but actual costs; and (2) the actual cost of milk for a producer-handler is the cost of production.

In this environment, dominated by the NMPF cooperative members, it is asserted that the appropriate transfer price is the difference between the Federal Order blend price, which does not exist in the market, and the Federal Order Class I price, which also does not exist in the market. This reasoning defies economic logic not only because these Federal Order prices are not market prices but also because in the real world, transfer prices are based on costs.⁵⁴

⁵⁰ Final Decision, 75 Fed. Reg. 10146, 47.

⁵¹ Cryan, Tr. 407.

⁵² Final Decision, 75 Fed. Reg. 10146, 47.

⁵³ See *Fairmont Foods Co. v. Hardin*, 442 F.2d 762, 766-67 (D.C. Cir. 1971) ("The court must invalidate orders resting on any basis other than such economic reasons,- whether the orders are ascribable to whim, which seems unlikely; or to response to the influence of major farm interests, which may be more likely; or merely bureaucratic error in supposing that the wisdom of experts as to what is needed in the public interest must be given dominance over the constraint of Congress.").

MR. MILTNER: And from your perspective, as an economist, the rational point to set [the transfer price] is not at the blend price but at their production?

DR. KNUTSON: Is at the cost of production of the producer-handler. I mean, the rationale is that you base the transfer price on the market price. You don't base a transfer price on a regulated Federal Order price that doesn't exist in the market. So, you know, the best basis that you've got for what that transfer price is by a producer-handler is the producer-handler's cost of production.⁵⁵

MR. MILTNER: If the purpose is to determine whether a milk plant -- a plant processing milk into fluid milk products, that pays a Class I regulated price, is at a disadvantage to a producer-handler plant that bottles the milk produced on its own farm, is it economically sound and rational to use the cost of milk production for the producer-handler plant as its transfer price?

DR. KNOBLAUCH: To use its full cost of production, I think that's reasonable.

DR. KNOBLAUCH: You might also add the caveat that operating a farm, you would like to have profits above just covering all your costs. So in some circumstances, you could say that it should be the cost of production plus some value. And we could talk about what or how you might calculate what that some value may be.⁵⁶

The Final Decision provides no reasoning as to why the Secretary elected to accept the Proponents' theoretical application of a transfer price when the only two independent economists, those retained by AIDA, explained that this economic theory was unsupportable in the real world.

Rather, the Final Decision rejects the testimony of the preeminent university agricultural economists and declares that the producer-handler somehow has an actual advantage over

⁵⁴ Knutson, Tr. 3044.

⁵⁵ Knutson, Tr. 3119-20.

⁵⁶ Knoblauch, Tr. 3411-12.

regulated handlers in the cost of milk to the plant. The actual evidence in the record establishes exactly the opposite. Regulated handlers can now and have historically been able to purchase milk for less than it costs producer-handlers to produce, as described in the following section.

3. The cost of production for a producer-handler exceeds the Class I price.

The cost of the milk used by producer-handlers at their plants is the cost of production. Producer-handler witnesses testified to and established this as a fact,⁵⁷ and even some proponent witnesses acknowledged that equating a producer-handler's costs to the blend price was theoretical and speculative:

A. . . . we're talking here in my testimony about the regulated minimum prices and the type of advantage that can accrue to a producer receiving, if you will, the uniform price and charging himself, if you will, the Class I price.

Q. We have no evidence at this point that that's occurring at all. That's a theoretical notion that you have put together in your statement, correct?

A. Yes.⁵⁸

What the proponents characterized and what the Secretary accepted as the alleged cost "advantage" of producer-handlers is actually the unarguable proposition that producer-handlers (at least prior to the Final Rule) do not make producer settlement fund payments.

Q. Okay. So when you calculate the possible advantage that the producer-handlers would have in your orders, such as in Order 1, a difference of 23 cents per gallon, basically that's the -- the bill that regulated plants have to the Market

⁵⁷ Shatto, Tr. 1188.

⁵⁸ Tonak, Tr. 545-46.

Administrator which producer-handlers would not have?

A. That is correct.⁵⁹

But the question of whether a producer-handler makes a pool payment and whether a producer-handler has a cost of milk that is actually less than the regulated minimum price is a critical distinction. The cost of milk which is purchased by the regulated handler is the federal order Class I price—comprised of the payment of the blend price to the producer and the payment to the pool. In contrast, the cost to the producer-handler is the cost of production. **And it is the total measure of those costs that would determine whether a cost advantage actually exists; not whether the producer-handler has a pool payment.** The Final Decision ignores this undisputed and critical fact.

The cost of production for the producer-handler routinely exceeds both the blend and Class I prices. In his testimony, AIDA's expert economist witness, Wayne Knoblauch, compared USDA data on the cost of milk production to the Class I price and identified a clear and consistent spread:

The USDA, Economic Research Service cost of milk production data represents the costs for the average producer. Thus, their data shows costs that are higher per hundredweight of milk produced than the Dairy Farm Business Summary. The ERS average data demonstrates that even when measured against the Class I price, the cost of production exceeds the Class I price by 5 to 8 dollars per hundredweight.⁶⁰

The testimony from other dairy farmer witnesses corroborated the conclusions drawn from Dr. Knoblauch's observations and research.⁶¹

⁵⁹ Asbury, Tr. 576-77.

⁶⁰ Knoblauch, Tr. 3022-23.

⁶¹ See, e.g. Damm, Tr. 746. Another proponent witness, Mike Kreuger, explicitly acknowledged that a producer-handler's cost of production for its milk could lead to situations where the

The following tables, compiled from testimony, hearing exhibits, and USDA data, demonstrate that the Final Rule places producer-handlers at a further decided competitive disadvantage to handlers purchasing milk at the Class I price.

The data on these tables are prepared from USDA ERS Cost of Production data for each marketing area, using state costs of production. The states utilized for each marketing area are indicated on the charts and are the same states selected by the state Departments of Agriculture⁶² in compiling data incorporated into charts contained in Hearing Exhibit 36. Costs of production were averaged for each of the states listed for each marketing area. Data for Class I prices and blend prices are the annual averages taken from Dairy Programs' website. For 2009, both costs of production and milk prices were utilized for January through May 2009.

The charts demonstrate that in most federal orders the cost of production exceeds both the blend prices and Class I prices consistently. This is consistent with the 2006 data supplied by the States, and the testimony and chart supplied by AIDA economist expert witness Dr. Wayne Knoblauch. While the data shows that in the high-price years of 2007 and 2008 that the Class I price may exceed the cost of production for areas with low costs of production, these prices are inconsistent and on average the cost of production exceeds federal order minimum prices.⁶³

These charts confirm the conclusion of the States that, "The fact that the Class I price is

producer-handler was at a cost disadvantage to regulated handlers, ". . .the cost of milk for an exempt entity is their cost of producing milk at the farm. And, you know, the current situation is pretty interesting, because currently it would not favor producer-handlers." Krueger, Tr. 1356. While Mr. Krueger is correct that producer-handlers are at a cost disadvantage to regulated handlers, he is wrong about the uniqueness of the situation, as this section illustrates.

⁶² The represented States were Vermont, Wisconsin, New Hampshire, New York, and Pennsylvania. They are referred to as "States" hereafter.

⁶³ See Ex. 36, p. 6 (noting that while some orders will show returns exceeding the Class I price in certain high price environments, "prices fluctuate.").

lower than the total cost of production **without question takes away the argument that producer-handlers enjoy any milk price advantage and clearly warrants a continued exemption.**⁶⁴ (emphasis added). The States also correctly observed that, “If producer-handlers were required to take part in the pooling and payment provisions of the federal order - the statistical uniform price would not meet the cost of production for the majority of farms. **Therefore there is not [a] raw milk cost advantage for producer-handlers but in fact a cost disadvantage.**”⁶⁵

⁶⁴ Ex. 36, p.6.

⁶⁵ Ex. 36, p.6.

2007

	Operating Cost of Production	Total Cost of Production	Blend Price	Blend Price Less Total Cost of Production	Class I Price	Class I Price Less Total Cost of Production
Northeast (VT, NY, PA)	15.56	25.77	19.92	(5.85)	21.39	(4.38)
Appalachian (VA, TN, KY)	16.57	30.41	20.36	(10.05)	21.19	(9.22)
Florida (FL)	14.57	21.44	21.29	(0.15)	22.01	0.57
Southeast (GA, MO, TN)	15.70	28.63	20.09	(8.54)	21.20	(7.43)
Upper MW (MN, WI, IL)	12.78	22.74	18.41	(4.33)	19.94	(2.80)
Central (IA, IL)	13.33	23.77	18.67	(5.10)	20.12	(3.65)
Mideast (OH, IN, MI)	12.93	22.74	18.75	(3.99)	20.12	(2.62)
Pacific NW (WA, OR, ID)	13.24	20.43	18.62	(1.81)	20.04	(0.39)
Southwest (TX, NM)	11.92	16.49	19.35	2.87	21.09	4.61
Arizona (CA)	11.91	16.00	18.95	2.95	20.47	4.47

2008

	Operating Cost of Production	Total Cost of Production	Blend Price	Blend Price Less Total Cost of Production	Class I Price	Class I Price Less Total Cost of Production
Northeast (VT, NY, PA)	17.52	28.06	18.63	(9.43)	21.21	(6.85)
Appalachian (VA, TN, KY)	21.09	35.87	19.87	(16.00)	21.28	(14.59)
Florida (FL)	16.87	24.02	21.84	(2.18)	22.89	(1.13)
Southeast (GA, MO, TN)	19.75	32.62	20.15	(12.47)	21.54	(11.08)
Upper MW (MN, WI, IL)	16.12	26.46	17.59	(8.87)	19.76	(6.70)
Central (IA, IL)	16.93	27.58	17.39	(10.19)	19.97	(7.61)
Mideast (OH, IN, MI)	16.89	26.46	17.92	(8.54)	19.94	(6.52)
Pacific NW (WA, OR, ID)	16.78	24.62	16.99	(7.63)	19.86	(4.76)
Southwest (TX, NM)	14.09	18.62	18.40	(0.22)	20.96	2.34
Arizona (CA)	16.27	20.82	17.43	(3.39)	20.31	(0.51)

2009

	Operating Cost of Production	Total Cost of Production	Blend Price	Blend Price Less Total Cost of Production	Class I Price	Class I Price Less Total Cost of Production
Northeast (VT, NY, PA)	15.60	26.22	12.35	(13.87)	14.73	(11.49)
Appalachian (VA, TN, KY)	17.28	31.20	13.60	(17.60)	14.89	(16.31)
Florida (FL)	12.98	19.16	15.82	(3.34)	16.87	(2.29)
Southeast (GA, MO, TN)	15.45	26.95	13.70	(13.25)	15.28	(11.67)
Upper MW (MN, WI, IL)	14.14	24.47	10.67	(13.80)	13.28	(11.19)
Central (IA, IL)	14.84	25.41	11.01	(14.40)	13.49	(11.92)
Mideast (OH, IN, MI)	14.14	24.47	11.47	(13.00)	13.49	(10.98)
Pacific NW (WA, OR, ID)	15.29	23.33	10.97	(12.36)	13.38	(9.95)
Southwest (TX, NM)	12.87	17.52	12.06	(5.46)	14.49	(3.03)
Arizona (CA)	14.81	19.45	11.20	(8.25)	13.76	(5.69)

Individual producer-handlers also testified to their costs of production, and in each of those instances, their costs far exceeded the applicable Class I prices. Jock Gibson of Lochmead

Dairy testified to a cost of production of \$18.03 per hundredweight, which is just his cash costs, compared with a Class I price of \$12.⁶⁶ Matt Shatto of Shatto Farms described a cost of production of \$25-\$30 per hundredweight, and explained that becoming an integrated producer-handler was the only means to save the Shatto family farm because, “the price that we were being paid for our milk did not cover the cost to produce it.”⁶⁷ Howard Hatch of Hatchland Farms testified that his plant’s milk cost is the cost to produce it and that “I’m in a real disadvantage going to my cost of production. I could buy milk on the market and save money. But I can’t guarantee – make the guarantees that I can when I have my own.”⁶⁸ Aurora Organic Dairy testified to a cost of production exceeding \$30 per hundredweight.⁶⁹ The aggregate USDA data, coupled with the evidence from individual producer-handlers directly contradicts the Secretary’s conclusion that producer-handler enjoy any cost advantage over handlers that purchase milk from producers. Therefore, this finding by the Secretary is not supported by the “substantial evidence” required to support the Final Decision and Final Rule.

4. Producer-Handlers bear the burden of balancing their milk supplies and demands.

The status of producer-handlers has been made clear in prior decisions concerning producer-handler regulations. The touchstone is producer-handler self-sufficiency, as explained by the Secretary in a decision concerning the former Texas and Southwest Plains Marketing Orders, supporting the existence of producer-handlers:

. . . [T]he policy has been to exempt such types of operations. Such policy has been based, generally, on findings in regulatory proceedings that producer-

⁶⁶ Gibson, Tr. 639-40.

⁶⁷ Shatto, Tr. 1183, 1189.

⁶⁸ Hatch, Tr. 290-91.

⁶⁹ Keefe, Tr. 2911.

handlers have no significant advantage in the market in their capacity as either handlers or producers as long as they are solely responsible for their production and processing facilities and assume essentially the entire burden of balancing their production with their fluid milk requirements.⁷⁰

In the decision limiting producer-handlers in the Pacific Northwest and Arizona Marketing Areas, the Secretary based his decision on the perceived ability of producer-handlers there to utilize unregulated areas to shift the burdens of balancing onto pooled producers:

[P]roducer-handlers in both the Pacific Northwest and the Arizona-Las Vegas marketing areas with route disposition of more than 3 million pounds per month enjoy sales of fluid milk products into unregulated areas such as Alaska and California. These examples contribute to demonstrating a shifting of the burden of balancing their milk production onto the order's pooled producers.⁷¹

The decision in Orders 124 and 131,⁷² does not stand for a wholesale departure from prior reasoning, but was allegedly premised on the unique marketing conditions of those two particular marketing areas.

This longstanding “balancing” policy and “principle of self-sufficiency”⁷³ has been referred to by the Secretary in 1958, 1974, and 1995, in addition to the 1989 Southwest Plains proceeding:

⁷⁰ 54 Fed. Reg. 27179, 27182 (June 28, 1989).

⁷¹ 70 Fed. Reg. 74166, 74187 (December 14, 2005).

⁷² No court or administrative body has ever had the opportunity to review the propriety of the Department's decision related to the Pacific Northwest and Arizona producer-handler regulations. The decision in Arizona was pre-empted by the terms of the Milk Regulatory Equity Act, and the legal challenge to the provisions in the Pacific Northwest was determined without reaching the merits of the producer-handlers' challenge. See 7 U.S.C. § 608c(5)(M)-(O), and *Edaleen Dairy, LLC v. Johanns*, 467 F.3d 778 (D.C. Cir. 2006). The arguments in this brief related to the imposition of compensatory payments and the authority of the Department to impose regulations where no purchase of milk occurs, and the authority to regulate producer-handlers, at all, have not been judicially determined.

⁷³ *In re Kreider Dairy Farms, Inc.*, 54 Agric. Dec. 805, 1995 WL 598331 at *32 (USDA 1995).

The economic theory of the ‘producer-handler’ exemption is that the ‘producer-handler’ is a self-contained production, processing and distribution unit which does not share its [fluid] milk utilizations with other producers supplying milk to the area, and does not count on the other producers to meet any of its needs (see 23 F.R. 6050, 6050-6053 (1958)) If the ‘producer-handler’ were permitted to receive milk from other sources, he could produce the exact quantity of milk for which he could find Class I utilizations, and then draw on the pool’s surplus milk to meet his peak demands. In such circumstances, he would be ‘riding the pool,’ i.e., counting on the pool to produce enough surplus milk to take care of his peak needs while not sharing the benefits of his [fluid milk] utilizations with other producers.⁷⁴

The factors traditionally considered by USDA in this “balancing” analysis are whether the producer-handler bears the entire risk and cost of the production of milk, the operation of the processing plant, the marketing and sale of milk, and the disposal of any milk that is surplus to its needs.⁷⁵ In this Final Decision, USDA has abandoned, without explanation, its policy on producer-handlers and balancing.

The record evidence demonstrates that producer-handlers do bear the burden of disposing of all their surplus milk whether by manufacturing other products, utilizing surplus on the farm, or selling surpluses at substantial losses.⁷⁶ Bulk sales at less than classified prices are a fact of

⁷⁴ *In re: Mil-Key Farm, Inc.*, 54 Agric. Dec. 26, 1995 WL 321502 *5 (USDA 1995), quoting *In re Yasgur Farms, Inc.*, 33 Agric. Dec. 389, 403-404 (USDA 1974).

⁷⁵ See *Kreider Farms*, 1995 WL 598331 at *27, quoting 23 Fed. Reg. at 6052 (the producer-handler exemption provides “full exemption from regulation for handlers who depend entirely on their own production as a source of supply and who do not burden the pool with any surplus or excess milk”).

⁷⁶ Some witnesses suggested that unless a producer-handler supplies a full line of Class I products to its customers, it has somehow shifted its burden of balancing. But this illogical argument ignores the fact that under the regulations now in existence, the producer-handler must bear all balancing costs. The fact that customers have choice in where they can purchase milk, or that not all handlers produce all Class I products is not an element of balancing as USDA has characterized the burden in prior decisions.

life for producer-handlers.⁷⁷ Producer-handlers selling surplus milk are price takers.⁷⁸ For one of the producer-handler witnesses with 20% Class IV utilization, the impact of bulk milk sales is \$2.20 per hundredweight on all milk—not just the bulk milk volumes.⁷⁹ Impacts of such a magnitude only add to the costs of the producer-handler operation. Not only do producer-handlers bear a cost of production in excess of the federal minimum prices, but because they are not guaranteed the federal minimum prices on milk not processed, they incur additional disadvantages.

On the other side of the ledger, when demands of customers exceed the available milk, the producer-handler is faced with the difficult decision to decline additional business. The balancing requirement imposes an effective limit on the growth of producer-handlers. If the operation must balance too much of its milk supply, it will not be profitable.⁸⁰ If it runs its fluid sales too close to its production, it would disappoint customers. And when the operation cannot any longer support its customer base from its own farms, it transitions to a regulated handler, buying milk from other producers.

The costs of balancing are so great that they function as a real world deterrent to adopting producer-handler status.⁸¹ Only when the integrated producer-handler can sufficiently manage its balancing requirements does producer-handler status become a viable option.

⁷⁷ Hatch, Tr. 254 ; Gibson, Tr. 630; Gilbert, Tr. 2462; Flanagan, Tr. 2565; Keefe, Tr. 2910; Kreider, Tr. 2633; Button, Tr. 3602.

⁷⁸ Keefe, Tr. 2931 (Aurora receives the Class IV price less expenses).

⁷⁹ Flanagan, Tr. 2565.

⁸⁰ Sharpe, Tr. 3639.

⁸¹ Dakin, Tr. 881-82; Docheff, Tr. 2592-93; Taylor, Tr. 3570.

5. The increasing size of dairy farms and speculation about what might happen cannot be a basis for changing the regulatory status of producer-handlers.

The proponent's justification for the changes adopted in the Final Decision and Final Rule focused not on what is currently occurring, but on what **might** happen if producer-handlers are not eliminated. The testimony of NMPF's staff economist, Roger Cryan, virtually mirrors the NMPF request for a hearing. Both are replete with speculation and conjecture:

- Collectively, they **could capture** a large share of the Class I sales in an individual market or nationally, if many of them adopted this model.⁸²
- Producer-handler provisions **increasingly threaten** orderly marketing.⁸³
- Although several Federal Order markets are **not now substantially disrupted** by the operations of large producer-handlers, it is good policy to establish uniform provisions which address this issue proactively, before such a clearly foreseeable problem develops.⁸⁴
- The market-by-market approach should also be avoided because the larger consideration here is **whether a proliferation of exempt plants is probable** and whether that proliferation **could cause** disorderly marketing, rather than what the impact of an individual handler may be.⁸⁵

The testimony from the various supporters of Proposals 1 and 26 echoed that they are not experiencing any actual problem with producer-handlers, but are looking for a prospective "fix."

- "Muller and Mid-West are not competing with any producer-handlers today however

⁸² Cryan, Tr. 405.

⁸³ Cryan Tr., 408.

⁸⁴ Cryan, Tr. 415.

⁸⁵ Cryan, Tr. 421.

over the last decade a number of large dairy farms have been built and began operating in our area.”⁸⁶

- “Q. I’m correct in assuming from your speech that you haven’t actually had any disruption in your, market from producer-handlers? A. That would be correct.”⁸⁷
- “Q. Your testimony implies to me that there are existing large producer-handlers that currently have a price advantage over your three plants. Is that correct? A. There’s no large producer-handler in our area at this time. What I should have said: Would have. Q. Would have, okay. A. Yes. Q. So this is -- you’re projecting something happening in the future? A. Yes, sir.”⁸⁸
- “In my local area, we don’t have any problems with them at the moment. There’s what I see as a potential threat, that it could happen, and we’re looking at this as a big proactive.”⁸⁹
- “One of my biggest concerns with the Federal Order hearing process is that quite often we hold hearings to fix last year’s problems. At this hearing, we have a chance to address a concern before it becomes a large problem.”⁹⁰
- “Based on prior hearing deliberations and the ongoing one here, the issue of producer-handler regulation is a difficult one for the Secretary of Agriculture and the Order system. Order hearings deal with change and there are always divergent opinions with regard to

⁸⁶ Tonak, Tr. 521.

⁸⁷ Tonak, Tr. 535.

⁸⁸ Asbury, Tr. 578.

⁸⁹ Newell, Tr. 714.

⁹⁰ Lee, Tr. 943.

change. In order to deal with the issues raised in this hearing the Secretary will need to act in a proactive way.”⁹¹

This Chicken Little argument to regulate producer-handlers is nothing new. In fact, NMPF, DFA, Dean Foods, and the other participants in this hearing made similar dire predictions about producer-handlers in Orders 5 and 7 over five years ago.⁹² Now, just as then, there is no forthcoming wave of producer-handlers. In most marketing areas, the number of producer-handlers is actually declining or stagnant. Evidence presented by USDA shows a decrease in the number of producer-handlers from 421 in 1967 to 37 in 2009.⁹³

And while the volume of milk handled by producer-handlers has increased over time, the percentage of milk handled by producer-handlers is little different now than it has been historically. USDA statistics show that the percentage of Class I sales by producer-handlers is 1.3%, the lowest level since 1959, according to the available USDA data.⁹⁴ In fact, the number of producer-handlers relative to the number of producers and number of handlers is decreasing:

⁹¹ Hollon, Tr. 3789.

⁹² Hearing Record online at: <http://www.ams.usda.gov/AMSV1.0/ams.fetchTemplateData.do?template=TemplateO&navID=IndustryMarketingandPromotion&leftNav=IndustryMarketingandPromotion&page=FMMOrder6b>.

⁹³ Ex. 7-A, Ex. 13.

⁹⁴ Ex. 7-A. Even if 23 million pounds of milk were added to the figures for December 2008 in Exhibit 7-A to account for former producer-handlers in the Pacific Northwest and Arizona marketing areas, the percentage of Class I sales by producer-handlers would be 1.9%, the same as it was in 1992 and below the peak level reported in 1969. GH Dairy does not believe that the modification of producer-handler volumes for Orders 124 and 131 by proponents’ counsel, reflected in Exhibits 74 and 74-A, is correct. Neither does the economic expert, Dr. Knutson, who opined that there was no economically sound or reasonable way to modify the plant volumes actually provided by USDA for meaningful analysis. Knutson, Tr. 3388.

It can readily be determined from Table 1 that in 1969 there were 343 producers for every producer-handler; in 2008 there were 1,018 producers for every producer-handler. . . . In 1969 there were 89 producers for every handler. In 2008 there were 143 producers for every handler. In 1969 there were 3.9 handlers for every producer-handler; in 2008 there were 7.1 handlers for every producer-handler. The conclusion I draw from these data is that by every one of these measures, the position of producer-handlers is slipping.⁹⁵

The most basic economic analysis holds that if being a producer-handler provided a cost advantage over other handlers or other producers, their numbers would be greater and increasing.⁹⁶ The fact that the numbers of producer-handlers have not grown underscores the fact that producer-handlers do not have the alleged cost advantage or that any “disorderly marketing” has arisen to justify the Final Rule.

6. The lack of pool participation does not justify the Final Rule.

It is a truism that if producer-handlers do not make pool payments, the blend price to producers differs from what it would be if such payments were made. The fact that blend prices are different but for the lack of a pool payment by producer-handlers does not speak to market disorder, especially because the producer-handler’s costs of milk exceeds that of regulated handlers. The non-pooling of milk by producer-handlers is nothing new, and has existed since enactment of the AMAA. Nor does it meet the statutory definition of disorderly marketing, especially in light of the Department’s self-sufficiency standard.

And in any event, producer mailbox prices are affected by a litany of factors such as the amount of milk that is eligible to be pooled, the buying habits of consumers, and the opportunistic depooling of milk by cooperatives and manufacturers, which has an impact on the blend price on an annual basis far greater than any impact of producer-handlers. In fact, even the

⁹⁵ Knutson, Tr. 3075-76.

⁹⁶ Knutson, Tr. 3387-88.

highest estimates of blend price impact by producer-handlers do not rise to a level of significance. The impact on the blend price of the national promotion program, which USDA is responsible for administering, reduces producer incomes by \$0.15 per hundredweight, which USDA recently characterized as “relatively small when compared to producer revenue.”⁹⁷ Similarly, opportunistic depooling reduces producer revenue by as much as 41 cents per month, based on the limited unrestricted data that USDA was able to provide.⁹⁸ In fact, the average impact of depooling in the Central Order during 2008 was far greater than the average impact of all producer-handler activities in the Order.⁹⁹ And this was after USDA had implemented regulatory changes to ensure that any depooling of milk in the Central Order would not be disorderly. The aggregate impact of all producer-handlers was estimated by one economist to be only one to two cents per hundredweight.¹⁰⁰

These myriad price impacts, coupled with variations in producer prices of magnitudes multiple times greater than the impact of producer-handler activity are inherent in milk markets and thus cannot be evidence of disorderly marketing.¹⁰¹ Therefore, any suggestion that impact on blend price is per se evidence of disorderly marketing is not supported by the record of this proceeding.

⁹⁷ 74 Fed. Reg. 23349, (May 19, 2009).

⁹⁸ Ex. 59, p. 4.

⁹⁹ Compare Ex. 59, p. 4 (average impact of \$0.113 per month) and Ex. 56 (average impact of \$0.058 per month).

¹⁰⁰ Knoblauch, Tr. 3026.

¹⁰¹ See *Cumberland Farms v. Lyng*, 1989 WL 52697 (D.N.J. May 15, 1989) (holding that amending a market order to add 2% to the order’s Class I volumes is “too small to support a change in regulation”) and compare with the 1.3% of the Class I volumes serviced by producer-handlers, Ex. 7A).

In the decision applying a limitation on producer-handlers in the Pacific Northwest and Arizona marketing areas, USDA devised a new test under which “the absence of equity among producers and handlers . . . should be deemed to” constitute disorderly marketing conditions.¹⁰² But absolute price equality among producers is not a requirement of the AMAA, not a reality in the marketplace, nor is it a measure for determining whether disorderly marketing conditions exist.¹⁰³

Numerous factors affect the prices that dairy farms receive independent of the composition and quality of their milk. As Dr. Knoblauch explained, “There is also a \$2.00 spread in what we call the Net Marketing Margin, which takes the Producer Price Differential plus all premiums minus all expenses (including hauling).”¹⁰⁴ He later explained that identical producers receive different prices due to unexplained actions of cooperative intermediaries:

Q. And based on the data that you’ve seen and you worked with Dr. Stephenson in these studies, after you strip out variations in the butterfat and the protein and the other solids, the somatic cell count and the producer price differential, you strip all that out, are those producers in reality receiving a uniform price for their milk?

[Objection from Mr. Beshore overruled.]

DR. KNOBLAUCH: Those two producers are hypothetical. In reality, if that makes sense, the answer is no. I have received many phone calls from farmers that get the copies of their data sent back and the comparison to the three closest neighbors, and when they start comparing it on the basis that you’re talking about, they’re rather irate, first with us, and then with who they’re selling their milk to,

¹⁰² 70 Fed. Reg. at 74185.

¹⁰³ Knoblauch, Tr. 3024 (the concept that dairy farmers delivering milk to pool handlers receive uniform prices, even after taking into account components and location differentials, is not reality); See also Rowe, Tr.1267-68 (describing that Northwest Dairy Association, which controls 90% of the milk in Washington, depools milk to the advantage of its producers, and to the detriment of other producers and Class I plants).

¹⁰⁴ Knoblauch, Tr. 3025-26.

because they're not getting the same prices.¹⁰⁵

Dr. Knutson also explained that producer income does not correlate to blend prices, and the concept of producer price equality is a mere statistical measure. Part of what impacts the income ultimately received by individual farmers are the give-up charges,¹⁰⁶ over-order premiums,¹⁰⁷ and gains from depooling¹⁰⁸ that various cooperatives receive. These payments inure to the benefit of those members of the benefitting cooperative, but not to other producers.

Furthermore, an impact of pennies per hundredweight of milk, in a regulatory scheme where the Class I base craters from \$20.78 in July 2008 to \$9.43 in March 2009 is not disruptive.¹⁰⁹

In fact, USDA acknowledged that as to the impact on the blend price by exempting milk from the pool, "this has always been the case."¹¹⁰ USDA has repeatedly found that this pricing factor was counterbalanced by the greater degree of risk that producer-handlers bear in assuming full responsibility for production, processing and distribution. And the cross-examination of Elvin Hollon establishes that it is not the blend price impact that the proponents are concerned about, but about eliminating competitive factors in the market, which is not a permissible factor to be considered in formulating marketing orders.

¹⁰⁵ Knoblauch, Tr. 3415-18.

¹⁰⁶ Knutson, Tr. 3062-63.

¹⁰⁷ *Id.*

¹⁰⁸ Knutson, Tr. 3091.

¹⁰⁹ See *Cumberland Farms*, 1989 WL 52697 (D.N.J. May 15, 1989); *Fairmont Foods Co. v. Hardin*, 442 F.2d 762, 770-71 (D.C. Cir. 1971).

¹¹⁰ 70 Fed. Reg. 74186 (December 14, 2005).

7. The Secretary's decision violated the RFA by use of producer size rather than handler size to measure regulatory impact on small business handlers proposed to be regulated.

The Secretary's failure to analyze the impact of the Final Rule on small entity producer-handlers by reference to the milk plant operator criteria for small business entities violated the FA. It is also unreasonably inconsistent, without explanation, with the determination of the Secretary at 64 Fed. Reg. 16026, 54384-86, 54409 (April 2, 1999), that RFA small entity analysis for producer-handlers is properly measured by plant operator criteria.

As explained in the Notice of Hearing, USDA has a special responsibility to consider the impact of proposed rules on small businesses. Like AMAA section 8c(9)(8), the Regulatory Flexibility Act requires the Secretary to take a hard look at less burdensome regulatory alternatives. Milk handlers with fewer than 500 employees are considered small businesses. Producer-handlers are a smaller subset of small business handlers, with small plants, few employees, and unique business model characteristics such as risk of the plant operator in the farm, and risk of the farm operator in the plant. A February 2005 report to Congress by the Chief Counsel for Advocacy, Small Business Administration, explains agency rulemaking obligations to small businesses as follows:

Before Congress enacted the Regulatory Flexibility Act in 1980, federal agencies did not recognize the pivotal role of small business in an efficient marketplace, nor did they consider the possibility that agency regulations could put small businesses at a competitive disadvantage with large businesses or even constitute a complete barrier to small business market entry. Similarly, agencies did not appreciate that small businesses were restricted in their ability to spread costs over output because of their lower production levels. As a result, when agencies implemented "one-size fits-all" regulations, small businesses were placed at a competitive disadvantage with respect to their larger competitors. This problem was exacerbated by the fact that small businesses were also disadvantaged by larger businesses' ability to influence final decisions on regulations. Large businesses have more resources and can afford to hire staff to monitor proposed regulations to ensure effective input in the regulatory process. As a result,

consumers and competition were undercut while larger companies were rewarded.¹¹¹

The SBA's manual, *A Guide to Federal Agencies: How to Comply with the Regulatory Flexibility Act* (2003) at p. 31, further explains that agency responsibilities extend to subsets of small businesses. A regulatory flexibility analysis "will enable direct comparison of small and large entities to determine the degree to which the alternatives chosen disproportionately affect small entities or a specific subset of small entities. Further, the analysis will examine whether the alternatives are effectively designed to achieve the statutory objectives."

In this proceeding, the principal proponents for new regulatory burdens on producer-handlers are the nation's largest milk companies, represented by IDFA, and the nation's largest dairy cooperatives, represented by NMPF. To paraphrase the SBA's Chief Counsel for Advocacy, GH Dairy is struggling to avoid proposed "one size fits all" rules that would benefit large IDFA members and large NMPF members, but uniquely burden their small business competitors.

8. The Secretary improperly excluded critical evidence establishing that regulated handlers could not only compete with a producer-handler, but could disrupt the producer-handler operation.

One producer-handler that participated in this hearing through counsel was Nature's Dairy of Roswell, New Mexico. Nature's Dairy was represented by counsel at the hearing, but during the course of the hearing, the principal of Nature's Dairy, Jeff Sapp, became medically disabled from appearing at the Cincinnati hearing to present his testimony in person.¹¹² Mr. Sapp presented direct written testimony by affidavit and certain business records of Dean Foods

¹¹¹ <http://www.sba.gov/advo/laws/flex/04regflx.html>. Report on the Regulatory Flexibility Act (February 2005, footnotes omitted, italics supplied).

¹¹² Hearing Tr. pp. 14-15, 62-64, 2586, 2624, 3264, Ex. 92, Motion from Nature's Dairy's counsel, included in the Hearing Record, which contains the proffered evidence described below.

in his possession.¹¹³ Mr. Sapp offered to make himself available for cross-examination by video conference, teleconference, deposition or other means.¹¹⁴ Mr. Sapp's proposed testimony related to proponents' factual allegations that producer-handlers have a competitive or economic advantage.

The proffered evidence included:

- a history of Nature's Dairy;
- identification of regulated milk plants and producer-handler plants that have gone out of business since 1985;
- identification of Dean Foods, with plants in El Paso, Albuquerque, and Lubbock, as Nature's Dairy's main competitor;¹¹⁵
- details of Nature's Dairy's annual fluid milk sales volume for an 8-year period;
- description of Nature's Dairy's primary current sales area and customers, within 80 miles of Roswell, NM;
- Description of Nature's Dairy's 2003 loss of its Big 8 Food Stores account – half of Nature's sales volume -- to Dean Foods (Price's Creameries) when Dean paid Big 8 a million dollars in advance, and promised to pay an additional \$12,000 per month per store, to gain Nature's share of that account and to become the exclusive supplier of milk and dairy products to Big 8;
- Description of Nature's Dairy's disadvantages in competition with large processors, such as Dean Foods, due to Dean's market and economic power, and Nature's Dairy's higher costs for processing, including such items as cartons, jugs, containers, labels, caps, chemicals, sugar, chocolate powder, electricity, gas, water, fuel, etc.; and

¹¹³ Exs. 92 – 93, not received.

¹¹⁴ Hearing Tr. p. 3266 .

¹¹⁵ The Dean Foods plants in these cities are known as Price's Creamery (El Paso), Creamland Dairies (Albuquerque), and Gandy's Dairies (Lubbock).

- Explanation that, if IDFA-NMPF Proposal No. 1 is adopted, Nature’s Dairy would become unprofitable, would be forced to close its plant, and the plant’s 27 employees would lose their jobs.

Upon objection by NMPF, IDFA, Dean Foods, and other proponents, the evidence and testimony proffered by Mr. Sapp was excluded by the presiding ALJ, and sealed in part from access by the public through the Hearing Clerk and USDA’s web-based record.¹¹⁶ The ALJ’s basis for such evidentiary exclusion was: “**witness unavailable in person**”¹¹⁷ “because Mr. Sapp is not here.”¹¹⁸

Despite the inability to attend in person due to his medical condition, Mr. Sapp and his counsel offered the Administrative Law Judge multiple alternatives to Mr. Sapp providing testimony for the hearing, as he was medically unable to be physically present in Cincinnati. Those options included telephonic appearance and videoconference, each subject to cross-examination under oath. Those options were refused. Mr. Sapp also proffered a declaration of sworn testimony for the record both to indicate the topics on which he would testify and to place some evidence before the Secretary regarding the experiences of Nature’s Dairy in dealing with competition as a producer-handler in the Southwest Milk Marketing Area. The declaration was rejected and sealed and remains so today.

Mr. Sapp’s proposed testimony would have spoken to the relative size of Nature’s Dairy and its inability to compete with the dominant milk bottler in its market. The issues that Mr. Sapp would have testified about and the issues addressed in the documents he proposed as exhibits at the hearing in this hearing directly contradict the determinations that producer-

¹¹⁶ Tr. pp. 3264-3294.

¹¹⁷ Attachment A, Ex. 92, attached, emphasis in record copy.

¹¹⁸ Tr. 3293.

handlers have a per se competitive advantage over regulated handlers. By denying Mr. Sapp any opportunity to be heard, not only have his due process rights been implicated, but so have those of the other hearing participants, including GH Dairy, who would have had the benefit of his testimony and expertise to include in the hearing record.

GH Dairy, through AIDA, objected to the exclusion of Mr. Sapp's testimony during the evidentiary hearing, and joined in Natures Dairy's motion to permit Mr. Sapp's testimony filed following the conclusion of the evidentiary hearing. The ALJ denied those motions.

The principal issues in this case relate to competition, claims of competitive advantage or disadvantage, and assertions by large milk plant operators and their trade association that producer-handlers have an economic advantage that allow them to take business away from large handlers by undercutting wholesale or retail milk prices. Dean Food's ability to pull out its checkbook and, for a million dollar advance payment, purchase exclusive rights to supply a small grocery chain with all of its milk and dairy product needs – as revealed on the face of Exhibit 93 – contradicts one of the central issues alleged by proponents, and tends to disprove proponents' claims of disadvantage in competing with smaller, less financially endowed plant operators.

The wholesale exclusion of this important documentary evidence and testimony taints the Final Decision and Final Rule and contributes to a finding that they are not supported by substantial evidence and are otherwise arbitrary and capricious.

In total, these noted deviations from the record evidence support a finding that the Final Decision and Final Rule are unlawful and must be set aside.

V. The Final Rule violates the AMAA’s requirements that orders enacted over the objection of handlers be the “only practical means” of advancing producer interests and that compensatory payments bear a direct relationship to a handler’s cost of milk.

A. The Final Rule is unsupported by any analysis that it is the only practical means of advancing producer interests.

Under section 8c(9) of the AMAA, where handlers do not consent to regulation by signing a marketing agreement, the Secretary is required to consider regulatory alternatives to achieve statutory objectives, and may adopt the more burdensome alternatives only if he makes a determination that they represent “the only practical means” of advancing the interests of producers pursuant to the declared policy, which policy is contained in 7 U.S.C. §602(4). This provision is a substantive, power-limiting feature of the AMAA.¹¹⁹

The §602(4) policy for milk marketing orders, as summarized by USDA’s AMS Administrator, is “to establish and maintain such orderly marketing conditions ...as will provide, in the interests of producers and consumers, an orderly flow of the supply ...to avoid unreasonable fluctuations in supplies and prices.”¹²⁰ Elaborating on statutory policy and objectives, Administrator Day emphasized that the milk order program is a marketing tool. It “is not a price or income support program...”¹²¹

¹¹⁹ *Block v. Community Nutrition Institute*, 467 U.S. 340, 342 (1984).

¹²⁰ Statement of Lloyd Day, Administrator Agricultural Marketing Service, U.S. Department of Agriculture, Before the House Committee on Agriculture Subcommittee on Livestock, Dairy, and Poultry (April 24, 2007) at p. 2, published at <http://agriculture.house.gov/testimony/110/h70423/Day.doc>, and <http://www.usda.gov/documents/4-24-07Day.pdf>.

¹²¹ *Id.* at 6, 11. See also USDA letters of 2003 to Congressmen Roy Blunt and Don Sherwood, published at <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELPRDC5050755>, and <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELPRDC5050756>.

Briefs and exceptions filed in the underlying rulemaking addressed at length the meaning of “orderly” in the supply and price context used in 7 U.S.C. §602(4), and its application in legislative, administrative and economic history for milk orders.¹²² The Under Secretary did not rule upon the parties’ proposed findings and conclusions. He did not explain how or why the choice he made furthered the §602(4) producer interests in milk supply adequacy, milk supply stability, or milk price stability. The Under Secretary did not address the more stringent decision-making standard of 7 U.S.C. §608c(9)(B) that the choice he made was the “only practical means” of advancing producer interests other than a rote recitation.¹²³

Elvin Hollon, under cross-examination at the hearing, explained that the situation that his cooperative and other proponents characterized as “disorderly marketing” has existed in the federal milk marketing order system since its inception. Accepting that argument means that the Secretary has tolerated a nationwide disorderly milk market for over 70 years.

Q. And how long have producer-handlers been exempt under the Act?

A. Since the beginning.

Q. Does that mean that the market has been disorderly in Order 1 since the beginning?

A. It means that now there are changes in the marketplace that we think require a hearing, or we request a hearing for the Secretary to consider them.

Q. And what are the changes in Order 1 that require any attention?

A. First of all, there are larger producer-handlers. There are -- they do not pay into the pool, they have a competitive factor in the marketplace. And we also think this is an issue that should be dealt with on a nationwide basis.

¹²² AIDA Brief at 6-12, 89-90; AIDA Exceptions at 6-7, 26-29; Select Milk Producers’ Brief at 13; Mallories’ Brief at 5.

¹²³ Final Rule, 75 Fed. Reg. at 21160.

Q. Hasn't that been the situation in Order Number 1 for 70 years?

A. It has.¹²⁴

Obviously, the Department would not have sanctioned market disorder for 70 years. What was not market disruption for seven decades or more cannot be transformed into market disruption by “whim . . . or [in] response to the influence of major farm interests.”¹²⁵ This absurd notion that producer-handlers have been disruptive since the inception of the AMAA is refuted not only by force of logic, but by decisions from the Department stretching back over decades, in which it was held that producer-handlers are not disruptive as long as they remain self-sufficient.

With respect to the AMAA's requirement that the Secretary determine that amending the producer-handler definition is the “only practical means” of furthering the purposes of the Act, the 70 plus year policy of the Department to not impose pricing regulations on producer-handlers is evidence that the marketing orders have, and must continue, to provide for their exemption. There simply is no statutory or evidentiary predicate to justify the Final Rule and Final Decision.

B. A pool payment assessed to a producer-handler premised on anything except the actual cost of production at the producer-handler's own farm would place them at a further price disadvantage to regulated handlers, in contravention of the AMAA.

The Secretary's adopted “transfer price” theory ignores the actual economic costs of producer-handlers and instead imposes a theoretical proxy which raises the costs for producer-handlers. The compensatory payment adopted in the Final Rule results in non-uniform pricing, which is prohibited by the AMAA.¹²⁶ It places producer-handlers at a further, substantial disadvantage by piling an extra charge on top of the already higher costs of production of

¹²⁴ Hollon, Tr. 3946-47.

¹²⁵ *Fairmont Foods*, 442 F.2d at 766.

¹²⁶ *See Sani-Dairy, a Div. of Penn Traffic Co., Inc. v. Espy*, 939 F. Supp. 410 (W.D. Pa. 1993) *aff'd* 91 F.3d 15 (3d Cir. 1996).

producer-handler milk.

The Secretary's Final Rule hinges on imputing a theoretical cost of milk to the producer-handler at the order's uniform price.¹²⁷ But any such payment must be founded in economic realities, not fanciful presumptions.¹²⁸

For producer-handlers who produce their milk supplies from their own farms, any pool obligation based on the blend price is hardly compensatory. Instead, it is confiscatory, as was described by a representative from Monument Farms:

If the proposal put forth by NMPF and IDFA is adopted by the USDA, affected producer-handlers in the Northeast would find themselves with an untenable disadvantage. Far from removing the price advantage, as stated by IDFA, this producer-handler would be faced with a cost of over \$20 a hundredweight, compared to his pooled competitor's cost of under \$14 per hundredweight for the current month of May.¹²⁹

Mr. Rooney later described Monument Farm's operating (cash) costs at \$19.65 per hundredweight.¹³⁰ Likely, the total cost of production for Monument Farms approaches \$25 per hundredweight, consistent with the data from USDA-ERS.

As noted above, the AMAA is a statute of limited authority. With respect to producer settlement fund payments to equalize costs among handlers, § 608c(5)(C) authorizes USDA to provide "a method for making adjustments in payments, as among handlers (including producers who are also handlers), to the end that the total sums paid by each handler shall equal the value

¹²⁷ See Knutson, Tr. 3119-20.

¹²⁸ *Lehigh Valley Coop. Farmers, Inc. v. U.S.*, 370 U.S. 76 (1962) (rejecting compensatory payments to the pool by non-pool handlers as demonstrably unsound as a mechanism to subsidize the pool milk and insulate the pool milk from competitive impact); *Sani-Dairy v. Espy*, 939 F. Supp. 410 (W.D. Pa. 1993) *aff'd* 91 F.3d 15 (3d Cir. 1996).

¹²⁹ Rooney, Tr. 1520.

¹³⁰ Rooney, Tr. 1521.

of the milk purchased by him at the prices fixed in accordance with paragraph (A) of this subsection.” Assuming, *arguendo*, that the AMAA permits the price regulations of producer-handlers that do not purchase milk, the compensatory payments required by the Final Rule and Final Decision result in producer-handlers bearing mandatory minimum prices far in excess of the fixed Class I prices.

The adoption of an irrebuttable presumption that the cost of production for milk from the producer-handler’s own farm is the blend price would put producer-handlers at a further competitive disadvantage to pool handlers. Since the actual cost of production for the producer-handler exceeds the blend price, the additional pool charge would result in a cost of milk far in excess of the Class I price. The resulting unequal cost of milk to handlers in the same marketing area would result in the certain loss of customers and valuable milk outlets to the producer-handler.

When a “compensatory” payment bears no relation to the actual costs of a handler’s milk, the effect is to make the milk more expensive and thereby protect the established pool handler from competition. The Supreme Court noted in *Lehigh Valley* that any compensatory payments must bear a relationship to the actual costs of the milk.¹³¹ The Supreme Court mandated that compensatory payments place, “. . . pool and non pool milk on substantially similar competitive positions at source.”¹³² But in *Lehigh Valley*, the effect of the compensatory payment was to, “make it economically unfeasible for a handler to bring such milk into the marketing area.”¹³³ The same is true for the “compensatory payment” imposed on producer-handlers by the Final

¹³¹ *Lehigh Valley*, 370 U.S. at 87 n. 13; *See also Sani-Dairy v. Espy*, 939 F. Supp. at 415.

¹³² *Lehigh Valley*, 370 U.S. at 84 (internal citations omitted).

¹³³ *Id.*

Rule, which cannot be distinguished from those previously struck down as illegal in *Lehigh Valley* and in *Sani-Dairy*.

VI. Conclusion and Request for Relief

Based on this Brief, upon the existing record of the Secretary's formal rulemaking proceeding, including post-hearing briefs (proposed findings of fact and conclusions of law), and Exceptions to the Recommended Decision, Petitioner GH Dairy requests a final adjudicatory decision finding that the amendments recommended in the Final Decision, and adopted by the Final Rule, are not in accordance with law. Petitioner also requests that the Final Rule be vacated and remanded to the Administrator, Agricultural Marketing Service, to undertake such action as may be consistent with law. Finally, Petitioner requests an award to reimburse all attorney fees, costs and expenses incurred in this action pursuant to the Equal Access to Justice Act and as may be allowed under any other law, rule or statute.

Respectfully submitted,

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Dated: May 23, 2011

CERTIFICATE OF SERVICE

I hereby certify that I have this 23st day of May 2011 caused a copy of the foregoing Brief to be served by the method indicated, upon the following:

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EXHIBIT 'A'

Excerpt from USDA Motion for Summary Judgment in *Horne v. USDA*, Docket 1:08-CV-01549, E.D. Calif, 2009; referenced at footnote 22.