

DEPARTMENT OF AGRICULTURE**Agricultural Marketing Service**

7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126 and 1131

[Doc. No. AO-14-A78, et al.; DA-09-02; AMS-09-0007]

Milk in the Northeast and Other Marketing Areas; Recommended Decision and Opportunity To File Written Exceptions on Proposed Amendments to Tentative Marketing Agreements and Orders

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule; recommended decision.

SUMMARY: This decision recommends that the producer-handler definitions of all Federal milk marketing orders be amended to limit exemption from pooling and pricing provisions to those with total route disposition of fluid milk products of 3 million pounds or less per month. The exempt plant definition would continue to limit disposition of Class I milk products to 150,000 pounds or less per month.

DATES: Comments must be submitted on or before December 21, 2009.

ADDRESSES: All comments received will be posted electronically without change, including any personal information provided. Comments (three copies) should be filed with the Hearing Clerk, United States Department of Agriculture, STOP 9200-Room 1031, 1400 Independence Avenue, SW., Washington, DC 20250-1031. You may electronically submit comments at the Federal eRulemaking portal: <http://www.regulations.gov>. Reference should be made to the title of the action and docket number.

FOR FURTHER INFORMATION CONTACT: Gino M. Tosi or Jack Rower, Senior Marketing Specialists, Order Formulation and Enforcement Branch, USDA/AMS/Dairy Programs, Stop 0231-Room 2971, 1400 Independence Avenue, SW., Washington, DC 20250-0231, (202) 720-7183, e-mail addresses: gino.tosi@ams.usda.gov and jack.rower@ams.usda.gov.

SUPPLEMENTARY INFORMATION: This decision recommends that the producer-handler provisions of all Federal milk marketing orders be amended to limit exemption from pooling and pricing to those with total route disposition of fluid milk products of 3 million pounds or less per month. The exempt plant definition would continue to limit

disposition of Class I milk products to 150,000 pounds or less per month.

This administrative action is governed by the provisions of sections 556 and 557 of Title 5 of the United States Code and, therefore, is excluded from the requirements of Executive Order 12866.

The amendments to the rules proposed herein have been reviewed under Executive Order 12988, Civil Justice Reform. They are not intended to have a retroactive effect. The Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601-674) (AMAA), provides that administrative proceedings must be exhausted before parties may file suit in court. Under Section 608c(15)(A) of the AMAA, any handler subject to an order may request modification or exemption from such order by filing with USDA a petition stating that the order, any provision of the order, or any obligation imposed in connection with the order is not in accordance with the law. A handler is afforded the opportunity for a hearing on the petition. After a hearing, USDA would rule on the petition. The AMAA provides that the district court of the United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review USDA's ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

Regulatory Flexibility Act and Paperwork Reduction Act

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service has considered the economic impact of this action on small entities and has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a "small business" if it has an annual gross revenue of less than \$750,000, and a dairy products manufacturer is a "small business" if it has fewer than 500 employees. For the purpose of determining which dairy farms are "small businesses," the \$750,000 per year criterion was used to establish a milk marketing guideline of 500,000 pounds per month. Although this guideline does not factor in additional monies that may be received by dairy producers, it should be an inclusive standard for most "small" dairy farms. For purposes of determining a handler's size, if the plant is part of a company operating multiple plants that collectively exceed the 500-employee limit, the plant will be considered a

large business even if the local plant has fewer than 500 employees.

Producer-handlers are dairy farms that process their own milk production. These entities must operate one or more dairy farms as a pre-condition to operating processing plants as producer-handlers. The size of the dairy farm(s) determines the production level of the operation and is a controlling factor in the capacity of the processing plant and possible sales volume associated with the producer-handler entity. Determining whether a producer-handler is considered a small or large business is therefore dependent on the capacity of its dairy farm(s), where a producer-handler with annual gross revenue in excess of \$750,000 is considered a large business.

The proposed amendments would obligate some large producer-handlers under the Federal milk marketing order system to the same terms as other fully regulated handlers of their respective orders provided they meet the criteria for qualification as fully regulated plants. Entities currently defined as producer-handlers under the terms of their order will be subject to the pooling and pricing provisions of the order if their total route disposition of fluid milk products is more than 3 million pounds per month.

Producer-handlers with total route disposition of 3 million pounds or less during the month will not be subject to the pooling and pricing provisions of any order as a result of this rulemaking. To the extent that current producer-handlers have route disposition of fluid milk products outside of the order's marketing areas, such route disposition will be subject to the pooling and pricing provisions of the orders if total route disposition causes them to become fully regulated.

If current producer-handlers have total route disposition of fluid milk products of more than 3 million pounds during a month, such producer-handlers will be regulated under the pooling and pricing provisions of the orders like other fully regulated handlers. Such large producer-handlers will account to the pool for their uses of milk at the applicable minimum class prices and pay the difference between their use-value of milk and the blend price of the order to that order's producer-settlement fund.

While this may cause an economic impact on those entities with more than three million pounds of route sales that are currently considered producer-handlers under the Federal order system, the impact is offset by the benefit to other small businesses. With respect to dairy farms whose milk is

pooled on Federal marketing orders, such dairy farms who have not heretofore shared in the additional revenue that accrues from the marketwide pooling of Class I sales by producer-handlers will share in such revenue. All producer-handlers who dispose of more than three million pounds of fluid milk products per month will account to all market participants at the announced Federal order Class I price for such use.

To the extent that some large producer-handlers become subject to the pooling and pricing provisions of Federal milk marketing orders, such will be determined in their capacity as handlers. Such entities will no longer have restrictions applicable to their business operations that were conditions for producer-handler status and exemption from the pooling and pricing provisions of the orders. In general, this includes being able to buy or acquire any quantity of milk from dairy farmers or other handlers instead of being limited by the current constraints of the orders. Additionally, the burden of balancing their milk production is relieved. Milk production in excess of what is needed to satisfy their Class I route disposition needs may receive the minimum price protection established under the terms of the Federal milk marketing orders. The burden of balancing milk supplies will be borne by all producers and handlers who are pooled and regulated under the terms of the orders.

During May 2009 the Northeast order had 57 pool distributing plants, 10 pool supply plants, 16 partially regulated distributing plants, 13 producer-handler plants and 40 exempt plants. Of the 83 regulated plants, 49 plants or 59 percent were considered large businesses. Of the 13,050 dairy farmers whose milk was pooled on the order, 628 farms or 5 percent were considered large businesses and 12,422 farms or 95 percent of dairy farms in the Northeast order were considered small businesses. Most of these dairy farms, large and small, could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Appalachian order had 21 pool distributing plants, 1 pool supply plant, 2 partially regulated distributing plants, 1 producer-handler plant and 4 exempt plants. Of the 24 regulated plants, 21 plants or 88 percent were considered large businesses. Of the 2,516 dairy farmers whose milk was pooled on the order, 159 farms or 6 percent were considered large businesses and 2,357 farms or 94

percent of dairy farms in the Appalachian order were considered small businesses. Most of these dairy farms, large and small, could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Florida order had 11 pool distributing plants, 5 partially regulated distributing plants and 2 exempt plants. The order had no pool supply plants or producer-handler plants as of May 2009. Of the 16 regulated plants, 12 plants or 75 percent were considered large businesses. Of the 249 dairy farmers whose milk was pooled on the order, 105 farms or 42 percent were considered large businesses and 144 farms or 58 percent of dairy farms in the Florida order were considered small businesses. Most of these dairy farms, large and small, could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Southeast order had 22 pool distributing plants, 3 pool supply plants, 6 partially regulated distributing plants and 12 exempt plants. The order had no producer-handler plants as of May 2009. Of the 31 regulated plants, 28 plants or 90 percent were considered large businesses. Of the 2,992 dairy farmers whose milk was pooled on the order, 187 farms or 6 percent were considered large businesses and 2,805 farms or 94 percent of dairy farms in the Southeast order were considered small businesses. Most of these dairy farms, large and small, could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Upper Midwest order had 24 pool distributing plants, 53 pool supply plants, 2 partially regulated distributing plants, 5 producer-handler plants and 11 exempt plants. Of the 79 regulated plants, 37 plants or 47 percent were considered large businesses. Of the 15,336 dairy farmers whose milk was pooled on the order, 1,001 farms or 7 percent were considered large businesses and 14,335 farms or 93 percent of dairy farms in the Upper Midwest order were considered small businesses. Most of these dairy farms, large and small, could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Central order had 30 pool distributing plants, 12 pool

supply plants, 1 partially regulated distributing plant, 7 producer-handler plants and 19 exempt plants. Of the 43 regulated plants, 35 plants or 81 percent were considered large businesses. Of the 3,600 dairy farmers whose milk was pooled on the order, 413 farms or 11 percent were considered large businesses and 3,187 farms or 89 percent of dairy farms in the Central order were considered small businesses. Most of these dairy farms, large and small, could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Mideast order had 22 pool distributing plants, 2 pool supply plants, 4 partially regulated distributing plants, 1 producer-handler plant and 17 exempt plants. Of the 28 regulated plants, 8 plants or 29 percent were considered large businesses. Of the 7,238 dairy farmers whose milk was pooled on the order, 504 farms or 7 percent were considered large businesses and 6,734 farms or 93 percent of dairy farms in the Mideast order were considered small businesses. Most of these dairy farms, large and small, could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Pacific Northwest order had 15 pool distributing plants, 8 pool supply plants, 13 partially regulated distributing plants, 5 producer-handler plants and 2 exempt plants. Of the 36 regulated plants, 20 plants or 56 percent were considered large business. Of the 657 dairy farmers whose milk was pooled on the order, 326 farms or 50 percent were considered large businesses. Because the Pacific Northwest order already fully regulates producer-handlers with monthly route distribution in excess of three million pounds per month, the proposed action will have a minimal effect on small farmers whose milk is pooled on the order.

During May 2009, the Southwest order had 19 pool distributing plants, 2 pool supply plants, 1 partially regulated distributing plant, 5 producer-handler plants and 2 exempt plants. Of the 79 regulated plants, 19 plants or 86 percent were considered large businesses. Of the 588 dairy farmers whose milk was pooled on the order, 318 farms or 54 percent were considered large businesses and 270 farms or 46 percent of dairy farms in the Southeast order were considered small businesses. Most of these dairy farms, large and small,

could benefit by receiving a higher blend price, if the recommended 3-million pound monthly Class I route disposition limitation for producer-handlers is adopted.

During May 2009, the Arizona order had 5 pool distributing plants, 1 pool supply plant, 15 partially regulated distributing plants and 1 exempt plant. The order had no producer-handler plants as of May 2009. Of the 21 regulated plants, 13 plants or 62 percent were considered large businesses. Of the 100 dairy farmers whose milk was pooled on the order, 95 farms or 95 percent were considered large businesses. Because the Arizona order already fully regulates producer-handlers with monthly route distribution in excess of 3 million pounds, the proposed action will have a minimal effect on small farmers whose milk is pooled on the order.

As of May 2009, in their capacity as producers, 15 producer-handlers would be considered large producers as their annual marketings exceed 6 million pounds of milk (500,000 pounds per month). During the same month, 22 producer-handlers would be considered small producers. Record evidence indicates that as of March 2009, seven large producer-handlers had total route sales of 2 million pounds or more per month. Therefore, seven or fewer large producer-handlers could potentially become subject to the pooling and pricing provisions of Federal milk marketing orders because of route disposition of more than 3 million pounds per month.

A review of reporting requirements was completed under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). It was determined that these proposed amendments would have minimal impact on reporting, recordkeeping, or other compliance requirements for entities currently considered producer-handlers under Federal milk marketing orders because they would remain identical to the current requirements applicable to all other regulated handlers who are subject to the pooling and pricing provisions. No new forms are proposed and no additional reporting requirements would be necessary.

This notice does not require additional information collection that requires clearance by the Office of Management and Budget (OMB) beyond currently approved information collection. The primary sources of data used to complete the forms are routinely used in most business transactions. Forms require only a minimal amount of information that can be supplied without data processing equipment or a

trained statistical staff. Thus, the information collection and reporting burden is relatively small. Requiring the same reports for all handlers does not significantly disadvantage any handler that is smaller than the industry average.

Interested parties are invited to submit comments on the probable regulatory and informational impact of this proposed rule on small entities.

Prior Documents in this Proceeding:
Notice of Hearing: Issued April 3, 2009; published April 9, 2009 (74 FR 16296).

Preliminary Statement

Notice is hereby given of the filing with the Hearing Clerk of this recommended decision with respect to proposed amendments to the tentative marketing agreement and the order regulating the handling of milk in the Northeast and all other marketing areas. This notice is issued pursuant to the provisions of the AMAA and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

Interested parties may file written exceptions to this decision with the Hearing Clerk, U.S. Department of Agriculture, STOP 9200—Room 1031, 1400 Independence Ave., SW., Washington, DC 20250–9200, by December 21, 2009 or through the Federal rulemaking portal at <http://www.regulations.gov>. Three copies of exceptions should be submitted if filed with the Hearing Clerk. All written submissions made pursuant to this notice will be made available for public inspection at the Office of the Hearing Clerk during regular business hours (7 CFR 1.27(b)). The hearing notice specifically invited interested persons to present evidence concerning the probable regulatory and informational impact of the proposals on small businesses. Some evidence was received that specifically addressed these issues and some of the evidence encompassed entities of various sizes. Such evidence was considered in this decision.

A public hearing was held upon proposed amendments to the marketing agreements and the orders regulating the handling of milk in all Federal milk marketing orders. The hearing was held pursuant to the provisions of the AMAA, as amended (7 U.S.C. 601–674), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

The proposed amendments set forth below are based on the record of a public hearing held in Cincinnati, Ohio,

pursuant to a notice of hearing issued April 9, 2009.

The material issues on the record of hearing relate to:

1. Producer-handler and exempt plant definitions in all Federal milk marketing orders.

Findings and Conclusions

All orders should be amended to limit producer-handlers to total Class I route disposition of not more than 3 million pounds per month as a condition for exemption from pooling and pricing provisions. The exempt plant definition of all orders should continue to limit disposition of Class I milk products to 150,000 pounds or less per month.

The Regulatory Status of Producer-Handlers

Currently, several orders define and describe a special category of handler known as producer-handler. Under the Pacific Northwest and Arizona orders (Orders 124 and 131, respectively) producer-handlers are subject to provisions that limit Class I route disposition to 3 million pounds or less per month within the respective marketing areas. The other 8 orders have no similar route disposition limit. The 3 southeastern orders do not allow producer-handlers to purchase supplemental milk while the remaining 5 orders provide producer-handlers the opportunity to purchase limited amounts. With noted exceptions, the producer-handler definitions of all Federal milk marketing orders exempt producer-handlers from the pooling and pricing provisions.

As a result of their exemption from pooling and pricing, producer-handlers, as handlers, are not required to pay the minimum class prices established under the orders nor are they, as producers, granted minimum price protection for disposal of surplus milk. Producer-handlers, in their capacity as handlers, are not obligated to equalize their use-value of milk through payment of the difference between their use-value of milk and the respective order's blend price into the producer-settlement fund. As such, producer-handlers retain the full value of milk processed and disposed of as fluid milk products by their operation within the marketing areas.

Entities defined as producer-handlers must adhere to strict criteria that limit certain business practices including the purchase of supplemental milk. Given these limitations, producer-handlers bear the full burden of balancing their milk production between fluid and other uses. Milk production in excess of their Class I route disposition does not

enjoy minimum price protection under the orders and may be sold at whatever price is obtainable in the market.

Producer-handlers are required to submit reports to the Market Administrator to ensure compliance with the requirements for their regulatory status as producer-handlers. In this sense, producer-handlers are regulated under the orders but are not "fully regulated" as are other handlers who are subject to an order's pooling and pricing provisions.

The Regulatory Status of Exempt Plants

The current exempt plant definition was implemented in January 2000 and is uniform across all orders. Exempt plants are not subject to full regulation on the basis of size. At or below the monthly Class I disposition threshold for exempt plants, these entities do not impact competitive relationships among handlers in the market such that full regulation is warranted. Exempt plants may operate solely as processing operations or may have the structure of producer-handlers. Operational structure is irrelevant in so much as qualification for exempt plant status is based solely upon Class I sales volume. Exempt plants are required to occasionally submit reports and information to the Market Administrator to ensure compliance with the exempt plant definition.

Summary of Testimony

Overview of Proposals

This proceeding was held in response to two proposals jointly submitted by the National Milk Producers Federation (NMPF) and the International Dairy Foods Association (IDFA). These proposals, marked as Proposals 1 and 2 would: (1) Eliminate the producer-handler provision from all Federal milk orders; (2) increase the exempt plant monthly limit on disposition of fluid milk products from 150,000 to 450,000 pounds; and (3) require unique labeling for fluid milk products distributed by exempt plants.

This proceeding also considered 17 alternative proposals received in response to the initial proposals. These proposals suggested a range of amendments to the producer-handler, exempt plant and pooling provisions.

The following summary of evidence presented during the proceeding is organized as follows:

1. Elimination of the producer-handler provisions and amendment of the exempt plant definition to include an increased limit on monthly Class I disposition.

2. Elimination of the producer-handler provisions and adoption of grandfathering.

3. Adoption of producer-handler provisions to include a limit on monthly Class I disposition.

4. Exemption of vertically integrated operations with retail and home delivery distribution.

5. Exemption of own-farm milk.

6. Establishment of individual handler pools.

Elimination of the producer-handler provisions and amendment of the exempt plant definition to include an increased limit on monthly Class I disposition.

Proposed by NMPF and IDFA, proposals published in the hearing notice as Proposal 1 and Proposal 2, seek to simultaneously eliminate the producer-handler definition from all Federal milk orders and increase the monthly Class I route disposition limit from the current 150,000 pounds to 450,000 pounds and require unique labeling for fluid milk products distributed by exempt plants. Proposals published in the hearing notice as 19 and 22 reiterated the positions contained in Proposals 1 and 2.

Representative members and supporters of NMPF including dairy farmer members, employees and representatives of Dairy Farmers of America (DFA), Mid-West Dairymen's Company (Mid-West), Lakeshore Federated Dairy Cooperative (Lakeshore), Michigan Milk Producers Association (MMPA), Prairie Farms Dairy (Prairie Farms), Maryland & Virginia Milk Producers Cooperative Association, Inc. (MD&VA), United Dairymen of Arizona (UDA), Northwest Dairy Association-Darigold (NDA-Darigold), and St. Albans Cooperative Creamery, Inc. (St. Albans) supported either the elimination of the producer-handler provisions or an increase in the exempt plant Class I route disposition limit, or both during the hearing.

A representative of NMPF testified in support of Proposals 1 and 2. NMPF is a trade association that represents 31 dairy farmer cooperatives. The witness was of the opinion that the exemption for producer-handlers was originally based upon the assumption that producer-handlers have limited sales of fluid milk products and little influence in the market. Using USDA data, the NMPF witness demonstrated that producer-handlers have a growing share of fluid milk sales in the markets that do not restrict the Class I disposition of producer-handlers. Given that some producer-handlers now sell large volumes of fluid milk products and significantly impact the market, larger

producer-handlers should not be exempt from pooling and pricing, the witness asserted.

According to the NMPF witness, large producer-handlers have a regulatory advantage associated with the price at which they acquire milk for processing and the sales revenues they retain because of the exemption they enjoy. Specifically, the witness testified that producer-handlers are essentially able to acquire their milk at the uniform price rather than the Class I price and as a result, enjoy a cost advantage over fully regulated handlers in procuring milk. The witness asserted that the uniform price is effectively the market price for producer milk and as such, the appropriate transfer price (the price at which producer-handlers transfer their internal milk supply to their plant) for analysis of the regulatory impact of producer-handlers. Additionally, producer-handlers' exemption from payment into the producer-settlement fund deprives Federal order pools of money that would otherwise be distributed among producers, the witness stated. Producer-handlers, the witness asserted, encounter the same costs from cow to bottle as other enterprises but are exempt from pool payment.

The NMPF witness testified that the potential exists for large dairy farms to become large producer-handlers. A more than 100 percent increase in dairy farms with more than 2,000 cows from 1998 to 2007 has occurred, the witness stated, noting that the monthly milk production of a 2,000-cow dairy is nearly 4 million pounds. Collectively, farms at this level of production, upon conversion to producer-handler status, could capture a large share of the Class I sales in an individual market, or nationally, the witness asserted. The witness testified that both dairy farms and handler operations are threatened by the potential for large farms to become producer-handlers. According to the witness, producer-handlers are already disruptive in most Federal order marketing areas and particularly in the Central order (Order 32) marketing area. The witness acknowledged that producer-handlers are not currently disruptive in all orders but asserted that the preemptive adoption of some uniform standards regarding producer-handler operations is necessary.

The NMPF witness explained that Proposal 2, seeking an increase in the exempt plant limit on monthly Class I disposition from 150,000 to 450,000 pounds, is based in part on a three-fold increase in milk production at the farm-level since the time when the current exempt plant limit was set. The witness

testified that plants with less than 450,000 pounds of route distribution per month have trouble competing with larger plants on a cost basis even when exempt from full regulation because the milk procurement price advantage is outweighed by higher processing costs. The witness also testified that farm size and economies-of-scale should be considered in setting an exempt plant limit, citing evidence of cost disadvantages for producer-handlers with less than 500,000 pounds of monthly production.

The NMPF witness testified that the unique labeling provision of Proposal 2 is designed to prevent milk buyers from exploiting exempt plants' price advantage through the purchase of a large supply of identically labeled milk at prices lower than those of other, fully regulated plants. Additionally, the witness testified that NMPF intends the 450,000-pound monthly limit on Class I disposition for exempt plants to apply to total sales rather than sales in a single market. According to the witness, Proposals 1 and 2 in combination would allow all but the largest producer-handlers to retain an exemption from pooling and pricing while newly exempting an additional 30 to 35 regulated or partially regulated plants. Furthermore, the witness asserted, adoption of Proposals 1 and 2 would establish more equitable rules for dairy farmers whose milk is pooled and priced under the terms of Federal milk orders.

A panel of three dairy farmer members of DFA, a separate witness representing DFA, and a witness representing both Mid-West and Lakeshore testified separately in support of Proposals 1 and 2. The DFA dairy farmer panelists own and operate separate farms in Wisconsin, Texas and Kentucky. DFA is a Capper-Volstead cooperative of approximately 10,500 farms that produce milk in 49 states. Mid-West is a Capper-Volstead cooperative representing 163 dairy farms. Lakeshore is comprised of Manitowoc Milk Producers Cooperative, Milwaukee Cooperative Milk Producers, Mid-West and Scenic Central Milk Producers Cooperative. Mid-West and Lakeshore are located primarily in Illinois and Wisconsin.

Both the DFA dairy farmer panel and the Mid-West-Lakeshore witness testified that the producer-handler exemption reduces revenues for all dairy farmers whose milk is pooled on Federal orders. The DFA witness and the Mid-West-Lakeshore witness asserted that producer-handlers also disadvantage fully regulated handlers. Specifically, the DFA witness and the

Mid-West-Lakeshore witness explained that producer-handlers retain the difference between the minimum Class I price and the statistical uniform price while fully regulated handlers that are similarly situated are required to account for milk at minimum class prices and pay into the producer-settlement fund. The Mid-West-Lakeshore witness added some dairy cooperatives that own and operate fluid milk plants have assumed the same risk as producer-handlers without enjoying the ability producer-handlers have, because of their exemption, to balance surplus production by adjusting packaged milk prices relative to production volume. The Mid-West-Lakeshore witness asserted that a producer-handler in the Upper Midwest (Order 30) marketing area, for example, has a \$0.14 per gallon "advantage," on average, over fully regulated handlers due to its pool exemption. Similarly, the DFA witness testified that since a producer-handler in Order 32 began supplying a regional grocer about a year ago, its milk has consistently been the lowest priced brand. In some of the markets where DFA markets milk, price concessions, including premium discounts, have been needed to meet competition from producer-handlers, and some of DFA's processor-customers have expressed concern that producer-handlers are marketing milk at such low prices that it is difficult to compete, the DFA witness stated.

The DFA dairy farmer panel stated that if fully regulated processing plants were closed due to unfair producer-handler competition, outlets for milk would become fewer and located further away from producers, which would result in higher hauling costs. Ultimately, the DFA dairy farmer panel was of the opinion that the integrity of the order system would be undermined, and the future of dairy farmers jeopardized, if the producer-handler provisions were allowed to remain. The Mid-West-Lakeshore witness echoed this position, noting that while Mid-West and Lakeshore do not currently compete with any producer-handlers, a large farm under construction near a Mid-West plant was identified as a potential producer-handler whose operations could lower the revenues of Lakeshore dairy farmers. The DFA witness provided data on the number of "larger" dairy farms across the country, estimating the potential negative impacts on producer minimum blend prices if these farms were to become producer-handlers. Accordingly, the DFA witness asserted that Proposals 1 and 2, if adopted, would add stability to

the order system, and assure regulated handlers that their competitors pay the same minimum prices.

The DFA witness testified that many producer-handlers have maintained their businesses within the 150,000-pound per month exempt plant limit on Class I disposition and the proposal to triple this size limit for the exempt plant provision would allow a reasonable expansion path for many of these operations. Furthermore, the DFA dairy farmer panel and the DFA witness asserted that a 450,000-pound per month limit would provide a majority of dairy farmers the opportunity to try on-farm processing and marketing, and if an operation is successful enough to grow the business beyond this level it would become fully regulated. The DFA witness also testified that the unique labeling component of Proposal 2 is essential because without it an incentive would exist for an integrator to "daisy-chain" a group of plants to process and package under the same label for the same customer. The DFA witness agreed with the position of NMPF and IDFA that the unique labeling provision would still allow for bottling under multiple labels as long as the labels were not shared across processors.

Witnesses representing MMPA, Prairie Farms and MD&VA testified separately in support of Proposals 1 and 2. MMPA is a Capper-Volstead cooperative in Michigan. Prairie Farms is a Capper-Volstead cooperative, based in Illinois, operating 35 fluid milk and dairy product processing plants, 26 of which are regulated under 5 Federal orders. MD&VA is a Capper-Volstead cooperative with more than 1,500 members, marketing member and non-member milk in 3 Federal orders in the Mid-Atlantic and Southeast. MD&VA owns and operates three fully regulated fluid milk plants, one balancing plant and has a majority interest in a second balancing plant.

The MMPA, Prairie Farms and MD&VA witnesses provided testimony that was largely in agreement with the testimony of the DFA dairy farmer panel, and the DFA and Mid-West-Lakeshore witnesses. The MMPA witness testified specifically to the increased average size of Michigan dairy farms and the possibility that these larger dairy farms may become producer-handlers. The Prairie Farms witness joined in this concern, stating that while there are currently only a few "large" producer-handlers in operation across the country, the potential for new ones exists. Similarly, the MD&VA witness asserted that despite the relatively small number of producer-handlers in the Appalachian and

Southeast (Federal Orders 5 and 7) marketing areas, the potential for growth in producer-handler numbers still exists. The MD&VA witness explained that the combined growth of large farms and discontinuation of smaller farm operations has created the potential for construction of bottling plants on large farms. Additionally, the MD&VA witness testified that the Appalachian and Southeast marketing areas, as deficit markets that source out-of-area milk, face the possibility of large farms located outside of the marketing areas obtaining producer-handler status and gaining advantages over fully regulated handlers who consistently supply the two markets. The MD&VA witness was of the opinion that producer-handlers should pay the same minimum prices as MD&VA's customers.

The Prairie Farms witness testified that as a fully regulated handler, Prairie Farms can compete with any other fully regulated handler but not with a producer-handler that has an unfair advantage owed to its exemption from full regulation. The MD&VA witness stated that MD&VA is billed on a monthly basis because of its pool obligation while producer-handlers are exempt, the MD&VA witness stated. Producer-handlers' exemption from pool payment is equivalent to a price advantage of \$0.23 per gallon in the areas in which MD&VA markets milk, according to the MD&VA witness.

The Prairie Farms witness testified that adoption of Proposals 1 and 2 would not harm those that want to process, package and sell own-farm milk. Rather, the proposed changes recognize that when a handler reaches a certain size, the size of that operation could negatively impact fully regulated handlers and producers alike. Similarly, the MD&VA witness noted that the adoption of the NMPF proposals would provide protection to the pool which is necessary because marketwide pooling is the only way all producers and cooperatives share in the higher value associated with Class I products.

The MMPA witness also testified that an increase in the exempt plant Class I route disposition limit to 450,000 pounds per month would allow relatively small processors to meet the needs of niche markets without causing disorder, and increase overall consumer demand for dairy products and encourage the development of new dairy products.

A dairy farmer witness representing UDA testified in support of Proposals 1 and 2. UDA is the only Capper-Volstead cooperative in the state of Arizona. The witness testified in support of Proposal 1 as a preventative measure, and noted

that producers in the Arizona (Order 131) marketing area have realized higher blend prices since a cap was placed on producer-handler Class I dispositions in a prior rulemaking. The UDA witness stated that plants with 450,000 pounds or less of monthly Class I disposition serve small niche markets, are not disruptive and should not be subject to full regulation.

A witness representing NDA and Darigold testified in support of Proposals 1 and 2. NDA is a Capper-Volstead cooperative comprised of 530 producers located in Washington, Oregon, Idaho, Utah, and California. NDA and Darigold Inc., wholly owned by NDA, own and operate bottling plants and manufacturing plants in the Pacific Northwest (Order 124) marketing area and Idaho.

The NDA-Darigold witness testified that the buyers in the region where NDA and Darigold operate are sophisticated and price conscious. Drawing from conversations with milk buyers, the witness illustrated that when buyers are presented the opportunity to buy Class I milk at a lower price, ruinous competition between fully regulated and unregulated handlers develops. The witness went on to explain that the combination of a buyer's desire for lower prices and the occurrence of similarly situated handlers competing on an uneven playing field creates disorderly marketing conditions within the market which drive prices below commercially reasonable levels.

The NDA-Darigold witness stated that the disorderly marketing and unfair competition that led to the changes in Orders 124 and 131 no longer exist since the implementation of the 3-million-pound limit on monthly Class I disposition in the marketing areas. The witness also noted that producers now receive a slightly higher blend price and three of the producer-handler operations affected by the rulemaking continue to operate.

The NDA-Darigold witness testified that handlers with 450,000 pounds or less of Class I sales per month should be treated uniformly under the exempt plant provision. The witness asserted that this proposed change closely reflects the AMAA's intent that regulation should apply equally to all handlers. The witness offered that aside from grandfathering certain current producer-handlers, the exempt plant provision should be the only basis for exemption from pooling and pricing in the future.

A witness appeared on behalf of St. Albans in support of Proposals 1 and 2. St. Albans is a dairy Capper-Volstead cooperative based in Vermont that

processes and markets milk pooled on the Northeast order (Order 1). The witness testified that the Northeast order has more producer-handlers and exempt plants than any other order. Relying on the Order 1 Annual Statistical Bulletin for 2008, the witness stated that the Class I sales from 15 producer-handlers and 46 exempt plants are not included in the marketwide pool. The witness was of the opinion that most of the exempt plants are also producer-handlers.

The St. Albans witness testified that large producer-handlers impact Federal order pools and a producer-handler located outside the Northeast marketing area marketed milk into that area during every month of 2008 in direct competition with fully regulated plants supplied by local producers. The witness asserted that while St. Albans currently faces no competition from producer-handlers located in the Northeast marketing area, the location of the producer-handler is irrelevant since milk shipped from outside the order competes with local production. As such, the witness stated that the rapid growth in volume of producer-handler milk sales represents a potential market disruption.

The following handler members and other supporters of IDFA including the Northeast Dairy Foods Association (NDFA), Worcester Creameries (Worcester), Elmhurst Dairy (Elmhurst), Mountainside Farms (Mountainside), Steuben Foods (Steuben), Harrisburg Dairies (Harrisburg), the Pennsylvania Association of Milk Dealers (PAMD), Anderson Erickson Dairy (AE), Price's Creameries (Price's), and Bareman Dairy (Bareman) testified in support of either the elimination of the producer-handler provisions or the increase of the exempt plant limit on Class I route disposition, or both.

A witness appeared on behalf of IDFA in support of Proposals 1 and 2. According to the witness, IDFA is a trade association representing manufacturers, marketers, distributors and suppliers of fluid milk and related products including ice cream, frozen dairy desserts and cheese. The witness noted that most of the milk purchased and processed by IDFA members is regulated under the Federal order system.

The IDFA witness testified that the elimination of the producer-handler provisions is necessary for a number of reasons, all of which give rise to disorderly marketing. According to the witness, exemption from pooling and pricing allows producer-handlers to, in effect, pay the uniform price rather than the Class I price for own-farm milk. As

a result, producer-handlers have a milk acquisition cost advantage over fully regulated plants, solely on the basis of a regulatory exemption, the witness stated. The witness asserted that disorderly marketing conditions arise when some but not all handlers are subject to payment of the Class I minimum price. According to the witness, handlers not subject to full regulation can use their artificial cost advantage to offer customers a lower price than can be offered by a fully regulated handler.

The IDFA witness also asserted that the need for the elimination of the producer-handler exemption stems from significant structural changes which have occurred at all levels of the dairy industry. The witness explained that in 1998 only 235 farms reportedly had more than 2,000 cows and by 2008 that number had increased to 730 and accounted for 30.5 percent of all U.S. milk production. Providing additional perspective, the witness noted that farms with more than 500 milk cows accounted for 58.5 percent of U.S. milk production in 2008. Cows in the top 5 milk producing states now produce on average, 23,000 pounds of milk per year, the witness stated. The witness illustrated that a 500-cow farm in these states could have monthly production of, on average, nearly 1 million pounds. Additionally, the witness explained that a 2,000-cow herd with the same average would be expected to produce nearly 46 million pounds annually, or 4 million pounds monthly. The witness was of the opinion that large farms, with milk production levels never contemplated when producer-handlers first became exempt from pooling and pricing, are present in the marketplace today.

With regard to Proposal 2, the IDFA witness asserted that IDFA and NMPF jointly support an increase of the limit on Class I disposition for exempt plants. The witness further explained that an increase in the exempt plant limit is intended to preserve regulatory exemption for those plants too small to cause material market disruption, including those small plants previously exempted as producer-handlers. The current 150,000 pounds per month threshold was adopted in all Federal orders as part of Federal order reform as it was the highest volume threshold in existence at the time, the witness noted. Furthermore, the witness asserted that since 1990, the time period for which data was available when the exempt plant provision was adopted, the average volume of fluid milk products produced by U.S. fluid milk bottling plants operated by commercial processors has roughly doubled, from

93.9 million pounds annually in 1990 to 189.8 million pounds in 2007. The witness noted that while the data might suggest a doubling of the threshold, the overall upward trend clearly shows that average fluid milk bottling plant volumes continue to increase over time, which warrants the adoption of a limit that allows for future growth while remaining tied to the structural trends of the industry.

Proposal 2, according to the IDFA witness, also requires that an exempt plant sell its fluid milk products using unique labels, lest this exemption be abused through the establishment of numerous "small" plants effectively linked together to market their milk jointly and to garner the advantages of a large plant without being subject to full regulation. The witness noted that this particular feature is not intended to prevent an exempt plant from marketing packaged fluid milk products under more than one label. The witness provided the example of an exempt plant with its own label and other labels distributed to a local grocery store and via home delivery to illustrate this assertion. Ultimately, the witness stated that an exempt plant should not be able to distribute fluid milk products under the same name used by any other handler.

A witness appeared on behalf of NDFA in support of Proposal 22 seeking elimination of the producer-handler provisions. NDFA is a trade association based in New York, representing dairy processors, manufacturers and distributors. The NDFA witness provided testimony similar to others regarding the outdated nature of the producer-handler exemption. The NDFA witness added that an exemption for both producer-handlers and exempt plants is inappropriate because producer-handlers and exempt plants are in direct competition with fully regulated handlers. The witness cited the procurement of raw milk at lower prices, ease of balancing and the ability to make pricing adjustments more quickly as advantages that accrue to exempt handlers. Furthermore, the NDFA witness asserted that exempt handlers retain the difference between the Class I price and uniform price which reduces the blend price to producers. However, the NDFA witness was not opposed to the current exempt plant provision.

A witness appeared on behalf of Worcester, Elmhurst, Mountainside and Steuben (Worcester et al.). With the milk of approximately 200 producers and additional purchases of cooperative milk, Worcester supplies Elmhurst, Mountainside and Steuben, all of which

are fluid milk plants. The witness echoed the testimony of the NDFA witness in support of the elimination of producer-handler and exempt plant provisions. The Worcester et al. witness testified in exclusive support of Proposal 1 in the event that the exempt plant provision was not eliminated.

By example, the Worcester et al. witness asserted that an existing New York producer with 4 million pounds of monthly production would have a cost advantage as a producer-handler and would reduce the amount of business that proximate fully regulated handlers could secure. The witness also testified that any increase in exempt plant volume would further contribute to handler inequity.

A witness representing Harrisburg and PAMD testified in support of Proposals 1 and 19. Proposal 19 would adopt the 450,000 pound per month limit on Class I disposition for exempt plants as proposed jointly by NMPF and IDFA. The witness testified that Harrisburg is a member of PAMD. Harrisburg is fully regulated under Order 1 with monthly Class I route distribution of 4 to 6 million pounds.

The Harrisburg witness stated that Harrisburg Dairies is not presently in direct competition with producer-handlers. The witness asserted that there is a threat presented by Western Pennsylvania producer-handlers servicing the same type of retail chains as Harrisburg Dairies. The witness testified that their operation would not survive in its current form if producer-handlers move into eastern Pennsylvania. Based on Harrisburg Dairies' experience as a regulated handler, the witness estimated that a producer-handler of similar size would have an average cost advantage of \$100,000 per month over a fully regulated plant because of the pool payment exemption. The witness testified that Harrisburg Dairies was recently asked to become a producer-handler and declined. The witness asserted that it is not reasonable for some processors to enjoy regulatory privileges that other processors do not.

A consultant witness, a witness representing AE and a witness representing Price's, each testified to the characteristics and impacts of producer-handlers. The consultant witness appeared on behalf of Prairie Farms, Dairy Institute of California, NDFA, AE, PAMD, Dean Foods Company (Dean), National Dairy Holdings, LP, Shamrock Foods Company (Shamrock), Shamrock Farms and partner farms.

The consultant witness has had involvement in the dairy industry for more than two decades and is currently

a shareholder in Wilcox Farms (Wilcox), a large fluid milk processor and the witness' former employer. AE is private family business with 525 full-time employees and a processing plant in Order 32. AE offers fluid milk and other dairy products that are distributed in Iowa and portions of six other states. Price's, a division Dean, has 170 employees and serves the El Paso, Texas, area.

The consultant witness and the AE and Price's witnesses did not testify in specific support or opposition to any proposals under consideration. Rather, each of the witnesses provided examples of producer-handler competition with fully regulated handlers. The consultant witness testified that in 1974, a large regional grocery chain asked Wilcox to build a fluid processing plant and qualify as a producer-handler as a means of supplying the customer at a lower cost. During the period that Wilcox was a producer-handler, the grocer was able to balance supply through another source, the consultant witness stated. The consultant witness further testified as to the nature of customer-driven competition, noting that after conversion to fully regulated status in 1987, Wilcox was occasionally asked to lower its price to meet a competitor even when the competitor could serve only a small number of stores.

The Price's witness testified to having recently lost business to a producer-handler in the El Paso area. The Price's witness opined that the producer-handler's processing capacity to be as much as 752,000 gallons per week—enough to supply 80 percent of the demand in the area. In March and April 2009, Price's stopped supplying several stores in the El Paso area when an operation that had gained producer-handler status in January 2009 assumed that portion of a national retailer's business, the witness testified. According to the witness, the national retailer had been purchasing 66,000 gallons per week from Price's before it switched to the producer-handler supplier. The witness was of the opinion that Price's lost business to the producer-handler solely on the basis of price. The witness further stated that after Price's lost the account, a Price's employee observed a \$0.34 per gallon reduction in the customer's retail price, translating to a wholesale loss of about \$4 per hundredweight (cwt). However, the Price's witness acknowledged that lower milk prices in El Paso were not solely attributable to the producer-handler in the area.

The AE witness testified that AE shares a large customer in the Kansas

City area with Heartland Creamery (Heartland), a producer-handler. The witness went on to explain that the shared customer traditionally uses a bid process to secure a supply of milk for two private labels and in 2007, AE successfully bid on the account consisting of the two private labels in addition to the branded product account AE already held. According to the AE witness, the customer's pricing scheme is such that the brand name product is priced about \$0.10 above the private label product displaying the store's name while the private label product with the more generic name is priced about \$0.20 below the store name product. Based on observations of the dairy cases in a number of locations and additional knowledge as to purchasing practices of the customer, the witness offered that AE continued supplying the customer with the generic label product until it was gradually replaced by Heartland's branded product at a lower price point. The witness testified that AE went from annualized sales of 185,000 to 40,000 gallons of the generic label in one year, and the generic label product is now no longer produced.

It was noted by the AE witness that the replacement of a low-cost generic labeled product with a branded product is somewhat unusual. Given that AE continues to supply the customer with the AE branded product and the private label store name product, the fact that, the AE generic label product was replaced by the Heartland branded product and the AE generic label product was in the most price sensitive category, the witness concluded that Heartland's ability to obtain the customer's business was solely on the basis of price not quality or service. In addition, based on AE employee conversations with the retailer, the witness asserted that the retailer account was lost on the basis of price, and in particular because of Heartland's pricing strategy of supplying the account at a lower price than the AE price.

The AE witness further asserted that sales of the AE-produced private label store name product have decreased approximately 200,000 gallons annually since the Heartland product was introduced. The witness estimated that Order 32 has lost approximately 3.25 million pounds from the pool due to the discontinuation of the AE private label generic name product and the reduction in sales of the AE private label store name product attributable to Heartland's direct competition.

The consultant witness and the AE witness both testified that regulated handlers are able to compete with

producer-handlers in terms of service, quality, advertising and packaging, but producer-handlers have a clear advantage in terms of price. The AE witness specifically noted that AE is able to respond to more efficient operations but the presence of regulation which creates inequality is not something that can necessarily be overcome.

The consultant witness went on to testify regarding producer-handler proliferation. For a producer with 10,000 cows it is comparatively easier to add a processing plant than for a processor with the capacity to process the milk of 10,000 cows to add dairy cattle, the consultant witness stated. In support of this assertion, the consultant witness testified that in the late 1990s, Wilcox built a plant with capacity for the milk of 5,000 cows for less than \$7 million, and the investment to double that capacity would likely have been less than \$3 million. The consultant witness stated that a recent University of Florida study found construction of a processing plant for the milk of a 10,000-cow herd would require about \$40 million.

The consultant witness described several recent trends that enhance producer-handler viability: many dairy farms are large enough to exclusively supply a processing plant; producer-handlers are attractive investments; and many milk buyers have multiple suppliers capable of balancing producer-handlers' supply. The witness testified that uncertainty of the future regulation of very large producer-handlers has constrained investment in these businesses, but if USDA does not modify the producer-handler provisions as a result of this proceeding, the number of producer-handlers will grow.

A witness representing Bareman, a fluid processor in Michigan, testified in support of Proposals 1 and 2. According to the witness, Bareman purchases milk from cooperatives and is fully regulated under the Mideast order (Order 33). The witness noted that Bareman competes against a number of large fluid milk processors and Country Dairy, a producer-handler.

The Bareman witness reiterated the testimony of others regarding the advantage created by the producer-handler exemption and its associated effects on pooled producers and fully regulated handlers. The witness added that Bareman, as a fully regulated handler, is assured that other fully regulated handlers pay minimum prices in the same manner that it does.

The Bareman witness testified to having lost some accounts to a producer-handler, often on the basis of

price. The witness provided an example wherein Bareman engaged in price competition with Country Dairy (a producer-handler) for a convenience store account during the spring flush. Bareman, the witness testified, was ultimately unable to meet the low price offered by the producer-handler. The disruption noted in this example, the witness asserted, arises because of producer-handlers' need to balance sales with milk production and their resultant willingness to turn to "fire sales" for established customers and any others that might be receptive.

Additionally, representatives of the Federation of Organic Dairy Farmers (FOOD), Cornucopia Institute (Cornucopia), National All Jersey (NAJ), and the State Departments of Agriculture in New Hampshire (NH), New York (NY), Pennsylvania (PA), Vermont (VT), and Wisconsin (WI), testified in support of the elimination of the producer-handler provisions, the increase of the exempt plant limit on Class I route disposition, or both.

A panel of three dairy farmers representing FOOD and a witness on behalf of Cornucopia testified in support of Proposal 2. FOOD is an umbrella organization that represents the Western Organic Dairy Producers Alliance (WODPA), the Midwest Organic Dairy Producers Alliance (MODPA) and the Northeast Organic Dairy Producers Alliance (NODPA). According to the panel, FOOD represents nearly two-thirds of the organic dairy farmers in the country. The Cornucopia witness testified that the Cornucopia Institute is a charitable organization serving the organic industry.

By example, the Cornucopia witness illustrated the ways that Aurora Organic Dairy's (Aurora) exempt status as a producer-handler is disruptive. The Cornucopia witness was of the opinion that Aurora used the regulatory loophole to establish one of the largest market shares in the organic dairy industry. The witness testified that adoption of a limit of 450,000 pounds of Class I sales per month for exempt plants, as suggested by Proposal 2, would be reasonable and sufficiently large to accommodate "legitimate" family farmers seeking to engage in processing and marketing dairy products, while minimizing disruption associated with the current producer-handler provisions.

The FOOD panel testified in support of a hard-cap limit of 450,000 pounds of Class I route disposition per month for both producer-handlers and exempt plants. The FOOD panel was of the opinion that a 450,000-pound per month limit on Class I disposition

would honor the original intent of the producer-handler exemption. Furthermore, the FOOD panel testified, an exempt plant limit of 450,000 pounds of Class disposition per month would ensure a level playing field while allowing small scale operations to package and sell their product locally.

The FOOD panel also testified that Aurora has been able to use the scale of its operation in combination with its exemption from full regulation to capture a great deal of the organic market in the Northeast. According to the FOOD panel, Aurora's significant presence in the Northeast marketing area has negatively impacted the price local organic producers receive for their milk and threatened the viability of the handlers that purchase local milk supplies.

A witness representing NAJ testified in agreement with Proposal 2. The witness testified that NAJ is a membership organization that represents over 1,100 dairy producers and is an affiliate member of both NMPF and IDFA. The NAJ witness testified that the current Federal order producer-handler and exempt plant provisions are inequitable. The witness was of the opinion that handlers with own-farm milk production can be treated very differently for outside purchases of milk depending on the marketing area where they have disposition. The witness testified that some Class I milk should be exempt from Federal order pooling and pricing, and as such, NAJ supports Proposal 2.

A panel of witnesses on behalf of the New Hampshire Department of Agriculture, Markets and Food; the New York Department of Agriculture and Markets; the Pennsylvania Department of Agriculture; the Vermont Agency of Agriculture, Food and Markets; and the Wisconsin Department of Agriculture, Trade and Consumer Protection (State Departments of Agriculture); and 19 producer-handlers and exempt plants located in Wisconsin adopted Proposal 2 in lieu of Proposal 9.

The State Departments of Agriculture panel supported the unique labeling provision of Proposal 2. The panel was of the opinion that this provision is necessary to prevent the aggregation of exempt milk for mass distribution, but was not in support of the adoption of any other labeling restrictions.

Conversely, a panel of consultant witnesses representing the American Independent Dairy Alliance (AIDA) and representatives of Braum's Ice Cream and Dairy Stores (Braums), Kreider Farms (Kreider), Aurora Organic Dairy (Aurora), GH Dairy—El Paso (GH Dairy), Heartland Creamery (Heartland),

Snowville Creamery (Snowville), Northeastern state legislators, Shamrock, Diamond D Dairy (Diamond D), a Southeastern dairy farm, Shatto Farms, Inc. (Shatto), Country Dairy, Mallorie's Dairy (Mallorie's), Hatchland Dairy (Hatchland), Dunajski Dairy (Dunajski), NDFA and Country Morning Farms (Country Morning) testified in opposition to the elimination of the producer-handler provisions, an increase in the exempt plant monthly Class I disposition limit, or both.

The panel of consultants testifying on behalf of the American Independent Dairy Alliance (AIDA) provided testimony as to the lack of foundation for Proposals 1 and 2. The panel testified that producer-handlers do not create disorderly marketing conditions since they supply only 1.46 percent of the national fluid milk market. The significant concentrations of market power enjoyed by cooperatives and processors result in producer-handler market share that is minuscule by comparison, the panel asserted. The panel further asserted that a primary objective of the AMAA is the consistent supply of fluid milk to consumers and given the Class I utilization levels of the orders it would appear there is no disruption present in the marketing areas.

Furthermore, the AIDA consultant panel asserted there is no realistic threat that producer-handlers will ever achieve such a scale of operation to become a source of disorder as defined by the AMAA. The panel was also of the opinion that if producer-handlers had a substantial competitive advantage as alleged, there would be more new producer-handlers. The panel acknowledged that one factor influencing the decision to become a producer-handler is the regulatory risk associated with the elimination or amendment of the provision. In addition, the panel provided its opinion of conditions which could be considered disorderly and those which could not and asserted that producer-handlers are not causing disorder. The panel was of the opinion that the crucial issue is whether treatment is equitable in light of the objectives of the AMAA.

The AIDA consultant panel stated that its analysis revealed a number of relevant considerations. The panel identified these considerations as follows: producer-handlers are frequently engaged in the production of unique and growing niche market products such as organic, kosher, and grass-fed milk, which are inherently much more costly to produce; some producer-handlers continue the tradition of home delivery; producer-

handlers adjust their production patterns to minimize surplus production, which would otherwise be sold at a substantial loss; the managers of producer-handler operations have to divide their attention between both the farming and the processing sides of the operation and as such, do not realize cost advantages associated with specialization; and producer-handlers have substantial capital investments in their production, processing and distribution. The panel asserted that ignorance of these realities would lead conclusions about producer-handlers to be drawn without foundation. The panel also explained that niche market products can take many forms, primarily based on the unique consumer preferences associated with a given product and a product can lose the "niche" categorization as it becomes relatively less unique due to a greater availability of products with similar attributes. The panel asserted that even producer-handlers who do not serve a niche market remain constrained by the costs of their operation and that producer-handler status is the only way they can compete in a monopolistic market situation.

The AIDA consultant panel was of the opinion that its survey of AIDA producer-handler members revealed a great level of diversity across the operations. More specifically, the panel noted that AIDA producer-handlers members: are all small businesses, relative to many cooperatives and processors; each have their own market niches that serve particular consumer tastes and preferences reflective of the ever increasing diversity of the consumer market; sometimes provide home delivery services; sometimes operate their own stores; market to smaller wholesale outlets with smaller volumes per account; market products with consumer prices that generally exceed those of conventional products; and provide necessary competition.

Based on analysis performed using USDA data, the AIDA consultant panel concluded that the average producer-handler increase in size lies between that of the producer and processor size increases between 1969 and 2008. Furthermore, the panel noted that USDA plant structure data shows that of the 45 producer-handlers in May 2008, 40 had sales volume of less than 2 million pounds and 5 had volume of over 2 million pounds. In comparison, 46 conventional pool plants had a volume of less than 2 million pounds and 210 had volume of over 2 million pounds—73 of which had volume of over 20 million pounds. The panel asserted that these figures clearly

indicate that producer-handler growth is constrained, and the requirement that producer-handlers must maintain sole ownership and control over their operations places a de facto limit on the size of producer-handlers dictated by the realities of integrated operations. However, the panel acknowledged that those producers who recently constructed bottling plants and intend upon seeking producer-handler status were not known at the time the analysis was conducted and as such, were not included. The panel also acknowledged that both producer and processor operations could realize lower costs with scale.

The AIDA consultant panel noted that USDA data indicates that producer-handler numbers have decreased from 421 in 1969 to 37 in March 2009. Additionally, the panel was of the opinion that USDA data does not indicate an increasing trend in producer-handler sales volumes. However, the panel acknowledged that the calculations used to arrive at these conclusions were for total volumes not Class I volumes, although the panel asserted that specific concentration on Class I volumes was not a necessary condition of a complete analysis. The panel also acknowledged that the analysis did not represent a scenario in which figures related to sales volumes for entities that had producer-handler status prior to the rulemaking in the Pacific Northwest and Arizona marketing area, which limited producer-handlers with a volume cap.

Cost-of-production, the AIDA consultant panel asserted, is the only figure relevant in assessing the cost of raw milk faced by the handler portion of producer-handler operations. The panel further asserted that the appropriate transfer price for use in any analysis of producer-handler impacts should be based on costs of production not the difference between the blend price and Class I price. The panel testified that in general, the cost of milk production for all size farms exceeds the uniform price by \$5 to \$8 per cwt. The panel did not utilize specific producer-handler data in the cost-of-production research presented, and the panel was of the opinion that producer-handler data would not be substantially different from other dairy farm sector data. The panel noted that the prices analyzed were selected arbitrarily and the panel was not aware of the locations from which they were collected. The panel further stated that regardless of herd size, dairy farmers cannot rely on simply marketing their raw milk to ensure long-term economic viability. The producer-handler exemption helps

farmers who opt to process their own milk compete with large fluid plants, the panel asserted. However, the panel asserted that producer-handlers do not have a price advantage as a result of their regulatory status. The AIDA consultant panel stated that disorder existed during the period when the AMAA was enacted due to the relatively few number of milk buyers and a large number of producers seeking outlets. The panel further asserted that a lack of marketing alternatives is currently an issue in some areas where producers are reduced to either marketing milk through a single cooperative or marketing as a producer-handler. By example, the panel provided the opinion that two producers in the same market may not equivalently enjoy the benefits of the pool, despite the fact that each producer delivers to the same cheese plant, because one producer markets through a cooperative classified as a buyer, while the other remains independent. The panel was also of the opinion that Federal orders do not provide uniform prices to producers because prices vary based on component values, over-order premiums and hauling charges. However, the panel testified that the analysis of producer prices presented did not take into account the formulas used to calculate paychecks based on the various factors. Ultimately, the panel asserted that if producer equity is a goal of Federal milk marketing orders, producer-handlers do not inhibit realization of such a goal.

According to the AIDA consultant panel, pooling producer-handler milk would add \$0.01 to \$0.02 per cwt to the average statistical uniform price, an amount the panel described as insignificant. The panel also asserted that uniform and Class I prices could not be used as a basis for determining disorder. The panel arrived at this conclusion based on the opinion that prices determined via regulation are not real; instead prices determined in the marketplace are real and should be the basis for examination and identification of disorderly conditions. Furthermore, the panel testified that the additional burden of paying into the pool and completing associated paperwork would put some producer-handlers out of business, although the panel did not provide a characterization of those that would be expected to go out of business.

The AIDA consultant panel addressed concerns that producer-handlers shift balancing costs. The panel argued that cooperative balancing is not just a service to the market because it is an integral part of cooperatives' marketing strategy. As part of that strategy,

cooperatives gain market power from performing the balancing function as it provides the benefit of milk supply control, which allows for the negotiation of full supply contracts, the panel asserted. It was the opinion of the panel that without balancing, cooperatives could not negotiate either full supply contracts or premiums. Based on its survey of AIDA members and USDA data, the panel concluded that producer-handlers manage production levels to correspond with product sales plus a sufficient surplus capacity and producer-handlers bear the burden of selling their small surpluses on the market at a price that is almost always at a loss.

Witnesses representing Braums, Kreider, Aurora, GH Dairy, Heartland and Snowville testified separately as members of AIDA. The AIDA members all testified in opposition to amendments to the current producer-handler provisions. Braums, a producer-handler, milks 12,000 cows with Class I utilization of about 50 percent and operates retail stores in Oklahoma, Texas, Arkansas, Kansas and Missouri. Kreider is a family operation located in Order 1 and has been a producer-handler since 1972. Aurora, a producer-handler, has 345 employees and is a national supplier of private-label and store-brand organic milk and butter. Aurora milks about 12,000 cows every day at 5 farms in Colorado and Texas, and is treated as a partially-regulated distributing plant under Order 131. GH Dairy, a producer-handler, with a plant located El Paso, Texas, sells milk to distributors and national retailers. Heartland is a producer-handler located in Missouri with distribution in Missouri, Kansas, Iowa, and Illinois. Snowville is an exempt plant located in Pomeroy, Ohio.

The Kreider witness testified that Kreider produces less than 2.5 million pounds of Class I products per month and has Class I utilization between 64 and 77 percent. The witness expanded upon the characteristics of Kreider's operation noting that surplus milk is often marketed to an ice cream plant or to a cheese manufacturer. While Kreider is currently below the level of 3 million pounds of monthly Class I disposition, the implementation of a 3-million pound per month cap on Class I disposition may work for Kreider in the short-run but would not be sustainable or profitable in the long-run, the witness stated. The witness revealed that Kreider temporarily lost producer-handler status at one time, and that the associated pool obligations precluded its profit-making ability. Ultimately, the witness asserted, the processing portion

of the enterprise would likely cease operations should Kreider have to make payments into the pool.

The Kreider witness asserted that Kreider fluid products are often priced at a premium to the store brand price. The witness testified that Kreider operates in a niche market within its local region, selling milk to customers at above-average prices based on the perceived value of the product. Kreider markets both non-kosher and kosher milk. According to the witness, Kreider products are higher quality because they are locally and sustainably produced, chilled rapidly, rbST-free and produced on a farm that allows for consumer visits, the witness asserted. All of these characteristics, the witness explained, add to operating costs.

According to the witness, Kreider produces kosher milk for Jewish communities in several East Coast states, and is under rabbinical supervision at the farm and in the plant and the same individual supervises both facilities. The witness was of the belief that while pool plants possess the ability to produce kosher milk, producer-handler operations are better suited to kosher milk production as a result of, in Kreider's case, smaller scale and vertical integration. The witness elaborated on this point, explaining that a pool plant with multiple lines and sources of milk would require kosher supervision of a greater magnitude than is the case for producer-handler operations wherein the plant and the farm are more proximate and under identical control.

The Aurora witness testified that one of the responsibilities of a producer-handler is to balance its own-farm milk supply. The witness indicated that Aurora balances through careful management of its finished goods inventory, powder and butter production with co-packers, bulk sales and farm production. The witness further explained that Aurora uses its longer life finished goods inventory to even out the peaks and valleys of customer orders relative to farm production. The witness noted that powder and butter serve as medium and long-term balancers as their shelf lives are substantially longer than that of fluid milk.

The Aurora witness testified that their cost-of-production is considerably higher relative to conventional producers because Aurora does not produce anything other than certified organic milk. The witness testified that a producer-handler acquires milk at the cost-of-production on the farm, and that the cost-of-production for organic milk always exceeds Federal order class and

uniform prices. The witness testified that Aurora has a \$30 per cwt cost-of-production, and that this figure includes the capital and operating expenses of the farms, but does not include transportation of milk from the farms to the processing plant or capital and operating costs associated with the processing plant. The witness also noted Aurora is not similarly situated to others in the organic marketplace because of the operation's investment in both organic dairy farming and processing, and the burden associated with the full risk and responsibilities of both.

According to the Aurora witness, retailers select private label suppliers who have the ability to provide the needed product and volume; prioritize the customer's business to meet all expectations and challenges; and deliver product orders reliably. The witness also noted that customers want private label suppliers that demonstrate rigorous quality assurance capabilities, maintain supply chain control and can implement corrective action effectively and quickly. The witness testified that one of the benefits of being vertically integrated is the ability to provide traceability and complete control of organic milk, characteristics that are important to Aurora's clientele. To demonstrate the importance of good customer service, the witness noted two examples in which acquisition and maintenance of customer accounts is not a function of price.

The Aurora witness indicated that in the organic market, the marketwide pool does not facilitate the balancing function due to the fragmented and dispersed nature of organic milk supplies and plants. The witness asserted that if the proposal to eliminate producer-handlers is adopted, Aurora would have to restructure and essentially completely revise its business model.

The Aurora witness was of the opinion that it is not possible to determine the presence or absence of orderly marketing conditions without considering the actual prices being paid to producers and the actual cost of milk incurred by handlers. The witness testified that based on the actual prices and costs, Aurora has not observed any unfair competition or the creation of any disruption in the market as a result of producer-handlers, nor has Aurora observed any producer-handlers with a price advantage that resulted in a competitive advantage.

The Aurora witness was of the opinion that any national policy that is adopted should preserve options and not foreclose them. The witness suggested that some of the proposals

punish vertical integration in any form other than a cooperative, which is anticompetitive and bad for consumers. The witness asserted that some of the proposals pick one business model as the winner, stifle entrepreneurial enterprises, and eliminate independent vertically-integrated operations that meet changing consumer demand.

The GH Dairy witness strongly opposed elimination of the producer-handler provisions and was of the opinion that producer-handlers are more diversified, innovative and responsive than cooperatives. The witness testified that GH Dairy's customers appreciate the source verification they get as a result of GH Dairy having its own dedicated milk supply. Additionally, the witness noted the benefits of total control over processing and milk quality.

The witness testified that GH Dairy's major competitor has 86 or 87 plants, while the witness's portfolio includes only 3. The witness asserted that producer-handlers are good for consumers because they bring competition to the marketplace. The witness further stated that dairy farmers have only two options, become a producer-handler or join a cooperative. The witness was of the opinion that while deregulation of the milk industry is preferable, most producers want regulation. The witness further testified that a producer-handler is not competitive until it distributes 1 million gallons per week (approximately 34 million pounds per month) so 34 million pounds of Class I disposition per month should be the limit for the producer-handler exemption. The witness affirmed that the transition of Sarah Farms, another entity owned by the witness, from producer-handler to fully regulated plant did not put the operation out of business. The witness testified that after becoming a fully regulated plant in April 2006, Sarah Farms underwent restructuring to increase production capacity and lower its costs.

The GH Dairy witness also offered rebuttal to the testimony of the Price's witness. According to the GH Dairy witness, GH Dairy was not a producer-handler at the time it successfully bid on school district business that had previously been held by Price's. Furthermore, the witness noted, the fluid products being supplied to the school districts originated at the Anderson plant in Nevada and were being transported by the witness' firm to the El Paso area. The witness also explained that the several El Paso area stores in which GH Dairy replaced Price's as the supplier belong to a

national retailer that uses one of the witness's other fluid processing operations, Sarah Farms (a fully regulated handler) as a supplier in another part of the country.

A panel of witnesses representing Heartland provided details regarding its operation. The panel noted that Heartland is a diversified operation which includes a goat dairy, a cow dairy and a milk plant.

The Heartland panel noted that Heartland recently obtained kosher certification to produce 11 products. Echoing the Kreider witness' testimony, the panel stated that Heartland was sought out by the kosher certification body, in part because of the dairy's proximity to the plant and the associated potential for a single individual to supervise both operations. The panel further elaborated that Heartland's kosher products could be marketed anywhere in the United States through the broker and distribution center that Heartland uses.

The Heartland panel testified that as a producer-handler, Heartland faces competitive constraints that regulated handlers do not; and alternatively, regulated handlers face competitive constraints that Heartland does not. To this point, the panel explained that Heartland is unable to purchase milk while regulated handlers can. More specifically, the panel was of the opinion that Heartland does not have a disruptive impact on the market, as the operation has neither an effect on blend price to the farmers nor an unfair competitive advantage relative to fully regulated processing plants. The panel further asserted that Heartland is at a substantial disadvantage when compared with regulated processors paying Class I prices because Heartland acquires milk at its internal cost-of-production. It was also the opinion of the panel that Heartland has no advantage of size or scale. The panel further noted that in a recent attempt to secure a new customer, Heartland was refused because the customer conveyed it was not worth the effort to switch suppliers based on a \$0.02 difference.

The Snowville witness was of the opinion that the operation of a fluid milk plant with only 450,000 pounds of Class I route distribution per month would not be feasible and as such, a 1 million pound per month limit on Class I disposition is more realistic.

The Snowville witness recounted earlier testimony that smaller dairy farmers have a \$4 to \$5 per cwt disadvantage, and speculated that if these farms are able to survive into the future, it would be through adding value or government subsidies. The witness

was of the opinion that if the option to become a producer-handler were to be eliminated, all small dairy farms below 1,000 cows would effectively disappear.

A panel testified on behalf of two dairy farms and Homestead. Homestead is a regulated plant located in the Order 5 marketing area. The panel testified in support of an increase in the exempt plant monthly Class I disposition limit. Homestead, according to the panel, is a family run operation that primarily packages milk in glass bottles and distributes, in part, via home delivery. The panel noted that Homestead also has limited arrangements with Kroger.

The Homestead panel suggested that 450,000 pounds of Class I disposition as the standard for the exempt plant provision is not high enough, and instead suggested a limit of 1 million pounds of Class I disposition per month. The panel acknowledged that the cumulative effect of numerous 1000-cow operations would be disruptive, but that numerous 100-cow operations would not be due to the financial constraints associated with such smaller operations.

A witness appearing on behalf of several Northeastern legislators testified in opposition to the elimination of the producer-handler provisions. The witness testified that the national impact of producer-handler dairy operations is very small and producer-handlers bear the true costs of production and delivery in the production of products that meet the demands of their consumers. In fact, the witness noted, state legislators have significant concerns about consolidation and concentration among the largest cooperatives and handlers and the associated impacts on the marketplace. Finally, the witness asserted that the problems in the dairy industry are not the result of a small number of producer-handlers, regardless of the sizes of the operations. The witness asserted that legislators in the Northeast think that a lack of competition in the dairy processing sector is damaging to both consumers and dairy producers in the Northeast.

A witness on behalf of Shamrock, an Arizona milk processor, testified in support of the limits on route distribution currently in place for producer-handlers under Order 131. According to the witness, Shamrock is unique in that it owns a dairy farm, Shamrock Farms, aside from its milk processing business.

The Shamrock witness testified that there are four primary fluid milk processors in Arizona. According to the witness, Shamrock's primary competitor is a former producer-handler out of

Yuma, Arizona. The witness testified that this former producer-handler is Shamrock's primary competitor because two of the other processors are primarily focused on own-store sales, leaving the balance of the retail supermarket channel, the mass merchandiser channel, convenience stores and foodservice operations to Shamrock and Sarah Farms.

The Shamrock witness stated that they are not particularly averse to the producer-handler exemption. However, the witness was of the opinion that the exemption is incompatible with having a market order system that all other players are required to operate under. The witness was also of the opinion that producer-handlers have a competitive advantage over regulated handlers because they do not pay the Class I price. However, the witness testified that the elimination of the entire producer-handler provisions is not particularly necessary.

A witness appeared on behalf of Diamond D Dairy, a dairy farm with a fluid milk processing plant in Colorado. The witness urged USDA to leave the current producer-handler regulations unchanged. The witness testified that Diamond D services 1,200 home delivery customers and 175 wholesale accounts in Colorado.

The Diamond D witness testified that approximately 50 percent of the Diamond D operation's milk is processed by its on-farm plant and the balance is sold to DFA. The witness indicated that Diamond D is currently a producer and fully regulated distributing plant intent upon, should business continue to grow, conversion to producer-handler status. According to the witness, Diamond D is both a producer member and a processor customer of DFA. The witness testified to paying DFA all of the normal fees and charges associated with milk marketing. The witness stated that those charges include balancing, milk hauling, forward haul, administrative and milk promotion fees, handling and service charges including over-order premiums. The witness testified that DFA charges approximately \$5 per cwt for certain services, which is an out-of-pocket cost. The witness also indicated that as a processor customer, Diamond D must purchase own-farm milk back from DFA for bottling. The witness stated that Diamond D's cost of production is around \$17 per cwt.

The Diamond D witness testified that rising costs left few options for survival. The witness further explained that they either had to become larger and presumably more efficient or increase revenues from the current operation.

The witness stated that the first option was unrealistic for a number of reasons including land constraints, and taking on responsibility of bottling and marketing was the only way to grow the bottom line. The witness testified that the operation's survival now is conditioned upon the option to become a producer-handler. Additionally, the witness was of the opinion that there exists no need to change producer-handler regulations under Order 32.

A dairy farmer witness, a member of DFA, testified in support of the current producer-handler provisions. The witness testified to operating a dairy farm in Southeast Florida and milking over 1,400 cows. The witness' operation opened a bottling plant in March 2009.

The operation does not currently have producer-handler status and is not causing any market disruption, the Southeast Florida dairy farmer witness stated. The witness was of the opinion that producer-handlers can better meet the demands of niche markets than fully regulated handlers. The witness testified that one of the reasons to become a producer-handler is to avoid payment into the marketwide pool. The witness was of the opinion that everyone should have the opportunity to be able to produce and bottle milk within the same operation. The witness testified to investments made in pursuit of qualification for producer-handler status.

A witness representing Shatto, a producer-handler located in Missouri, testified in opposition to any changes to the producer-handler provisions. The witness stated that Shatto milks 300 cows and distributes fluid products in the Kansas City area. The witness noted that Shatto constructed an on-farm bottling facility in 2003, and became a producer-handler as a means of adding value and selling locally. The witness testified that Shatto's small family operation does not compete with any other organization serving the area, and that its pricing is not comparable to others in the market. According to the witness, Shatto's pricing is higher across the board because of the premium, niche products it markets.

The Shatto witness was of the opinion that disorderly market conditions do not exist, and that Shatto's small operation, in particular, does not create disruption. The witness further asserted that Shatto does not obtain any price advantage over any other cooperative or similar sized producer-handler, and would not do so even with Class I disposition of one million pounds per month. Furthermore, the witness noted, Shatto does not have problems balancing supply with demand.

The Shatto witness testified that Shatto faces additional costs resulting in higher production costs than those faced by other operations. Further, the witness stated the level of these costs remove Shatto from competition on the basis of "milk cost-of-production by size" as referenced in Proposal 1. Thus, the ability to suggest that a limit should be based upon some average economies of scale has been eliminated, the witness asserted. Additionally, the witness asserted that the economies of scale rationale employed by NMPF is misleading and unjust in light of the actual costs related to production, since a farm cannot significantly reduce production costs without transitioning away from best management practices. The witness testified that Shatto's per cwt on-farm cost, with nearly 300 cows, far exceeds the \$18 noted in Proposal 1, and is likely closer to \$25 or \$30 per cwt. As such, the witness explained that Shatto is at a significant cost disadvantage compared to not only operations of a similar size, but also cooperatives of all sizes.

The Shatto witness was of the opinion that the proposal to eliminate the producer-handler provision is unjust and inconsistent with the original intent of exempting producer-handlers serving small niche markets that would otherwise be left alone by large entities. The witness also asserted that the proposal will eliminate many small operations like Shatto, and reduce one component USDA claims is necessary for perfect competition.

The witness testified that Shatto would be unable to absorb the cost of regulation associated with NMPF's proposals and Shatto would be required to pay into the pool for use of own-farm milk. The witness testified that overall, Proposal 1 penalizes operations for taking steps to save the small family farm with an on-the-farm bottling facility. The witness testified that small family farms would be unable to expand relative to increased customer demand and meet rational business goals, and a large number of producer-handlers, specifically those with fewer than 600 cows, would go out of business if the NMPF proposals are adopted. The witness was of the opinion that this would shift more sales to large, multistate operations and cooperatives.

A witness representing Country Dairy, a producer-handler, testified in opposition to any changes to the producer-handler provisions. Country Dairy, located in Michigan, has monthly production of 2.4 to 2.6 million pounds and markets through Cedar Crest Dairy.

In the 1990s, Country Dairy's milk was sold at a \$0.15 to \$0.25 premium

because it was rbST-free and an account was secured based on its rbST-free milk supply, the Country Dairy witness stated. The witness was also of the opinion that Country Dairy's products are sold at retail for a premium because consumers perceive the products to be of a higher quality. The witness revealed that 93 to 98 percent of Country Dairy's production is Class I, and that Country Dairy has had an exclusive distribution agreement with Cedar Crest Dairy, a dealer, since 2001. According to the witness, most of Country Dairy's milk is sold under the Country Dairy label although some is store branded. The witness acknowledged that some of the store branded milk is also supplied by another processor within the same market, through Cedar Crest.

The Country Dairy witness testified that Country Dairy bears all risks of milk production and processing. The witness explained that Country Dairy's prices tend to follow Class I prices, but at times of high production, prices are reduced to sell milk and further establish retail relationships. The witness noted that in the past, when Country Dairy was responsible for product distribution, this high production discount ranged from \$0.10 up to \$0.20 per gallon. The witness testified that Country Dairy competes with regulated processors to supply the same kinds of retailers. Michigan retailers, even those supplied by fully regulated handlers, advertise and sell milk at very low prices, the witness asserted. The witness was of the opinion that this practice may reflect retailers' willingness to sell at a loss. Ultimately, the witness asserted that producer-handlers are not a disruptive factor and should not be subject to limitations on monthly Class I disposition.

A panel of witnesses testified on behalf of Mallorie's, a producer-handler located in Oregon. The panel testified that Proposals 1 and 2 should be rejected, and if some rules are necessary to regulate large producer-handlers, the existing rules in Order 124 should be used as a model for other milk orders.

The Mallorie's panel stated that the decision to regulate producer-handlers with Class I disposition in excess of 3 million pounds per month in the Pacific Northwest required Mallorie's to significantly restructure its operation and lay off a number of employees. The panel further asserted that the complete elimination of the producer-handler provisions would likely disadvantage small stores dependent on producer-handlers to supply their limited needs, which are not attractive to larger, fully regulated handlers. The panel asserted that Mallorie's operation, with Class I

disposition below 3 million pounds per month, is too small to solicit larger accounts. The panel further testified that Mallorie's faces costs much higher than those faced by larger fluid milk processors, and as a producer-handler, nets \$2.50 to \$3.50 below the Class IV price for surplus milk.

A witness testified on behalf of Brunton Dairy Farm (Brunton), a producer-handler located in Pennsylvania, milking 106 cows. According to the witness, Brunton consists primarily of a glass bottle home delivery component and an on-farm retail store. The witness testified that producer-handlers do not have any price advantage over fully regulated handlers, and that any advantage producer-handlers have over fully regulated handlers is on the basis of product quality. The witness testified to producing products priced above other brands of milk, and to replacing other brands in the marketplace because consumers desire better milk not cheaper milk. The witness was of the opinion that amendment to the producer-handler provisions could change the way in which Brunton conducts business, resulting in a change in the quality of product produced. As such, the witness testified that the current regulations should not be changed. The witness was also of the opinion that increased regulation for producer-handlers, or the complete elimination of the producer-handler provisions, would increase the costs of certain niche products such as those produced by Brunton.

Witnesses representing Hatchland, Mountain Dairy and Dunajski testified in support of the current producer-handler provisions. Hatchland, a producer-handler located in New Hampshire; Mountain Dairy, a producer-handler located in Connecticut; and Dunajski, a producer-handler located in Massachusetts all market milk in the Order 1 marketing area. The Hatchland witness and the Dunajski witness testified in specific opposition to Proposals 1 and 2. The NDFA witness testified in opposition to Proposal 2. The NDFA witness testified that the pooling and pricing exemption for plants with less than 150,000 pounds of Class I route disposition should be maintained.

A witness testified on behalf of Country Morning, a producer-handler located in Othello, Washington. The witness testified in support of the current producer-handler provisions. The witness acknowledged that Country Morning is subject to the 3-million pound cap on producer-handlers under Order 124. The witness testified that

Country Morning is the only processing plant in Washington State that markets milk directly from the farm to the consumer without blending milk from other farms. The witness testified that Country Morning bottles milk under a private label owned by a distributor, and acknowledged that the same label may be used for milk from other plants. The witness indicated Country Morning does not actively seek sales under a particular label or sell surplus through co-labeling.

The Country Morning witness testified that if it lost producer-handler status, Country Morning would owe between \$50,000 and \$60,000 to the pool each month, and neither the farm nor the plant would survive. The witness further testified that the producer-handler issue was debated and settled in the Pacific Northwest decision three years ago and does not need to be revisited.

Elimination of the producer-handler provisions and adoption of grandfathering.

Proposals 17 and 26 were offered by NMPF and Mallorie's, respectively, as applicable should the producer-handler provisions be eliminated. These proposals seek to "grandfather" the exemption from pooling and pricing for operations that currently have producer-handler status, provided they are compliant with certain limitations. NMPF was joined by MD&VA, UDA, NDA-Darigold, the DFA dairy farmer panel and a DFA representative in support of Proposal 26. Proposal 17 was supported by NAJ, with modifications.

Proposal 20, proposed on behalf of Continental Dairy Products, Inc. and Select Milk Producers, Inc., was withdrawn on the basis that it was closely related to Proposal 17.

Those in opposition to either Proposal 17 or Proposal 26, or both, included Aurora, Snowville, Kreider, Mountain Dairy, the FOOD panel, Dunajski, the State Departments of Agriculture, Hatchland, Diamond D, the Southeastern Florida dairy farmer, MPPA, Bareman and Cornucopia.

NMPF testified that taken together, Proposals 1, 2, and 26 would only regulate 3 to 5 of the largest producer-handlers in the country, all of whom have estimated annual sales of at least \$10 million and packaged fluid milk product sales in excess of 15 million pounds per month. The NMPF witness stated that it is necessary to both regulate all producer-handlers distributing more than 3 million pounds of packaged fluid milk products per month, and limit the proliferation of producer-handlers marketing between 450,000 and 3 million pounds per

month. The witness testified that if adopted, Proposal 26 would reduce the regulatory impact of Proposal 1 on existing producer-handlers that fall within the range of 450,000 to 3 million pounds of monthly Class I disposition.

Several witnesses representing cooperatives testified in support of Proposal 26. The MD&VA witness testified in support of Proposal 26 as a part of the package of proposals offered by NMPF. The UDA witness explained that UDA supports the creation of a new category of exempt plant to include plants with producer-handler status in 2008, providing those plants have 3 million pounds or less of Class I sales of uniquely branded products. The St. Albans witness supported the right of small, existing producer-handlers to continue operation. The NDA-Darigold witness testified in support of "grandfathering" provided that it only applies to current producer-handler operations under 3 million pounds of monthly Class I disposition, and the producer-handler exemption is phased out. The NDA-Darigold witness also asserted that if a provision allowing entities with producer-handler status as of the date of enactment of the new regulation was adopted then a significant number of entities may engage in a quick shift to obtain producer-handler status prior to the regulatory change.

The DFA dairy farmer panel and the DFA witness testified in support of Proposal 26. The panel further stated that allowing an existing producer-handler to retain their status up to the 3-million pound limit on monthly Class I disposition would be fair and have little impact on the market provided that if the business exceeds 3 million pounds of Class I disposition per month it will be treated as a fully regulated handler.

Proposal 17 received supporting testimony by the Mallorie's panel. The panel testified that if Proposals 1 and 2 are adopted, existing producer-handlers should be able to retain their exemption through grandfathering, as suggested in Proposal 17. The panel testified that during 2008, Mallorie's milk production averaged 3.1 million pounds per month, with average Class I utilization of 63 percent; average Class II use of 15 percent; and Class IV utilization ranging from 9 to 29 percent, with an average of 22 percent for the year.

The Mallorie's panel testified that the producer-handler provisions were reviewed extensively in Orders 124 and 131, and limits on Class I disposition went into effect in 2006. The panel testified that producer-handlers in these orders have adjusted to the new rules

and that there is no reason to readdress the subject. The panel was of the opinion that a growing number of consumers are concerned about where their milk comes from and how it is produced. The panel asserted that larger processors cannot meet these concerns, but operations like Mallorie's, as a producer-handler, can.

The Mallorie's panel further testified that if its operation were to become fully regulated the effect would be catastrophic. The panel testified that when the Federal Order 124 producer-handler exemption was set at a maximum of 3 million pounds, Mallorie's responded with a herd size reduction, and discontinuation of both a heifer raising facility and a leased 300-cow dairy. The panel stated that about 25 employees lost their jobs and purchases of feed, other supplies and services were reduced by nearly one-third or over \$3 million a year. The panel also testified that if Mallorie's were to go out of business, the local and Oregon State economies would lose over \$6 million per year.

The Mallorie's panel submitted a modification to Proposal 17, explaining that if it is adopted, then a limit of 6 million pounds of monthly Class I route disposition should become the point at which a grandfathered producer-handler loses the exemption from pooling and pricing.

The NAJ witness testified that NAJ supports Proposal 17 with some suggested modifications. According to the witness, NAJ suggests the replacement of language that calculates a volume of exempt own-farm milk dependent on historical sales limited to 3 million pounds per month, with a simple limit on the exemption at 3 million pounds per month of own-farm production.

The NAJ witness testified in opposition to the portion of Proposal 17 that outlines the calculation of the amount of own-farm milk production to be considered exempt, and all of Proposals 20 and 26, because these proposals advocate using a handler's historical processing and sales of own-farm milk to establish an exemption from future pool obligations. These proposals, the witness noted, would penalize handlers beyond a given point in time. This would also be the case, added the witness, for new processors without previous sales figures to establish a base, despite planning for bottling operations that occurred under existing provisions. The witness was also of the opinion that it is inequitable to treat existing producer-handlers differently from producers with the

desire to become future producer-handlers.

As members of AIDA, the Aurora and Snowville witnesses testified in specific opposition to Proposal 26, and the Kreider witness testified in opposition to all proposed grandfathering of the producer-handler exemption. The Hatchland witness also testified in specific opposition to Proposal 26. The FOOD panel testified in opposition to any type of "grandfathering" provisions for either producer-handlers or exempt plants. The State Departments of Agriculture panel also testified in opposition to any grandfathering provisions. The MMPA and the Bareman witnesses testified in opposition to any proposals that would allow for the grandfathering of producer-handlers should the exemption be eliminated.

The Mountain Dairy and Dunajski witnesses testified in opposition to the adoption of grandfather clauses on the basis that these types of proposals would limit exempt status to include only those operations currently classified as producer-handlers. The Diamond D witness and the Southeast dairy farmer witness testified in opposition to grandfathering clauses. The Diamond D witness asserted that grandfathering would exclude Diamond D from becoming a producer-handler in the future. The Southeast dairy farmer witness testified that such clauses would prevent new producer-handlers from entering the market. Similarly, the Homestead panel testified in opposition to Proposal 26 and was of the opinion that future generations should have the ability to become producer-handlers.

The Cornucopia witness testified in opposition to "grandfathering" existing producer-handlers unless qualification for grandfathering included a 3-million pound per month limit on route disposition and packaged fluid sales.

Adoption of producer-handler provisions to include a limit on monthly Class I disposition.

Many hearing participants were in support of maintaining the producer-handler provision but limiting the Class I disposition a producer-handler could have to remain exempt. There were 10 proposals that would meet this intent, published in the hearing notice as Proposals 3, 4, 7, 8, 9, 11, 12, 13, 14 and 21. The proposed changes regarding Class I sales limits for producer-handlers were recommended as either "hard-caps" or "soft-caps." Hard-caps would limit the Class I route disposition of producer-handlers, and if exceeded, would fully regulate the producer-handler on their entire volume of Class I sales. Soft-caps would only regulate

the producer-handler on the volume of Class I sales over a certain limit. Hatchland, Lochmead Dairy (Lochmead), FOOD, Monument Farms (Monument), Mountain Dairy, Dunajski, Shatto, the State Departments of Agriculture, Homestead, Country Morning and NDFA all testified in support of amending the current producer-handler provisions to include a Class I sales volume limitation.

Opposition to either general limitations of, or the specific application of soft-cap limitations to, the producer-handler provisions was expressed on behalf of IDFA, Diamond D, the Dairy Institute of California (DIOC), HP Hood, NMPF, DFA and NDA-Darigold.

The Hatchland witness testified as the proponent of Proposal 3, which would regulate producer-handlers in the Northeast order with more than 3 million pounds of monthly Class I route disposition. Hatchland, according to the witness, produces nearly 800,000 pounds of milk per month. As such, the witness testified, a 3-million pound limit on monthly route disposition by producer-handlers would allow Hatchland to grow in the future.

The witness testified that Hatchland is a unique dairy operation with an on-farm store and delivery business providing milk in glass bottles to homes throughout the Northeast. The witness emphasized that Hatchland occasionally buys from, or sells to, a cooperative, but ultimately must balance own-farm production. The witness was of the opinion that given the extra costs incurred by Hatchland's unique operation, the exemption from the pooling and pricing provisions does not result in a competitive advantage over regulated handlers.

A witness representing Lochmead, a producer-handler, testified in support of Proposal 4. Lochmead, based in Oregon, has average monthly sales of nearly 1 million pounds and operates 42 Dari-Mart retail stores.

The Lochmead witness testified that both producers and producer-handlers have increased in size since the producer-handler provisions were first established. According to the witness, this increase in size necessitates a limit on monthly route disposition to remain exempt from pooling and pricing provisions. The witness testified that Lochmead would be unable to compete with the larger, more efficient bottlers and would go out of business, were it to become fully regulated.

The FOOD panel testified in support of establishing a 450,000-pound hard-cap on monthly Class I route disposition for producer-handlers. The panel

testified that this proposed change honors the original intent and purpose of the exemption.

The FOOD panel testified that WODPA, MODPA and NODPA members face unfair competition from a large producer-handler that sells organic milk nationally. The FOOD panel testified that this producer-handler sells milk through national supermarket chains, thereby competing with locally produced organic milk at an economic advantage based on the pooling and pricing exemption. The FOOD panel was of the opinion that the regulatory exemption for large organic producer-handlers lowers the prices received by organic dairy farmers whose milk is pooled and priced under the terms of Federal milk orders. The FOOD panel testified in opposition to any type of soft-cap limitations for either producer-handlers or exempt plants.

A witness appeared on behalf of Monument, a Vermont-based producer-handler, in support of establishing a 3-million pound per month exemption on Class I route distribution for producer-handlers. The witness also testified in support of Proposal 13 submitted by the New England Producer-Handler Association, Inc.

The witness testified that Monument produces approximately 1 million pounds of milk per month. The witness stated that Monument does not have any advantage over fully regulated handlers due to costs of production that typically exceed the Class I price. The witness added that Monument must continually balance demand with available supply, pay a premium to purchase additional milk if necessary, and receive the lowest class price or less to sell excess milk.

As a proponent of Proposal 13, the witness for Mountain Dairy expressed support for a 3-million pound limit on the monthly volume of milk a producer-handler may distribute while retaining a regulatory exemption. The witness testified that Mountain Dairy delivers milk to individual homes and also supplies retail customers. The witness testified that Mountain Dairy milks about 500 cows. The witness was of the opinion that the exemption of producer-handlers from the pooling and pricing provisions of Federal milk orders is not contributing to disorderly marketing conditions in the Order 1 marketing area.

Proposal 7 received supporting testimony by the Dunajski witness. The witness testified that Dunajski Dairy is located and markets nearly 350,000 pounds of Class I products per month in the Greater Boston area. The witness was of the opinion that Dunajski Dairy does not compete with large bottlers on

the basis of price, and is not disruptive in Order 1.

The Dunajski witness was of the opinion that the current producer-handler exemption should not be changed. However, the witness was also of the opinion that three million pounds of Class I sales per month would be an acceptable cap on the producer-handler exemption providing that no labeling restrictions accompany the cap.

The Shatto witness presented testimony as the proponent of Proposals 11 and 12. The witness stated that Shatto's proposals address the reduction in competition, the negative impact on small businesses, and the overall regulation of the dairy industry as alternatives to Proposal 1. The witness proposed the producer-handler exemption be kept in place with a limit of 1 million pounds of Class I sales per month because, according to the witness, producer-handlers under this limit are not disruptive to the market, and would be unable to survive the financial impact if the producer-handler exemption were to be eliminated entirely. The witness asserted that the effects of Proposals 11 and 12 on small business are more appropriate than Proposal 1.

The Homestead panel of witnesses testified in support of a 3-million pound per month limit on the Class I sales of producer-handlers. The Homestead panel testified that Homestead Creamery and the two associated farms supplying its milk are collectively recognized as a producer-handler by the state of Virginia but not by the Federal order system. Homestead Creamery, according to the panel, is currently a regulated handler. The panel was of the opinion that the producer-handler definition should change to accommodate Homestead, a processor that has farms operated in common rather than owned in common.

The Country Morning witness testified that a limit of 3 million pounds on monthly Class I sales volume for retention of producer-handler status would be acceptable. Similarly, the Shamrock witness did not object to establishment of an upper limit on the route disposition of producer-handlers.

Proposal 8 was testified to by the panel representing the State Departments of Agriculture. The panel testified that farmers in NH, NY, PA, VT, and WI, are moving toward vertical integration, particularly with regard to cheese manufacturing. The panel testified that the producer-handler provision is important in those states because consumers have shown significant interest in the locally-

produced, niche products producer-handlers provide.

The State Departments of Agriculture panel testified that total producer-handler volume in NH, NY, PA, VT, and WI is small relative to total milk production, and that producer-handlers do not create disorderly marketing conditions. The panel asserted that one producer-handler with production greater than three million pounds of route disposition per month could be disruptive. The panel provided specific examples to justify their position that producer-handlers need room to grow. The panel stated that a 2-million pound per month figure is appropriate as it appears to be the level at which economies of scale are realized. The panel further stated that three million pounds per month would be the absolute upward bound as a cap on the producer-handler exemption.

The State Departments of Agriculture panel also testified that marketwide pooling is crucial to dairy farms in the five states represented, and an unlimited producer-handler exemption will ultimately destroy Federal order pooling as it erodes minimum prices and sharing of Class I revenues. The panel advocated a 2-million pound per month limit on producer-handler route disposition.

The NDFA witness suggested that if the producer-handler provisions were not eliminated and a limit was established on the Class I sales volume of producer-handlers, Order 1 should have a lower limit than other Federal orders. The witness supported this assertion by noting that in Order 1 there are significant differences in geographic size and population, and a relatively high number of producer-handlers and exempt plants. Based on a characterization of general statistics, the witness asserted that from 2002 to 2008, total fluid milk sales for producer-handlers across 8 of the 10 Federal orders has increased by over 60 percent and fluid milk sales from exempt plants increased by over 20 percent, while at the same time, total fluid milk sales from fully regulated plants decreased nearly 4 percent. Similarly, for Order 1, total fluid milk sales from producer-handlers from 2000 to 2008 increased nearly 106 percent, and total fluid milk sales from exempt plants increased nearly 44 percent. The witness also testified that dairy farms managed by governments and colleges should be excluded from any hard-cap on the volume of Class I route disposition to maintain an exemption from the pooling and pricing provisions of Federal orders.

The IDFA witness argued that the proposals seeking to continue the producer-handler exemption from pooling and pricing provisions with some volume limit could, in effect, continue the problem of disorderly marketing created by this exemption.

The Diamond D witness testified in opposition to limitations to the producer-handler exemption on the basis that a 3-million pound cap on route disposition may affect Diamond D in the future if the operation grows.

A witness representing the Dairy Institute of California (DIOC) appeared at the request of NMPF for the purpose of describing the producer-handler exemption under California's state milk pooling system. According to the witness, DIOC is a California based trade association representing fluid milk handlers and dairy product processors. The witness opined that USDA may find California's experience with producer-handlers relevant in formulating Federal order policy.

The DIOC witness stated that there are two regulatory schemes for producer-handlers in California. According to the witness, the first option, the "exempt producer-handler," allows for the pool exemption of own-farm production provided that both milk production and sales average less than 500 gallons per day (129,000 pounds) and 95 percent of both production and sales are disposed to retail/wholesale outlets. The second option, the "option exempt producer-handler," effectively operates under a soft-cap, allowing for deduction of exempt milk volume from any Class I pool obligation in a similar manner as suggested by Proposal 17.

The DIOC witness provided opinion and evidence as to producer-handlers' raw milk cost advantage compared to fully regulated handlers. The witness, using data provided by the California Department of Food and Agriculture (CDFA), calculated the advantage for California milk testing 3.5 percent butterfat and 8.7 percent nonfat solids by subtracting the quota price per cwt from the Class I price. The witness stated that the raw product cost advantage for producer-handlers was calculated by dividing the advantage per cwt by the number of whole milk gallons in a cwt of milk. The witness noted that this cost advantage varies greatly depending on the relationship between the Class I price and the pool quota price. For the period of January 2000 to March 2009, stated the witness, the raw milk cost advantage for producer-handlers averaged \$0.113 per gallon. The witness added that for the most recent 12-month period, the cost advantage averaged \$0.177 per gallon.

Overall, the witness was of the opinion that producer-handlers have a lower raw milk cost than fully regulated handlers, leading to a producer-handler competitive advantage.

The DIOC witness testified that producer-handlers have increased their share of Class I sales at the expense of fully regulated competitors. Relying on CDFCA data, the witness compared the "option exempt producer-handler" share of the California Class I market with the share attributed to regulated handlers from July 1995 to August 2008. The witness testified that the producer-handler share of the Class I market increased from 14.8 to 23.4 percent.

In summary, the DIOC witness testified that the soft-cap type producer-handler exemption in California has significantly advantaged producer-handlers and disadvantaged fully regulated handlers. The witness was of the opinion that the provision has created a dilemma for policy makers who struggle to reconcile the goal of providing equal prices to competing handlers.

A witness appeared on behalf of HP Hood to provide a description of soft-cap producer-handler provisions, similar to those advanced in Proposal 17, and the resultant impact on the competitive landscape in the northern California milk market. HP Hood is a Massachusetts-based handler that owns and operates 22 milk processing and manufacturing facilities.

The witness testified that HP Hood has repeatedly lost business to producer-handlers who can sell milk at a lower price. The witness testified that the exemption for producer-handlers under the California milk pooling plan has decreased the revenues of producers whose milk is pooled and allowed producer-handlers to increase their share of the California Class I market. The witness noted that the intent of government-controlled dairy pricing systems should be to provide market stability for both producers and processors and avoid the creation of opportunities for one party to benefit at the expense of another.

The NMPF witness echoed testimony provided by the DIOC and HP Hood witnesses, noting that soft-caps have been problematic in California. The witness was of the opinion that soft-caps, applied in the Federal order system, would have a negative effect on uniform pricing.

The DFA witness and the NDA-Darigold witness testified in opposition to all proposals seeking establishment of soft-caps regulating only a portion of a producer-handler's sales. The DFA witness stated that minimum order

prices would be unclear to buyers, causing them to wonder if competitors had access to lower priced milk due to the soft-cap. The DFA witness also asserted that a soft-cap would require a greater level of administration. The NDA-Darigold witness stated that the adoption of soft-cap provisions would further increase the advantages associated with producer-handler status.

Exemption of vertically integrated operations with retail and home delivery distribution.

Proposal 24 would exempt from regulation milk sold by producer-handlers through "handler-controlled retail channels" including home delivery and handler-controlled retail outlets, regardless of sales volume.

The AIDA consultant panel testified that Proposal 24 is intended for adoption only if USDA amends the producer-handler provisions. The rationale for this proposal, the panel explained, is that sales through home delivery and handler-controlled retail outlets are entirely controlled by the handler and do not have an impact on the pool.

The Braums witness testified in support of Proposal 24. The Braums witness testified that Braums' business model is unique, as the company sells own-farm milk and related dairy products in company-owned retail stores that do not carry any other fluid milk brand. The witness further testified that Braums serves a niche market that other fluid milk retailers do not. According to the witness, as a producer-handler, Braums must self-balance and cannot use outside suppliers. The witness further asserted that Braums' supply is limited to only what its farm is able to produce.

The witness testified that Braums' products are not available anywhere other than Braum's retail stores, and the operation has never been approached to begin supplying milk to other retailers. The witness noted that no other operation produces or sells Braums' branded milk products, and since Braums sells its product all the way through to the retail level, the operation incurs all the same costs and risks of other producer-handlers along with the additional costs and risks associated with its exclusive distribution and retail business. The witness also stated that Braums does not enjoy a price advantage because the operation has had to make substantial investments in the milk production side of the business.

The Braums witness was of the opinion that they are not a disruption in the market, and that depooling has had a far greater impact on blend prices in

Order 32 than the exemption of producer-handlers from pooling and pricing provisions. The witness added that if Braums were to become fully regulated, the blend price in Order 32 could actually decrease based on Braums' utilization.

The Kreider witness testified in opposition to Proposal 24. The witness did not support an exemption from pool obligation for volumes of milk sold at retail by producer-handlers. Kreider, the witness testified, does not currently sell to retail customers, direct to consumers through home delivery, or via farm store.

The IDFA witness noted that the adoption of Proposal 24 would create new incentives for existing regulated handlers to invest in dairy farms and retail stores for the sole purpose of gaining an exemption from pooling and pricing regulations. The Shamrock witness agreed with the IDFA witness, stating that the adoption of a retail and home delivery exemption may result in the creation of a loophole that would possibly need to be revisited in the future.

The NMPF witness stated that an exemption granted for handler sales conducted exclusively through handler-controlled outlets, as advocated by Proposal 24, is inequitable and would allow those handlers to balance their supply through the rest of the market. The DFA witness echoed the NMPF witness' position, adding that an Order 32 producer-handler selling milk entirely through its own retail outlets currently aggressively competes for retail sales, which has led to disorderly marketing.

Exemption of own-farm milk.

Proposal 23, proposed by AIDA, would remove the producer-handler provision from all milk orders and exempt from regulation milk procured from a farm owned by a handler. Additionally, this proposal would treat handlers with own-farm production as partially regulated distributing plants.

The AIDA consultant panel testified that under Proposal 23, handlers with own-farm milk would be allowed to down-allocate the volumes of own-farm milk to their lowest value of use in their producer-settlement fund obligation calculation. Additionally, the panel stated that adoption of this proposal would allow handlers with own-farm production to purchase milk from pool sources, providing that all purchased milk would be up-allocated to the handler's highest value use. The panel also offered that handlers with own-farm production could elect partially-regulated distributing plant status for own-farm milk volume as an alternative

to full exemption of own-farm milk. The panel concluded that adoption of this proposal would allow producer-handlers to remain in business and compete in an orderly manner.

The Braums, Kreider, Aurora, GH Dairy, Heartland and Snowville witnesses testified in conditional support of Proposal 23. The witnesses supported its adoption should the current producer-handler provisions be eliminated or restricted.

The NAJ witness testified in support of Proposal 23, with the modification that own-farm milk production should be exempt up to 3 million pounds per month, and any additional own-farm or purchased volume should be subject to pooling and pricing. The witness testified that expansion of the existing partially-regulated distributing plant provisions to include an exemption of the first 3 million pounds of own-farm milk would be equitable for producer-handlers with less than 3 million pounds of own-farm milk, those with more than 3 million pounds of own-farm milk, and those with a combination of own-farm and purchased milk.

The NMPF, IDFA and DFA witnesses testified in opposition to Proposal 23. The NMPF witness stated that the exemption of own-farm milk would disproportionately benefit large producer-handlers, while the IDFA witness noted that the adoption of Proposal 23 would create new incentives for existing regulated handlers to invest in dairy farms.

Establishment of individual handler pools.

Proposal 25, as proposed by the members of AIDA, would establish individual handler pooling provisions in all Federal milk orders. The AIDA consultant panel was of the opinion that adoption of individual handler pools would encourage milk in higher class uses to move where needed and assure that Class I revenues accrue to producers serving the Class I market. Additionally, the panel asserted that there would be little incentive for the supply area to expand beyond what is sufficient to serve the needs of the market, thus saving transportation costs. The panel concluded that Proposal 25 would treat producer-handlers the same as any other handler because producer-handlers would function as a regulated handler under the order, and would be able to buy milk from other producers at the blend price. Finally, adoption of Proposal 25 would allow producer-handlers to compete in an orderly manner, and allow producers and cooperatives to benefit from producer-handlers' sales in excess of own-farm

production, the panel asserted. The panel acknowledged reliance on the Nourse Commission Report (Nourse Report) in the preparation of its testimony, and encouraged USDA to reference it in making a determination. The panel represented that its heavy reliance on the Nourse Report in lieu of past decisions of the Secretary stemmed from its useful guidance on disorderly conditions.

The Braums, Kreider, Aurora, GH Dairy, Heartland and Snowville witnesses testified in conditional support of Proposal 25. The witnesses advocated its adoption in the event that the current producer-handler exemption be eliminated or restricted.

The Aurora witness acknowledged that if Proposal 25 were adopted, Aurora could continue to operate as a vertically-integrated business, although some modification might be necessary. The witness testified in support of individual handler pools on the basis that organic producers and processors obtain very limited benefits from the marketwide pooling system. The witness was also of the opinion that this is also true of other differentiated milk markets such as grass-fed and kosher. Individual handler pools would result in differentiated producers and processors gaining equity with respect to pooling, the witness asserted.

A witness representing Oberweis Dairy (Oberweis) testified in specific support of Proposal 25. Oberweis operates a distributing plant in Order 30 with 3 to 5 million pounds of monthly Class I disposition and home delivery.

The Oberweis witness testified that individual handler pools would benefit Oberweis and its producer suppliers. The witness testified that Oberweis competes with producer-handlers in the Virginia and Detroit markets. The witness stated that it is perfectly acceptable for regulated plants to compete with producer-handlers. The witness also testified that the government should not set minimum milk prices because prices are better determined in the marketplace.

The St. Albans witness testified in opposition to individual handler pools. The witness was of the opinion that individual handler pools would only benefit producers in close proximity to fluid plants. The witness stated that marketwide pooling is crucial to the economic survival of St. Alban's members because St. Albans is based in a rural area where most of the milk goes into manufactured products not fluid milk products.

The NDA-Darigold witness, the NAJ witness and State Departments of Agriculture panel testified in opposition

to all individual handler pool proposals. The NDA-Darigold witness was of the opinion that individual handler pools would damage the marketwide pooling system—a system NDA and Darigold have found to be essential for producer support of Federal orders. The NAJ witness asserted that the establishment of individual handler pools would lead to disorderly marketing conditions because returns generated by sales of higher priced Class I milk would only be shared among those producers with access to a Class I processing plant.

The NMPF, DFA, IDFA, Mid-West-Lakeshore and UDA witnesses also testified in opposition to individual handler pooling. The DFA witness testified that individual handler pools should not be adopted because handlers operating fluid plants would gain market power and increase competition for access to the Class I market. Furthermore, the DFA witness was of the opinion that individual handler pooling is not compatible with the AMAA's basic tenet of minimum order prices for both producers and handlers. The IDFA witness echoed the DFA witness, noting that rather than being innovative, Proposal 25 instead proposes going back many years despite the findings of a number of hearings over the years which found individual handler pools contribute to disorderly marketing. The NMPF witness testified that individual handler pools threaten the Federal order system because producers supplying milk that balances the market would not benefit from Class I revenues.

Post-Hearing Briefs

Post-hearing briefs filed on behalf of proponents and opponents for the elimination of or amendment to the producer-handler definitions in all Federal milk marketing orders reiterated testimony and provided legal arguments as to why producer-handlers should or should not be fully regulated under the orders. Proponents and opponents alike stressed testimony and evidence purported to strengthen their specific positions. Presented below is a summary of the briefs as they related to the economic and marketing conditions in all marketing areas.

A brief filed on behalf of the New England Producer-Handlers Association, Inc., Willard J. Stearns & Sons dba Mountain Dairy, Monument Farms, Inc. and Homestead Creamery (New England Producer-Handlers Association, Inc. *et al.*) reiterated positions given at the hearing: producer-handlers in Order 1 do not give rise to disruption resulting from a significant impact on the blend price paid to producers; there exists no

evidence to support the conclusion that producers with a large number of cows intend to construct bottling facilities and seek producer-handler status; consumer interest is a factor to be weighed during the determination of the regulatory treatment of producer-handlers; the producer-handler definition should be broadened to include entities operating in common; the exempt plant limit of 150,000 is inadequate and should be increased to 1 million pounds per month; and the exempt plant limit should be increased to 3 million pounds of monthly Class I route disposition in the event that the producer-handler provisions are eliminated.

In their brief, New England Producer-Handlers Association *et al.* requested that findings regarding the regulatory treatment of producer-handlers be separate for each of the Federal milk marketing orders. New England Producer-Handlers Association *et al.* argued that record evidence indicates that each order's findings should be based upon existing conditions within that order's marketing area. Specifically, it was argued that the circumstances that existed prior to amendment of the producer-handler provisions of Order 131, and the circumstances that currently exist in the Order 126 marketing area, do not exist in either the Order 1 or 5 marketing areas. Accordingly, the position taken in the New England Producer-Handler Association *et al.* brief was that proposals to eliminate the producer-handler provisions of Orders 1 and 5 are not relevant to the prevailing conditions in either of the two marketing areas.

A brief filed on behalf of Land O'Lakes, Inc (LOL) agreed with testimony given in support of Proposals 1 and 2. LOL is a Capper-Volstead cooperative with more than 4,000 dairy farmer members marketing in and pooling milk on 5 Federal orders. The LOL brief also detailed support for the grandfathering of existing producer-handler operations at a level to be determined by the Secretary and opposition to Proposals 23, 24 and 25.

In their brief, LOL noted that record evidence regarding the entrance of GH Dairy into the El Paso market supports the conclusion that a producer can transition their farm into a producer-handler operation with relative ease in a short period of time. LOL identified testimony that the conversion of a dairy farm into a producer-handler operation is more favorable, given the economics of market entry, than the conversion of a dairy processing plant into a producer-handler operation.

The LOL brief also detailed market disorder associated with the current producer-handler provisions. LOL stressed that the impact of producer-handler operations varies by size of order and the number of producer-handlers selling into a given marketing area. LOL further noted that record evidence indicates an impact on the blend price of as much as \$0.12 per cwt for Order 32. LOL identified testimony that shows disorderly marketing exists as a result of pricing inequity between producer-handlers and fully regulated handlers. Previously, according to LOL, pricing discrepancies were not as significant when producer-handler operations were smaller, and larger regulated handlers could compete through increased plant efficiency but as producer-handler operations have grown, regulated handlers' advantage based on scale efficiency has eroded.

A brief filed on behalf of a Florida dairy producer reiterated testimony given on the record in support of maintaining producer-handler provisions in Federal orders and detailed the producer's opposition to Proposals 1 and 26.

A brief filed on behalf of Midwest and Lakeshore reiterated Midwest and Lakeshore's support for Proposals 1 and 2 and opposition to all other proposals presented at the hearing. In their brief Midwest-Lakeshore noted by illustration that raw milk production cost differences are not relevant to an operation's status as a producer-handler. Midwest-Lakeshore concluded that a distinct exemption for producers who elect to bottle their own milk is not necessary, instead an exemption for all handlers with 500,000 or fewer pounds of monthly Class I disposition is sufficient to accommodate vertically integrated entities and others whose presence does not give rise to disorderly marketing conditions.

A brief filed on behalf of NAJ reiterated and clarified positions taken by NAJ at the hearing. NAJ claimed in its brief that NAJ's modification to Proposal 17 would result in the addition of at least 17 million pounds of milk to Federal order pools each month. In brief, NAJ reasserted that the exemption of producer-handler's first three million pounds of own-farm milk disposed of as Class I during the month is equitable for producer-handlers who use less or more than three million pounds of own-farm, or use a combination of own-farm and purchased milk.

A brief filed on behalf of Select and Continental articulated support for the goals of Proposals 1, 2 and 26, albeit with certain noted exceptions to Proposal 26. In their brief, Select and

Continental highlighted evidence presented by proponents and opponents and offered current and historical overviews regarding the regulatory treatment of producer-handlers. Select and Continental supported their position that producer-handlers should not gain economic advantage as a result of their exemption from pooling and pricing. Select and Continental asserted that amendments to the regulations governing producer-handlers should be based upon economic fundamentals.

The Select and Continental brief included details regarding the important role played by producer-handlers in the marketplace through their service of a full range of consumer demands and provision of competition to markets that would otherwise be characterized by imbalances in market power. The brief detailed a number of arguments supportive of the use of transfer prices faced by producer-handlers as the basis for determining competitiveness with fully regulated handlers. Select and Continental asserted that any limit on the monthly Class I sales volume of producer-handlers should be determined according to the level of advantage enjoyed by producer-handlers. The level of this advantage, according to Select and Continental, can be identified by comparing producer-handler transfer prices and the Class I price. Select and Continental further argued that while the determination of an appropriate limit on the producer-handler provisions is necessary because economic advantages accrue with increased size, a finite limit number cannot be determined on basis of the hearing record. However, Select and Continental asserted that an appropriate limit would allow producer-handlers with less than 3 million pounds of monthly Class I route disposition to continue operations with exemption from pooling and pricing. Select and Continental also asserted that the adoption of a limit on the basis of total producer-handler sales rather than merely in-area sales is justifiable and warranted.

In their brief, Select and Continental also opposed the adoption of an exempt plant threshold in excess of 450,000 pounds of monthly Class I route disposition. The rationale for the exemption of "exempt plants" is distinct from the rationale for the exemption of producer-handlers and as such, a single definition intended to encompass the two types of entities would be inappropriate, Select and Continental argued. In this regard, the Select and Continental also pointed out that the exempt plant threshold limit is not based on farm size or production but

on the level of Class I distribution. The rationale underlying the exemption of plants with 450,000 or fewer pounds of monthly Class I disposition relates, at least in part, to administrative convenience, asserted Select and Continental.

The Select and Continental brief detailed arguments in opposition to using retail price data in the determination of disorderly marketing conditions and the amendment of the producer-handler provisions to include labeling restrictions. Select and Continental argued that the analysis of retail price data does not provide a clear illustration of disorder due to handler inequity because such analysis is unable to disaggregate handler pricing to consumers from other factors involved in setting retail prices. As to proposed unique labeling restrictions, the Select and Continental asserted that since any relative advantage between producer-handlers and regulated handlers should be determined on the basis of the regulatory treatment of producer-handlers, there is no need for adoption of labeling restrictions.

Furthermore, Select and Continental argued in their brief that when average dairy farm size data is compared with producer-handler numbers, opposite trends are revealed and as such, there is insufficient basis for concern that the growth in the number of large farms suggests the potential for the growth in the number of producer-handlers. The brief also indicated that the presence of organic producers and organic producer-handlers in the market should not result in different regulatory treatment by marketing orders as production methods are not relevant.

The Select and Continental brief detailed agreement with the adoption of provisions that would provide for a "grandfathering" clause to be applied to current producer-handlers. Continental and Select asserted that such a clause should allow entities classified as producer-handlers prior to July 1, 2009, with monthly Class I route disposition of no more than 3 million pounds to retain their exemption from pooling and pricing. According to Select and Continental, whatever method is selected for limiting producer-handler disposition of Class I sales, it is more important that current producer-handlers operations within the proposed limit not be fully regulated.

A brief was filed on behalf of Upstate Niagara Cooperative, Inc. (Upstate Niagara). Upstate Niagara is a Capper-Volstead cooperative that owns fluid processing and manufacturing plants regulated under several Federal orders, including Orders 1 and 33. Their brief

detailed support of the positions taken by NMPF and IDFA.

A brief filed on behalf of the State Departments of Agriculture of New York, Pennsylvania, New Hampshire, Vermont and Wisconsin (State Departments of Agriculture) stressed support for a 3-million pound limit on monthly Class I route disposition for producer-handlers. The State Departments of Agriculture also detailed opposition to an unlimited pooling and pricing exemption for Class I sales through producer-handler-controlled retail channels, and the adoption of a producer-handler grandfather clause.

According to the State Departments of Agriculture brief, a limit on producer-handler Class I sales volume is necessary as it would allow producers processing own-farm milk to continue to meet growing demand for locally produced, single-source milk while also preventing the erosion of the value of marketwide pools. In their brief, the State Departments of Agriculture stressed that any limitation on producer-handler Class I sales volume should apply to total sales. The State Departments of Agriculture also indicated that producer-handlers with three million or fewer pounds of monthly Class I route sales should be allowed to make temporary purchases of limited amounts of supplemental milk from other sources without loss of producer-handler status.

A brief filed was on behalf of DIOC. In their brief, DIOC provided analysis of specific proposals and testimony presented during the hearing. More specifically, the DIOC discussed the impact of California's producer-handler provisions that allow for soft-cap limits on Class I sales volume. The brief also stressed the relevance of California's producer-handler experiences to the current proceeding, the concept of transfer pricing as related to producer-handlers' cost advantage and the concept of economic rents.

In their brief, DIOC reiterated its testimony given on the substantial negative effects of producer-handlers in the California milk marketing system. Producer-handlers, according to DIOC, realize greater economic returns than similarly situated farms and plants that are not fully integrated. DIOC went on to assert that advantage arises because of producer-handler exemption from pooling and pricing. That exemption, DIOC stressed, allows the integrated producer-handler firm to either earn a greater return at the farm level by paying itself the Class I price, or earn a greater return at the plant level by paying the farm side of the operation less than the Class I value for milk

supplied. DIOC concluded that the advantage enjoyed by producer-handlers is not a direct result of realized scale economies but rather is the result of revenue that is not shared with the pool.

A brief filed on behalf of Mallorie's Dairy, Nature's Dairy and Country Morning Farms (Mallorie's Dairy et al.) reiterated arguments against the adoption of Proposal 1 and for the adoption of Proposal 17 should Proposal 1 be adopted. The majority of these arguments rest upon the opinion that proponents lack evidence supporting adoption of their proposals. Mallorie's Dairy et al. also proposed that should the Secretary determine that changes to the producer-handler definitions are necessary, then the current size limitation on producer-handlers in Orders 124 and 131 should be adopted in other markets as dictated by record evidence of the need for change in those orders.

In their brief, Mallorie's Dairy et al. stressed that calculation of producer-handler advantage as the difference between the Class I price and the blend price is in error. Rather, Mallorie's Dairy et al. asserted that producer-handlers, like fully regulated handlers, use own-farm milk in other classes and as such, their pool obligation would likely be something less than the Class I price minus the blend price applied to total production. Mallorie's et al. further stated that proponents' use of erroneous calculations resulted in an overstatement of producer-handlers' purported competitive advantage.

The Mallorie's Dairy et al. brief also articulated additional factors determinant in producer-handlers competitive position relative to fully regulated handlers. According to the brief, smaller producer-handlers' processing, balancing and distribution costs exceed those of larger pool distributing plants and as a result, smaller producer-handlers are unable to compete with fully regulated plants, or to cause disruption in the fluid market on the basis of price.

A brief filed on behalf of IDFA reiterated its support for Proposals 1 and 2 exclusively, and highlighted testimony supportive of its position. IDFA also purported a lack of evidence supporting other proposals and detailed its opposition to the adoption of any proposals other than Proposals 1 and 2. IDFA asserted that the adoption of Proposal 1 is warranted based on the testimony of dairy farmers, cooperative representatives, and regulated fluid milk processors that provided numerous examples of producer-handlers' presence giving rise to disorderly

marketing in several Federal milk marketing orders.

In its brief, IDFA stressed that significant structural changes within the dairy industry have nullified any historical justification of the producer-handler exemption from pooling and pricing provisions. Movements toward concentration and consolidation in the dairy farm sector combined with unbounded producer-handler provisions in many Federal orders, has caused producer-handlers to have a significant negative impact on orderly marketing conditions and the potential for an even greater negative impact is present, according to IDFA.

IDFA also asserted in its brief that the adoption of Proposal 2 is warranted. IDFA revealed that an increase of the exempt plant qualification threshold from 150,000 pounds to 450,000 pounds of monthly Class route disposition will allow small handlers, including previously exempt small producer-handlers, to enjoy an exemption from pooling and pricing provisions because they are too small to cause material market disruption. IDFA further asserted that Proposal 2 should be adopted in its entirety. According to the IDFA brief, the unique labeling restriction feature in Proposal 2 is necessary to avoid linking together the sales of numerous small exempt plant handlers in an effort to gain the volume advantages of larger, fully regulated handlers.

A brief filed on behalf of AE, Dean, National Dairy Holdings, NDFA, PAMD, Parker Farms, Shamrock and Shamrock Farms (AE et al.) articulated collective support for Proposal 1. In their brief, AE et al. also noted that all parties represented in brief except NDFA support Proposal 2. The brief detailed opposition to an increased exempt plant Class I distribution limit should USDA decline adoption of any proposals under consideration in this proceeding or if USDA adopts any proposal other than Proposal 1. AE et al. also detailed specific opposition to any proposals that include soft-cap provisions. Finally, AE et al. acknowledged that certain parties represented in their brief could accept an amendment of the orders that would establish a 3-million pound hard-cap limit on monthly Class route sales for producer-handlers. Adoption of this limit, according to AE et al., would restore orderly conditions in most circumstances.

In their brief, AE et al. asserted that record evidence reflects the threat of producer-handler proliferation. In particular, AE et al. argued that recent growth in producer-handler volumes, retailing customers search for producer-

handler suppliers and the presence of producers actively structuring their operations with the express intent of becoming a producer-handler, is precisely the sort of evidence indicative of a potential threat to the maintenance of orderly marketing conditions. *AE et al.* also argued on behalf of NDFA that the exempt plant qualification threshold in Order 1 should not be increased due to the potential aggregate impact of such an amendment. According to the brief, record evidence shows a substantially larger number of exempt plants in Order 1 than in any other order.

The *AE et al.* brief detailed a number of reasons to support its position that Federal orders should include unique label requirements in the event that the exempt plant qualification threshold is increased or the producer-handler provisions are not entirely eliminated. Requirements for the unique labeling of packaged fluid milk products, according to the brief, will prevent the Class I sales volumes of exempt handlers, used in aggregate, from being balanced against the Class I sales volumes of fully regulated handlers. *AE et al.* provided several illustrations in support of this assertion and noted that unique labeling requirements would not prevent an exempt handler from bottling under several labels or bottling under a label other than one bearing its own name. Rather, the brief related that the only circumstance which would be prevented by unique labeling requirements is when any exempt handler or producer-handler bottles milk under the same label used by other handlers.

The *AE et al.* brief cited several examples from the record that they assert establish the presence of producer-handler driven disorderly marketing conditions in individual orders as well as across all orders. *AE et al.* further asserted that producer-handlers do not actually face balancing costs high enough to eliminate the price discrepancy between their operation and fully regulated handlers. The testimony of regulated handlers and producer-handlers alike, according to the *AE et al.*, addressed this very issue. *AE et al.* furthered this assertion, noting examples where producer-handlers were balanced by fully regulated suppliers, or supplied fluid milk products at retail under a label used by another [fully regulated] handler. Producer-handlers have a market impact across multiple marketing areas because some producer-handlers have distribution that is national, noted *AE et al.* The effect of producer-handler's multi-order distribution, according to *AE et al.*, is amplified by retailers'

common practice of requiring fully regulated handlers to match producer-handler low-cost competing offers in an entire region.

In their brief, *AE et al.* also asserted that record evidence supports the conclusion that producer-handlers' market share has increased even as the number of producer-handlers in operation has decreased. *AE et al.* stressed that this trend leads to concluding that producer-handlers, as individual entities, have grown in size and that they present a greater potential for further growth and disorderly marketing. In this regard, the brief cited testimony provided by two dairy farmers who recently constructed processing plants with the intent of seeking producer-handler status. The potential for growth in producer-handler market share combined with retailers' knowledge of the pricing advantage enjoyed by producer-handlers is indicative of existing and future disorder, according to *AE et al.* Furthermore, *AE et al.* asserted, if producer-handlers' cost of surplus disposal exceeded the advantage of their exemption from full regulation, then it would be irrational for those operations to continue. *AE et al.* concluded that if no action is taken to limit or eliminate the producer-handler definitions in all orders, then fully regulated handlers will be put at further disadvantage and the benefits of marketwide pooling will be threatened.

A brief submitted on behalf of NMPF summarized its position and highlighted record evidence in support of adopting Proposals 1, 2 and 26. In its brief, NMPF stated that the adoption of Proposals 1, 2 and 26 would: allow plants meeting a small business definition to continue operations with an exemption from the pooling and pricing provisions of the Orders; prevent the aggregation of exempt plant Class I sales to circumvent regulation; improve revenues paid to producers via increased blend prices; and allow handlers to face uniform classified prices. According to NMPF, any provisions regarding exempt handlers adopted as a result of this proceeding should apply to total sales and not only to sales in a particular marketing area, and should include unique labeling restrictions to prevent integration of many small exempt handlers in search of a cost advantage based upon exempt milk supplies. NMPF further asserted that the amendments presented in Proposals 1, 2 and 26 are warranted given current and potential disorder, and taken collectively would restore orderly conditions within the system. NMPF reiterated its opposition to Proposals 3,

4, 5, 7, 8, 11, 13, 15, 17, 18, 20, 21, 23, 24, 25, 27 and 28.

In its brief, NMPF asserted that both farm sizes and handler operations are growing and the increasing availability of new technologies has drawn the industry to seek scale efficiencies. This new climate presents greater potential for producer-handler proliferation since many dairy farms are now large enough to enjoy economies of scale in milk production and processing and the cost advantage associated with the producer-handler exemption, NMPF emphasized. Some producer-handlers, according to NMPF, have already reached the size and scale necessary to compete directly with fully regulated handlers and that some current producer-handlers have grown to distribute nationally and internationally. Additionally, NMPF stressed in its brief that producer-handlers in low- and high-Class I utilization marketing areas, exhibit Class I utilization significantly in excess of area averages of fully regulated distributing plants. Record evidence, the brief asserted, indicates that producer-handler sales comprise a significant and growing share of the Class I sales in several markets. Furthermore, when full regulation occurs, producer-handlers can and do survive.

In brief, NMPF pointed out that producer-handlers' costs-of-production are not relevant in assessing their impact on orderly marketing conditions. NMPF further asserted that establishment of a transfer price at which producer-handlers acquire own-farm milk is unnecessary because the correct comparison is between the regulatory costs of producer-handlers and similarly situated plants and the farms that supply them. On this basis, producer-handlers face costs that are no different, except that producer-handlers have obligation to the producer-settlement fund, NMPF concluded.

In its brief, NMPF reiterated that producer-handlers are a cause of disorderly marketing conditions because their exemption from pooling and pricing regulation decreases revenue that is otherwise paid to producers and interferes in setting uniform class prices to handlers. NMPF furthered this position noting that marketwide pooling is necessary for the integrity of the Federal order system and the exemption from pooling and pricing of producer-handlers erodes its effectiveness. The larger individual producer-handler operations become, the more a producer-handler's exempt status undermines producer equity, NMPF indicated. The cost advantage of producer-handlers, according to NMPF, equals the difference between the

average value of milk used and the uniform price. This advantage is significant in an industry where bids are often considered and awarded on differences of less than a penny, NMPF maintained. The magnitude of producer-handlers' impact revealed by record evidence to be as high as \$0.12 during certain months in Order 32, NMPF noted in its brief. The brief cited other record testimony revealing that producer-handlers also impact the blend price in Order 1.

The NMPF brief articulated the fiercely competitive nature of the retail-grocery market. According to NMPF, retailers have sought to gain producer-handlers as suppliers in search of price advantages at retail, and producer-handlers can effectively avoid balancing their production when retailers first rely on all of the milk that a producer-handler can offer by meeting the remainder of their needs through other regulated sources. NMPF also noted the testimony of a producer-handler with national distribution which revealed that producer-handlers balance against alternative suppliers.

NMPF, in its brief, explained how the adoption of any proposals other than Proposals 1, 2 and 26 would be ineffective in addressing the current disorderly marketing conditions caused by producer-handlers. Specifically, NMPF stands in opposition to all other proposals. NMPF noted particular concern that the adoption of individual handler pooling in lieu of marketwide pooling would result in disorderly marketing and be detrimental to the Federal order system. In this regard, NMPF explained that individual handler pooling would reward handlers who can selectively recruit larger producers to supply milk needed for Class I use without acknowledging the balancing services provided by other handlers in the market.

In its brief, NMPF argued that the record supports grandfathering current producer-handlers with no more than three million pounds of monthly Class I route disposition provided grandfathering also includes provisions requiring unique labeling of package fluid milk products and farm and plant ownership exclusive of ownership in other farms or distributing plants. According to NMPF, these conditions collectively ensure the independent nature of producer-handlers as was intended when this category of handler was first created.

NMPF concluded in its brief that adoption of their package of proposals on a national basis is appropriate and is required to correct current disorderly marketing conditions and to preempt

future disorder, noting adoption would eliminate the need for numerous and redundant hearings. With a national view, NMPF asserted that the collective adoption of Proposals 1, 2 and 26 would likely result in the full regulation of not more than five current producer-handler entities.

A brief submitted on behalf of AIDA reiterated the testimony of AIDA members and further articulated AIDA members' positions. AIDA asserted that Proposals 1 and 26 and other proposals that would eliminate or restrict producer-handler operations should be denied and the status quo maintained. Should the Secretary find that change to the producer-handler provisions is necessary, AIDA asserted, only Proposals 23, 24 and 25 should be considered for adoption.

In their brief, AIDA asserted that the preemptive regulation of producer-handlers and measures to prevent their proliferation are not warranted. In this regard, AIDA highlighted testimony that producer-handler competition is not currently an issue. AIDA concluded that the decreasing number of producer-handlers should be evidence enough that no threat of proliferation exists. Furthermore, the AIDA also concluded, while the volume of producer-handler milk has increased, the total percentage of Class I sales attributable to producer-handlers is at its lowest level in more than 40 years.

AIDA reiterated their assertion that the record supports concluding that producer-handler raw milk costs are equivalent to farm-level cost-of-production and not the Federal order blend price. In this regard, AIDA referenced USDA statistics that demonstrate farm-level cost-of-production exceeds both the blend price and the Class I price and as such, producer-handlers acquire own-farm milk at costs higher than either of these prices. Accordingly, AIDA asserted that the blend price is not the appropriate transfer price of milk from a producer-handler's farm to its plant. Instead, AIDA asserted, the only economically rational transfer price is the farm cost-of-production incurred by the producer-handler. Among other things, AIDA maintained, without evidence of an unfair cost advantage, no basis can be established to conclude that producer-handlers give rise to disorderly marketing conditions.

Expanding upon the argument that disorderly marketing conditions are not evident, AIDA stressed in its brief that disorderly marketing can only be found when consumers are unable to obtain a sufficient supply of fluid milk at reasonable prices. Applying this

definition to the current record, which AIDA asserts does not show any consumer inability in buying milk, AIDA concluded that disorderly marketing is not present. AIDA also referred to testimony of proponent witnesses that acknowledged that producer-handlers are not currently causing disorderly marketing conditions. AIDA went further to suggest that any decisions regarding the regulatory treatment of producer-handlers must be based upon economic conditions and equity rather than equality amongst regulated parties.

In their brief, AIDA indicated that producer-handlers do compete with fully regulated handlers on the basis of price, but also stressed that price alone is not the only determinant factor of competition and producer-handlers are evidence of nothing more than healthy competition. AIDA insisted that competition is not the same as disorderly marketing and asserted that Federal orders are not intended to limit or eliminate competition. AIDA relied on several examples from the record which they purport to show that producer-handlers do not compete solely on the basis of price and also countered testimony intended to show the competitive advantages producer-handlers enjoy by being exempt from pooling and pricing.

AIDA cited in their brief record testimony demonstrating that producer-handlers meet the regulatory test of bearing the burden of balancing their milk supply. Based on the testimony of several producer-handlers, AIDA concluded that producer-handlers are price-takers when selling surplus milk and the price received for surplus milk is lower than the classified prices. In addition to bearing the burden of their surplus, producer-handlers do not enjoy the Federal order minimum prices for surplus milk as do pooled producers, AIDA asserted.

AIDA presented several arguments in their brief to demonstrate the irrelevance of the impact producer-handlers have on blend prices. While AIDA acknowledged an impact, they argued that the impact is not significant relative to the impact of several other marketing conditions tolerated by Federal orders, including the depooling of milk.

AIDA noted in their brief that the producer-handler model is, in many marketing areas, the only alternative for producers outside of marketing through a cooperative. AIDA also asserted that through the producer-handler option, producers are able to provide differentiated products through innovative methods and marketing

channels that are best served by the producer-handler business model. In this regard, AIDA mentioned several prominent regulated handlers serving the current marketplace that began as producer-handlers. Accordingly, AIDA concluded that USDA should leave the producer-handler definition unchanged.

In the event USDA finds the need for changing the producer-handler provision, AIDA asserted in their brief that Proposals 23, 24 and 25 should be adopted because they are less-burdensome alternatives to the other proposals under consideration in this proceeding. According to AIDA, the two parts of Proposal 23 would allow handlers to exempt own-farm milk volumes from pool obligation while also allowing handlers with own-farm milk production to elect partially regulated distributing plant status.

In their brief, AIDA reasserted that Proposal 24 is primarily intended for adoption in the event that USDA determines that the producer-handler provisions need amending to include Class I disposition limits, while also maintaining that the proposal could be adopted even in the event that the producer-handler provisions were completely eliminated. AIDA reiterated that the proposal's intent is to exempt producer-handlers with handler-controlled retail channels because their control of milk is complete from production through to final disposition to the consumer and because there is no impact on the pool. AIDA noted that this provision is intended to be liberally construed so as to include independent contractor relationships within the handler-controlled retail channel.

In their brief, AIDA reiterated their position that individual handler pooling (Proposal 25) is an alternative to marketwide pooling as a means to address the producer-handler issue. According to AIDA, the adoption of individual handler pools would not only allow producer-handlers and regulated handlers to enjoy more equal treatment, it would also better reflect Class I market demands and the producers serving those demands. AIDA asserted that it would also eliminate the need for pooling standards and the hearings required to determine them, as well as eliminate the disorderly impacts of depooling. AIDA concluded that the possibility of unequal producer prices under individual handler pools would not be a great issue.

In their brief, AIDA also detailed support for increasing the exempt plant's limit on Class I distribution independent from consideration of the regulatory treatment of producer-handlers. Citing from the record, AIDA

supported a Class I distribution limit of 1 million pounds per month.

Discussion and Findings

General

At issue in this proceeding is the reconsideration of the current exemption of certain handlers from pooling and pricing provisions of Federal milk marketing orders. All milk marketing orders provide for the exemption of handlers known as producer-handlers and plants that have less than 150,000 pounds of monthly Class I route disposition—commonly referred to as exempt plants. While exempt plants are limited to 150,000 pounds or less of monthly Class I disposition, the producer-handler definitions, except in Orders 124 and 131, specify no disposition limitation.

A proposal seeking elimination of the producer-handler definitions asserts that the pooling and pricing exemption of this category of handler has become a source of current or potential disorder in the marketplace and should be eliminated across all orders. A companion proposal to mitigate regulatory impacts associated with elimination of the producer-handler definitions was offered to be adopted simultaneously. This companion proposal seeks to increase the exempt plant limit of monthly Class I disposition from 150,000 to 450,000 pounds. As proposed, it is intended to allow current small scale producer-handlers, those with less than 450,000 pounds of Class I disposition per month, to be exempt from pooling and pricing provisions of the orders.

Numerous additional proposals were offered and considered as alternatives to these two proposals. While all producer-handlers endorse the status quo, the alternative proposals are offered in the event that USDA determines the producer-handler definitions should be amended. Several current producer-handlers and other interested parties offered proposals that would add a monthly Class I route disposition limit to the producer-handler definitions. Other proposals seek to prevent proliferation of new entrants under the producer-handler definition while allowing existing producer-handlers to retain their current status. One proposal seeks to recast the producer-handler definitions to exempt only those entities with the additional risk and burden of exclusive distribution through producer-handler-controlled retail channels. Another proposal seeks to change the method of pooling milk and the classified use-values of milk in the orders. Finally, proposals that seek to

exempt handlers' own-farm milk production disposed of as packaged fluid milk products were offered.

The record reveals that there are currently over 100 entities across the Federal milk marketing order system meeting the current exempt plant definition. Many of these entities are operated by dairy farmers who bottle and sell their milk production as fluid milk products. If not for their monthly Class I route dispositions being less than 150,000 pounds, these entities would likely meet the producer-handler definition of their respective orders. Although some exempt plant handlers fit the producer-handler definition, which requires handlers to have integrated production, processing and route disposition at their exclusive enterprise and risk, exempt plant handlers have no such restrictions. In other words, exempt plants may be exclusively supplied with milk purchased from dairy farmers. Irrespective of production, processing and route disposition, an exempt plant incurs no Federal order minimum payment obligation to the dairy farmer(s) from whom milk was purchased.

The AMAA requires the setting of uniform prices to producers regardless of how the milk of any single dairy farmer is used and uniform prices to similarly situated handlers (Section 608c(5)). Handlers who are similarly situated pay at least the class prices established under the orders for milk. Producers are paid at least the minimum uniform (blend) price that is determined through marketwide pooling. A marketwide pool, through the mechanism of a producer-settlement fund, equalizes the classified use-values of milk pooled on an order among handlers and determines a uniform price paid to producers. Marketwide pooling allows for equitable sharing of the cost of supplying and balancing the Class I market. These two key features of milk orders—classified pricing and marketwide pooling—provide the basic foundation for orderly marketing and address the AMAA's primary objective of ensuring orderly marketing.

There are currently four different producer-handler definitions used in Federal milk marketing orders. The three southeastern orders (Orders 5, 6 and 7) have no Class I route disposition limits and do not provide for the purchase of milk beyond the own-farm production of a producer-handler. The producer-handler definitions of 5 other orders also have no limit on Class I route disposition but provide for the limited purchase of milk of 150,000 pounds or less per month beyond own-

farm production. Only Orders 124 and 131 have a limit on Class I route disposition in their marketing areas that, when exceeded, obligates producer-handlers to pooling and pricing provisions of these orders in the same manner as the fully regulated plants. The producer-handler definition of Order 131 differs from that of Order 124 in that it also places certain restrictions on product labeling. Nevertheless, the common criterion of all producer-handler definitions for all orders is the requirement that the entire operation be under the sole risk and enterprise of the producer-handler.

Despite previous rulemaking proceedings which considered full regulation of producer-handlers, it was not until 2006 that some producer-handlers became subject to pooling and pricing provisions under Orders 124 and 131. In that formal rulemaking proceeding, USDA adopted a 3-million pound per month Class I disposition limit in the marketing area that, when exceeded, results in the full regulation of producer-handlers. No changes were made with regard to the exempt plant definitions of the two orders. Shortly after implementation of the amended Orders 124 and 131, enactment of the Milk Regulatory Equity Act of 2005 required implementation of additional regulatory criteria affecting handlers and producer-handlers in *all* Federal milk marketing orders.

In the producer-handler proceeding for Orders 124 and 131, USDA found that the exemption of large scale producer-handlers from pooling and pricing disrupted the orderly marketing of milk. The record of that proceeding demonstrated that large scale producer-handlers enjoyed a price advantage over regulated handlers while simultaneously decreasing blend (uniform) prices to dairy farmers. The record of this proceeding does not support the same conclusion. Of greater significance, the record of this proceeding indicates that all producer-handlers enjoy a competitive pricing advantage over fully regulated handlers because of their exemption from pooling and pricing provisions. This is not surprising as any entity exempted from the regulatory plan will cause prices to be set at a lower level than the prices that would otherwise be uniform to producers and handlers. It is clear from this proceeding that as Class I dispositions of a producer-handler increase, the order's ability to set prices that are uniform to handlers and producers is eroded.

Depending on the volume of Class I disposition, the exemption from obligation to account for milk at

minimum classified prices, and the exemption from payment into the producer-settlement fund of the difference between a producer-handler's use-value of milk and the blend price become critical factors that give rise to disorderly marketing conditions. Large producer-handlers become increasingly able to market fluid milk at prices below those that can be offered by fully regulated handlers because the classified prices set by the order are not uniform. The exemption from payment to the producer-settlement fund renders the order unable to set uniform prices to producers.

The record of this proceeding demonstrates that producer-handlers with monthly Class I route disposition of three million pounds or less are not a cause of disorderly marketing conditions that warrant correction by eliminating the producer-handler definition across all Federal milk marketing orders. Accordingly, it is reasonable to conclude that the objectives of the AMAA can continue to be achieved without the complete elimination of the producer-handler definitions across the system of orders. It is also reasonable to conclude that all orders should be amended so that the producer-handler definitions include some limitation on the amount of Class I dispositions that a producer-handler may have before becoming obligated to the system's regulatory plan of pooling and pricing. Doing so is necessary to maintain the integrity of the Federal order system and orderly marketing conditions.

Elimination of the producer-handler definition and increasing the exempt plant monthly limitation of Class I disposition.

Record evidence reveals that the elimination of the producer-handler definitions of the orders is not necessary and an increase in the exempt plant threshold from the current 150,000 to 450,000 pounds on Class I route disposition per month is not warranted. Nevertheless, testimony and evidence provided by proponents, most notably NMPF and IDFA and associated witnesses, identified shortcomings of the current producer-handler definitions.

Producer-handler exclusion from pooling and pricing has historically been based on the premise that the declared policy and objectives of the AMAA, namely orderly marketing, could be achieved without the extension of full regulation to this category of handler. USDA has articulated its authority to obligate producer-handlers to further regulation, including marketwide pooling and minimum

pricing provisions, if they singularly or collectively have a negative impact on the market. USDA found the activity of large scale producer-handlers to be a source of significant and measurable disorder in the Arizona and Pacific Northwest marketing areas.¹ Accordingly, those orders were amended to establish a 3-million pound limit on monthly Class I disposition in the marketing area in the producer-handler definitions beyond which pooling and pricing regulation applies to the handler.

Prior rulemakings consistently articulated USDA's authority to subject producer-handlers to full regulation. For example, in a Final Decision for the Puget Sound order, a predecessor to the Pacific Northwest order, USDA found that producer-handlers should continue to be exempt from pooling and pricing provisions of the order with the caveat that producer-handlers could be subject to further regulation if justified by prevailing market conditions.² This position was amplified in a subsequent Puget Sound Final Decision wherein USDA found that a hearing should be held to consider the regulation of producer-handlers if the marketing area was susceptible to being affected by producer-handlers or if producer-handler sales could disrupt or operate to the detriment of other producers in the market.³ Such policy was also articulated in another decision concerning producer-handlers in Texas and the Southwest Plains.⁴ That decision concluded that it would be appropriate to obligate producer-handlers to the pooling and pricing provisions of the order if it could be shown that producer-handlers cause market disruption.

The proposals for elimination of the producer-handler definition are primarily based upon issues regarding producer-handler size, specifically the volume of Class I route disposition. The elimination of the producer-handler definition across the system of orders is proposed to be offset by an increase in the exempt plant monthly Class I route disposition limit. This would, as the proponents intend, mitigate the impact of the proposed regulatory change on current producer-handlers characterized as not having a significant impact on orderly marketing conditions.

¹ Official notice is taken of Final Decision, published December 14, 2005 (70 FR 74166).

² Official notice is taken of Final Decision, published May 13, 1966 (31 FR 7062-7064).

³ Official notice is taken of Final Decision, published July 21, 1967 (32 FR 1073-1074).

⁴ Official notice is taken of Recommended Decision, published June 28, 1989 (54 FR 27179).

Producer-handlers are persons who operate dairy farms and generally process and sell only their own milk production. A pre-condition to operating a processing plant as a producer-handler is the operation of a dairy farm. Consequently, the size of the dairy farm determines the production level of a producer-handler's farm operation and is also the controlling factor of the volume that is processed by the plant and that is available for distribution. Accordingly, the major consideration in determining whether a producer-handler is a large or small business is its capacity as a dairy farm. Under SBA criteria, a dairy farm is considered large if its gross revenue exceeds \$750,000 per year which equates to a production guideline of 500,000 pounds of milk per month. Accordingly, a producer-handler with Class I disposition in excess of three million pounds per month is considered by this decision to be a large business.

At what size a producer-handler begins to have a significant impact on a market's pooled participants should be determined by whether minimum prices are uniform to producers and among handlers. Testimony in this proceeding presented the argument that the presence of effective prices—or actual prices paid and received—that differ from minimum prices set under the orders is indicative of disorder. This decision disagrees. The regulatory plan of the milk order program is not tasked with setting the effective prices. Rather, the regulatory plan of the milk order program provides for setting and enforcing *minimum* prices paid by handlers and received by producers. The effective prices producers receive can and do vary, but prices paid to producers and their cooperatives cannot be lower than the minimum price established under the orders. The fact that cooperatives can re-blend the price they pay for the marketing of their producer member milk is neither an example of disorderly marketing conditions nor germane to evaluation of the conditions appropriate for excluding handlers from the pooling and pricing provisions of the orders.

Because producer-handlers do not share the additional value of their Class I sales with a market's producers, their exemption from the pooling and pricing provisions is conditioned on the premise that the burden of surplus disposal (milk not used for fluid uses) is borne by them alone. The surplus milk of a producer-handler may be sold for any price, but germane to this condition, such surplus milk does not receive the minimum price protection offered by marketwide pooling. When a

producer-handler is able to avoid the burden of surplus disposal while also retaining the entire additional value of milk accruing from Class I sales, equity among producers and handlers is jeopardized and disorderly marketing conditions can ensue. When uniform minimum price conditions exist, the basis for orderly marketing is present. In the absence of uniformity of minimum prices among producers and handlers, the basis for orderly marketing is undermined.

The record supports the finding that adoption of a limit on producer-handler Class I dispositions per month can mitigate the disorderly marketing which arises when producer-handlers are able to avoid bearing the burden of surplus disposal. Bearing the burden of surplus disposal is a fundamental demonstration of a producer-handler balancing their milk production with market demand for their Class I products. Disorderly marketing conditions are present when a producer-handler becomes able to directly or indirectly balance their Class I dispositions with the surplus milk of pooled producers. The record indicates examples of indirect balancing of producer-handlers on the regulated market. The record also indicates that as the size of a producer-handler's Class I disposition increases, conditions arise that offer an even greater ability to effectively transfer the balancing burden to the regulated market.

While opponents to the elimination of the producer-handler definitions argue otherwise, this decision agrees with proponent arguments, presented by witnesses testifying in support of NMPF and IDFA positions, that the difference between the Class I price and the blend price is a reasonable estimate of the price advantage enjoyed by producer-handlers even if it is not possible to determine the precise level of the advantage for any individual producer-handler. This price advantage is compounded as a producer-handler's Class I utilization increases. In addition, allowing producer-handlers to have unlimited Class I disposition will result in a measureable impact on the blend price received by pooled producers.

This decision finds no reason to consider the higher costs purportedly associated with the operation of producer-handlers a relevant factor for determining conditions in which handlers should or should not be subject to full regulation. All handlers face different processing costs. These differences may be the result of divergent plant operating efficiencies related to size or to that portion, if any, of milk supplied, which may be

produced and supplied from own-farm sources. Whatever the cost differences may be and the reasons for them, all fully regulated handlers must pay the same minimum Class I price, and equalize their use-value of milk (generally, the difference between the Class I price and the blend price) through payment into the order's producer-settlement fund. Similarly, all producers face different milk production costs. Producer cost differences, for example, may be the result of farm size or variation in milk production levels attributable to management ability. Producers, regardless of their individual costs, receive the same blend price.

Establishment of individual handler pools.

The marketwide sharing of the classified use-values of milk among all producers supplying a marketing area is an essential feature of the Federal milk marketing order system. It ensures that producers supplying a given marketing area receive the same uniform price for their milk, regardless of its end use. In combination with classified pricing, marketwide pooling has, among other things, successfully mitigated price competition between producers seeking the higher-valued fluid outlets for their milk. Abandonment of the marketwide pooling system in favor of an individual handler pool system would reverse the stability achieved by its adoption in all Federal milk marketing orders.

The record reveals that justification for the adoption of individual handler pooling is rooted in a collection of extremely selective excerpts of a study authored by dairy industry participants and published in 1962. The study, commonly referred to as the Nourse Report, examined in great detail the Federal milk marketing order system. The few excerpts used to advance the features of individual handler pools pale in comparison to the Nourse Report's cautions as to its use as well as descriptions of the superior qualities associated with marketwide pooling. Over the years, USDA has repeatedly concluded that marketwide pooling promotes orderly marketing conditions more completely and is one of the most important marketing order tools used to ensure uniformity in prices to producers.⁵ In markets where much of the milk is handled by operating cooperatives and large surpluses of milk are unevenly distributed among handlers, conditions observable today,

⁵ Official notice is taken of: Final Decision, published April 2, 1999 (64 FR 16026); Final Decision, published October 13, 1955 (20 FR 7689); Final Decision, published June 15, 1990 (55 FR 25618).

marketwide pooling best ensures orderly marketing. This is the same opinion of the Nourse Report.

Individual handler pooling did have a role to play in the orderly marketing of milk, but only under very specific conditions. On the eve of milk marketing order reform implementation which instituted, among other things, the current large regional milk marketing orders, individual handler pooling existed for only one very small marketing area that had a single fully regulated handler distributing Class I products. When a marketing area has a single fully regulated handler, the classified prices established under the order and the blend price returned to dairy farmers supplying that handler are uniform. However, when a market contains more than a single regulated handler, the individual handler pooling system cannot provide uniform prices to producers.

As marketing areas grew in geographic size and in the number of handlers competing for Class I sales and manufacturing of other dairy products increased, marketwide pooling became the method ensuring uniform prices to producers. The pooled milk of producers shared in the additional revenue accruing from the higher classified use-value of Class I sales and the burdens of lower classified use-values. Under an individual handler pooling plan, producers supplying handlers with differing utilizations would receive different prices. These differences would be particularly notable between producers delivering to handlers with high manufactured class utilization and those with a majority of Class I uses. Producers supplying a handler with high Class I utilization would receive higher prices than producers whose milk was delivered to manufacturing handlers. Returns distributed to producers in this manner are not uniform nor can they be when a market consists of multiple handlers.

To the extent that individual handler pooling is an alternative to the elimination of the producer-handler definitions, USDA long ago determined it to be inferior to marketwide pooling. While it may be a novel way to address the issues under consideration in this proceeding, it does so by a claim that a producer-handler is paying itself the use-value of its own milk. Its adoption could not be immediately implemented as it would, for example, require an overhaul of an order's pooling standards plus the addition of other criteria to ensure that distributing plants had an adequate supply of milk for fluid uses.

The central issue of this proceeding is the consideration of the conditions that

warrant exemption of handlers from full regulation not whether the method of pooling should be changed. Individual handler pooling does not directly address when and under what circumstances handlers can be exempted from pooling and pricing without undermining orderly marketing. Accordingly, the proposal for adopting individual handler pooling (Proposal 25) is not recommended for adoption.

Grandfathering, Soft-caps, and Own-farm Milk Exemptions

Three proposals, Proposals 17, 23, and 26, submitted in response to Proposals 1 and 2 received testimony in support of "grandfather clauses" and exemptions for "own-farm" milk supplies. In the context of this proceeding, "grandfather clause" refers to an exception that would allow current producer-handlers to continue their operations with added restrictions. "Own-farm" milk here refers to the amount of milk processed for use by a handler who is also the producer of that milk. These alternative proposals to the elimination or amendment of the producer-handler definition calling for these features are not recommended for adoption.

While requesting the elimination of the producer-handler definition in all orders, NMPF asserts that their Proposal 26 is consistent with this request because it effectively halts the proliferation of new producer-handlers. This decision disagrees and does not recommend NMPF's Proposal 26 for adoption. If the position is taken that the exemption of producer-handlers from pooling and pricing causes disorderly marketing conditions, then it would be reasonable to conclude that the current producer-handler exemption, regardless of any limitations placed on Class I route dispositions, should come to an end. A willingness to accept a 3-million pound per month limit on Class I route dispositions for current producer-handlers begs the conclusion that producer-handlers with Class I dispositions at or below this level are not disorderly or, at the least, represent a tolerable deviation from strict application of pooling and pricing provisions.

Grandfathering clauses, as proposed, would create inequity between persons who are currently producer-handlers and other entities who may in the future seek to supply milk as producer-handlers. Adoption of these types of provisions would essentially create a new category of handler based solely on their regulatory status during a specified time period. Dairy farmers that aspire to produce, process and market milk at

their own enterprise and risk would be denied the opportunity to join the new "grandfathered" category.

As previously discussed, the broad purpose of the AMAA is to establish and maintain orderly marketing conditions. Its purpose is not to create barriers to entry into a viable business or marketing alternative. New-to-market operations should not be denied the ability to form under the same provisions as current entities that have already met the producer-handler definition. Concern for the proliferation of producer-handlers is overly proscriptive.

In their post-hearing brief, Mallorie's Dairy, proponent of Proposal 17, articulated a willingness to accept the current size limitation of 3 million pounds of Class I route disposition of the PNW and Arizona orders as a reasonable alternative to elimination of the producer-handler provisions. This willingness was conditioned upon a USDA recommendation against the elimination of the producer-handler provisions and for the application of the Class I route disposition limit common to the PNW and Arizona orders across all other orders. As this decision recommends adoption of amendments similar to those acceptable to Mallorie's Dairy, no further consideration is given to Proposal 17, as proposed by Mallorie's Dairy.

Modifications to Proposal 17 as offered by NAJ request consideration for provisions which would create a new category of handler. In their post-hearing brief, NAJ advocated the creation of an exemption for handlers with own-farm milk supplies. With NAJ's modification to Proposal 17, handlers with own-farm milk would be exempting the first three million pounds of own-farm milk disposed of as Class I during the month. NAJ asserts that this would be equitable for handlers with less or more than the three million pounds of own-farm Class I dispositions or a combination of own-farm and purchased milk. This decision does not find NAJ's proposed changes to be equitable as represented by NAJ.

NAJ suggests that handlers with own-farm milk should be partially regulated distributing plants with an exemption from pooling and pricing equal to their own-farm milk volume. While this modification uses terminology common to current regulation it in fact represents a recast meaning of the term "partially regulated." Unlike pool distributing plants, partially regulated handlers are handlers that distribute fluid milk products into a marketing area but do not meet the standards for full regulation under that order. NAJ uses

the term “partially regulated” to refer instead to handlers who would only be subject to full regulation for own-farm fluid milk product volume in excess of three million pounds and all purchased milk volume. This would essentially create a unique exemption based upon the origin of the milk supplies received by a given handler.

As proposed, NAJ’s modification is grounded in a justification based upon the source of a milk supply. It would not be appropriate to have differentiated regulatory treatment of milk supplies on the basis of origin. The current producer-handler provisions require that operations be performed at their exclusive control and through a dependence on their own milk production without reliance on purchased milk.

AIDA, proponents of Proposal 23, offered two versions of Proposal 23 to be considered as distinct from one another. Both versions would require the creation of handler categories specific to handlers with own-farm milk supplies reflecting certain provisions that currently govern the regulatory treatment of pool distributing plants and partially regulated plants, save one major exception. Under the first variation of Proposal 23, handlers with own-farm milk would be treated as fully regulated plants with the ability to down-allocate all own-farm milk supplies. The second variation would allow handlers processing own-farm milk for Class I use to elect partially regulated status.

The first version of Proposal 23 would cause handlers with own-farm milk to have a price advantage due to their exemption from pooling and pricing while handlers without own-farm milk would be subject to pooling and pricing provisions of the orders. The second version of Proposal 23 seeking treatment of handlers with own-farm milk as partially regulated plants would treat differently those handlers without own-farm milk supplies. Adoption of this proposal would cause differentiated treatment of similar plant operations solely on the basis of supply sourcing. Furthermore, the provisions offered in Proposal 23 are far less restrictive than the current producer-handler provisions, which proponents of Proposal 23 contend should not be changed. Either form of Proposal 23 would cause inequitable treatment of similarly situated handlers due to an exemption favoring handlers having own-farm milk supplies.

While AIDA describes their proposed changes using terminology common to current regulation, the proposals are different than current regulations. The

proposals do not consider conditions under which full exemption from pooling and pricing regulation is warranted. Proposal 23 uses needlessly complex methods to address an issue that may be more easily fixed by simply modifying the current producer-handler definition to include a limit on monthly Class I route disposition. Accordingly, this decision does not recommend the adoption of either version of Proposal 23.

The portion of Proposal 23 and the NAJ modification that propose total or partial exemption from pooling and pricing based on own-farm production disposed of as Class I while allowing for purchase of milk from other producers, deviates from the long-held own risk and enterprise conditions associated with the producer-handler definition. If adopted, each of these two proposed changes would create a soft-cap exemption. Soft-caps exempt some Class I disposition while subjecting any additional disposition to pooling and pricing. This would cause inequitable treatment across similarly situated handlers where handlers with own-farm milk could “smooth” the price advantage gained on the volumes of exempt fluid milk products across any additional Class I sales. In turn, this would also allow handlers with own-farm milk to undercut prices offered by those handlers without own-farm milk strictly as a consequence of regulation.

This decision notes the testimony regarding the use of similar soft-cap limits for producer-handlers under California’s milk marketing regulatory plan. California’s milk marketing regulatory system is similar to that of the Federal order system. The soft-cap limits there led to inequity among similarly situated handlers. According to the record, other fully regulated handlers with similar Class I disposition, but without own-farm milk production, were placed at a competitive disadvantage relative to those handlers with own-farm production.

Retention of the Producer-Handler Definition With Limits on Class I Disposition

As discussed above, the exemption of producer-handlers of any size (and exempt plants) from the regulatory plan of milk orders immediately leads to minimum prices under the orders that are not uniform to producers and handlers. However, USDA has a long history in which certain categories of handlers have not been subject to the full regulatory scheme in order to achieve the AMAA’s objective of orderly marketing.

While having an absolute impact on milk orders’ ability to set uniform prices to similarly situated handlers and return uniform prices to producers, the volume of milk represented by exempt plant route dispositions has had and continues to have a de minimis impact on orderly marketing. As such, USDA has concluded that the full regulatory plan need not be applicable to such small handlers. The exempt plant limit on Class I dispositions represents a measure of participation in the market that while exempt, is tolerable and does not undermine the purpose of the order system and its treatment of larger handlers.

The same de minimis impact on orderly marketing owed to producer-handler Class I route disposition volume has been, in part, the rationale for their exemption from full regulation. Simply stated, producer-handlers have historically conducted small scale operations and have been subject to certain requirements to remain exempt from full regulation. Those requirements have been that the operation: Be under the sole enterprise and risk of the producer-handler; bear the full responsibility and risks associated with the care and management of the dairy animals and other resources necessary for milk production; and engage in and exclusively control the processing and distribution of their Class I products. Under these and other requirements unique to each order, producer-handlers have been determined to have neither an advantage in their capacity as producers or as handlers.

With these conditional requirements for producer-handlers, there was no need to consider further regulatory requirements for this category of handler. Additional amendments to the producer-handler definitions became necessary when producer-handler size was shown to be a cause of disorderly marketing conditions in the Arizona and Pacific Northwest marketing areas, and a cap of three million pounds per month on Class I dispositions in the marketing area was adopted.

The record reveals that the number of producer-handlers and all other categories of handlers is declining. Opponents of change from the status quo conclude that this is justification to leave the producer-handler provisions unchanged. This decision disagrees. In evaluating the impact producer-handlers may have on orderly marketing, the volume of milk marketed by any individual producer-handler is more important than the overall trend in the number of producer-handlers.

The size of individual producer-handlers will impact orderly marketing

conditions in any of the Federal order marketing areas if left without limit. Size of operation will have a direct bearing on competitive equity between producer-handlers and fully regulated handlers. Producer-handler size will increasingly affect an order's ability to set uniform prices to similarly situated handlers and to producers. Producer-handler size will increasingly magnify disorderly marketing conditions and practices where the burden of balancing and surplus disposal is effectively transferred to the regulated market. These examples of the presence and anticipation of disorderly marketing conditions can be largely mitigated by establishing a reasonable limit on a producer-handlers' Class I route dispositions.

Establishing a reasonable limit on total Class I route disposition in all producer-handler definitions for all Federal milk marketing orders unifies the policy objectives of the AMAA to establish and maintain orderly marketing conditions. Establishment of a reasonable limit on Class I disposition does not require changing other order-specific features contained in the producer-handler definitions that have been provided to address local marketing conditions. The addition of a uniform limit on producer-handler total monthly Class I route dispositions in all orders is consistent with the past establishment of the uniform limits, characteristics and features of various milk marketing order provisions applicable to other categories of regulated handlers.

The limit acceptable to or broadly supported by both handler and producer interests is three million pounds of monthly Class I disposition. This decision finds that a 3-million pound per month limit on total Class I route disposition is reasonable. The evidence supports a conclusion that most producer-handlers continue to be small enterprises that have minimal impact in the marketing areas in which they operate. Their participation in the market is not giving rise to disorderly marketing conditions that warrant establishing a more restrictive limit on Class I disposition. Implicit in this finding is that producer-handlers with no more than three million pounds of monthly Class I disposition represent a level of market participation such that the AMAA goal of establishing and maintaining orderly marketing is achieved.

The record supports concluding that a direct relationship exists between producer-handler size and the potential for disorder. More specifically, the record supports the conclusion that

adoption of a limit on producer-handlers' total monthly Class I route disposition across all orders is necessary to maintain orderly marketing conditions. This represents a needed change to the producer-handler provisions of Orders 124 and 131, which only consider producer-handlers' monthly Class I dispositions within the respective marketing area. Adoption of a limit on the total Class I route disposition of producer-handlers is reasonable and should mitigate the inequitable conditions associated with distribution in other marketing areas or where the handling of milk is not regulated. The producer-handlers with more than three million pounds of total Class I disposition per month that meet the pooling standards of an order will have all of their distribution of Class I products pooled and priced no matter where that milk is sold. The producer-handlers with more than three million pounds of total Class I disposition per month that do not meet the pooling standards of an order will be treated as partially regulated distributing plants for route sales in the marketing areas.

An additional proposal, Proposal 24, seeking an unlimited exemption for producer-handlers marketing own-farm milk disposed of as fluid milk products through retail channels under the same handler's exclusive control is not recommended for adoption. This decision gave consideration to the testimony and evidence, which revealed that producer-handlers distributing fluid milk products exclusively through their own retail channels are self-contained and do not balance against pooled supplies. While this seems to adhere to a long-held producer-handler characteristic, the responsibility and risk for balancing is still relative to producer-handler size, as defined by total monthly Class I disposition, which represents a significant contributing factor to disorderly marketing. At issue is the ultimate displacement of Class I sales that would otherwise be supplied through regulated sources.

This decision does not recommend that the producer-handler definitions be amended to include unique labeling restrictions. The rationale offered in support of establishing labeling restrictions offers interesting scenarios of the consequences that may arise without its inclusion. The scenarios speak to how the restrictions will provide better assurances that producer-handlers cannot balance their Class I dispositions on the fully regulated market and cannot daisy-chain together to effectively circumvent otherwise intended regulation. This decision finds such an addition to either the producer-

handler or exempt plant definition to be overly proscriptive. The record lacks evidence, apart from theoretical constructions, demonstrating a reasonable need for its adoption. This recommended decision finds that producer-handlers with total Class I route disposition in excess of three million pounds per month enjoy significant competitive sales advantages because they do not pay the Class I price for raw milk.

While the adoption of a 3-million pound per month limit on total Class I disposition will not completely eliminate the impact of producer-handlers across the order system, it should result in a reduction in any current and future market disruption. It is also consistent with many of the positions detailed during this proceeding, and will likely prevent a significant increase in the magnitude of disruption observed in the marketing areas.

Ruling on Motions

A motion submitted on behalf of Nature's Dairy moved for review and reversal of the Administrative Law Judge's decision to exclude the testimony of a witness on behalf of a producer-handler, namely Nature's Dairy. The motion requested that the hearing be reopened for the purpose of cross-examination of the Nature's Dairy witness. New England Producer-Handlers Association *et al.* and AIDA joined Nature's Dairy and submitted motions to that effect. The presiding Administrative Law Judge denied the Nature's Dairy, New England Producer-Handler Association *et al.* and AIDA motions prior to certification of the record. This recommended decision concurs with the ruling of the Presiding Administrative Law Judge; accordingly, the motions submitted on behalf of Nature's Dairy, New England Producer-Handler Association *et al.* and AIDA are denied.

Rulings on Proposed Findings and Conclusions

Briefs and proposed findings and conclusions were filed on behalf of certain interested parties. These briefs, proposed findings and conclusions and the evidence in the record were considered in making the findings and conclusions set forth above. To the extent that the suggested findings and conclusions filed by interested parties are inconsistent with the findings and conclusions set forth herein, the requests to make such findings or reach such findings are denied for the reasons previously stated in this decision.

General Findings

The findings and determinations hereinafter set forth supplement those that were made when the orders were first issued and when they were amended. The previous findings and determinations are hereby ratified and confirmed, except where they may conflict with those set forth herein.

a. The tentative marketing agreements and the orders, as hereby proposed to be amended, and all of the terms and conditions thereof, will tend to effectuate the declared policy of the Act;

b. The parity prices of milk as determined pursuant to Section 2 of the Act are not reasonable in view of the price of feeds, available supplies of feeds, and other economic conditions which affect market supply and demand for milk in all marketing areas, and the minimum prices specified in the tentative marketing agreements and the order, as hereby proposed to be amended, are such prices as will reflect the aforesaid factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest; and

c. The tentative marketing agreements and the orders, as hereby proposed to be amended, will regulate the handling of milk in the same manner as, and will be applicable only to persons in the respective classes of industrial and commercial activity specified in, the marketing agreements upon which a hearing has been held.

d. All milk and milk products handled by handlers, as defined in the tentative marketing agreements and the orders as hereby proposed to be amended, are in the current of interstate commerce or directly burden, obstruct, or affect interstate commerce in milk or its products.

Recommended Marketing Agreement and Order Amending the Orders

The recommended marketing agreements are not included in this decision because the regulatory provisions thereof would be the same as those contained in the orders, as hereby proposed to be amended. The following order amending the order, as amended, regulating the handling of milk in all milk marketing areas are recommended as the detailed and appropriate means by which the foregoing conclusions may be carried out.

List of Subjects in 7 CFR Parts 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, and 1131

Milk marketing orders.
For reasons set forth in the preamble, 7 CFR parts 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, and 1131 are proposed to be amended as follows:

1. The authority citation for 7 CFR parts 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, and 1131 continues to read as follows:

Authority: 7 U.S.C. 601–674, and 7253.

PART 1001—MILK IN THE NORTHEAST MARKETING AREA

2. Amend § 1001.10 by revising paragraph (a) to read as follows:

§ 1001.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1005—MILK IN THE APPALACHIAN MARKETING AREA

3. Amend § 1005.10 by revising paragraph (a) to read as follows:

§ 1005.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1006—MILK IN THE FLORIDA MARKETING AREA

4. Amend § 1006.10 by revising paragraph (a) to read as follows:

§ 1006.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1007—MILK IN THE SOUTHEAST MARKETING AREA

5. Amend § 1007.10 by revising paragraph (a) to read as follows:

§ 1007.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1030—MILK IN THE UPPER MIDWEST MARKETING AREA

6. Amend § 1030.10 by revising paragraph (a) to read as follows:

§ 1030.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1032—MILK IN THE CENTRAL MARKETING AREA

7. Amend § 1032.10 by revising paragraph (a) to read as follows:

§ 1032.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1033—MILK IN THE MIDEAST MARKETING AREA

8. Amend § 1033.10 by revising paragraph (a) to read as follows:

§ 1033.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1124—MILK IN THE PACIFIC NORTHWEST MARKETING AREA

9. Revise § 1124.10 introductory text to read as follows:

§ 1124.10 Producer-handler.

Producer-handler means a person who operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, from which total route disposition during the month does not exceed 3 million pounds, and who the market administrator has designated a producer-handler after determining that all of the requirements of this section have been met.

* * * * *

PART 1126—MILK IN THE SOUTHWEST MARKETING AREA

10. Amend § 1126.10 by revising paragraph (a) to read as follows:

§ 1126.10 Producer-handler.

* * * * *

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition during the month does not exceed 3 million pounds;

* * * * *

PART 1131—MILK IN THE ARIZONA MARKETING AREA

11. Revise § 1131.10 introductory text to read as follows:

§ 1131.10 Producer-handler.

Producer-handler means a person who operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, from which total route disposition during the month does not exceed 3 million pounds, and who the market administrator has designated a

producer-handler after determining that all of the requirements of this section have been met.

* * * * *

Dated: October 15, 2009.

Rayne Pegg,

Administrator, Agricultural Marketing Service.

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