

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

**In the Matter of:**

**ARIZONA-LAS VEGAS AND PACIFIC )  
NORTHWEST MARKETING AREAS )**

**DOCKET NOS. A0-368-832  
A0-271-837, DA-03-04**

**BRIEF AND PROPOSED FINDINGS OF FACT  
AND  
CONCLUSIONS OF LAW**

**SUBMITTED JOINTLY BY**

**SHAMROCK FOODS COMPANY, SHAMROCK FARMS  
AND  
DEAN FOODS COMPANY**

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## I. INTRODUCTION

This Brief and Proposed Findings of Fact and Conclusions of Law is submitted on behalf of Shamrock Foods Company, Shamrock Farms Company and Dean Foods Company.

Shamrock Farms Company is a producer of raw milk in Arizona. Both Shamrock Foods Company and Dean Foods Company operate fluid milk plants, defined as handlers under federal milk marketing orders (“FMMO”). They acquire raw milk from dairy farmers known as producers. Federal orders require these handlers to pay uniform class prices for their milk, and through the producer-settlement fund, create a “blend price” payable to all producers that is also uniform as to all producers. “The uniform pricing for producers must be combined with a pooling system for handlers in order to avoid inequities.” *United Dairymen of Arizona v. Veneman*, 279 F.3d 1160, 1162 (9<sup>th</sup> Cir. 2002). The underlying rulemaking proceeding herein is a single issue proceeding that is exceedingly important because exempt producer-handlers are adversely affecting the market for milk in the Arizona and Pacific-Northwest marketing areas. This is creating the very inequities that the FMMO system is designed to prevent.

The proper treatment of producer-handlers is the single most important issue facing the federal order system today as it reaches to the very heart of the system –whether and how to assure uniformity by regulating some, or all, producer-handlers as handlers under the FMMO system. As will be conclusively demonstrated, the producer-handler regulatory exemption has no basis in the underlying statute and can and should exist, if at all, pursuant to historic administrative convenience justifications only. As such, proposals considered at the rulemaking hearing to restore equality and uniformity to the federal order system can and should be adopted immediately.

Under present federal milk order provisions, producer-handlers escape the uniform regulation required by the FMMO system. Today, separately or together, producer-handlers are significant competitors in at least the Arizona and Pacific-Northwest milk marketing areas. They can and do sell to major wholesale and retail outlets as price leaders. They can and do substantially affect the market for fluid milk products. They can and do have market sales removed from the regulated industry resulting in unequal treatment of the remaining competitors. They can and do negatively impact the prices paid to remaining dairy farmers. They can and do use other regulated or unregulated markets to “dispose” of their surplus in ways, heretofore unknown in the federal order program, such that surplus disposal is not only *not* a problem, but is actually an additional benefit. They thus benefit on both sides of the regulatory equation – not paying the same uniform class prices imposed on regulated handlers and not receiving the same uniform prices paid to producers. This undermines the regulatory system entirely and is counter to the purposes of the Agricultural Marketing Agreements Act (“AMAA”).

Moreover, the historic justification for USDA not regulating producer-handlers simply does not apply given the size and scope of these operations. And it is not as if the regulatory program in question were brand new or subject to a lack of clarity as to what is demanded by the statute. “Uniform” prices paid by all handlers to all producers has long been mandated. *U.S. v. Rock Royal Co-operative, Inc.*, 307 U.S. 533 (1939). Yet uniformity has been and is defeated completely by the present system that permits a certain “faction” to avoid full regulation while all others may not. Such lack of uniformity is not justified by the enabling legislation or the U.S. Constitution. It is precisely the kind of “faction” condemned by James Madison in the *Federalist Papers* [1787], no. 10 (“faction . . . adverse to the rights of other citizens, or to the permanent and aggregate interests of the community”):

To secure the public good, and private rights, against the danger of . . . faction, and at the same time to preserve the spirit and form of popular government, is then the great object to which our inquiries are directed.

*Id.*

In reality, the Secretary of the United States Department of Agriculture (“Secretary”) in recognizing the importance of this issue, could and should retrace her steps<sup>1</sup> and restore orderly marketing through the elimination of the statutorily unjustified producer-handler exemption entirely. Notwithstanding clear statutory instruction, proponents of uniform treatment are nonetheless prepared to recognize that administrative efficiency may still play a role in the Secretary’s decision-making (*i.e.*, that a genuine *de minimis* rule may be permissible). As such, proponents offered and support an alternative that would fully regulate producer-handlers, just like all other handlers when a specified volume (*e.g.*, 3,000,000 pounds per month) is surpassed. This bright line test would restore order in most circumstances (there would still be regulatory disruption as the result of not regulating smaller operations) and restore handler confidence in a system that depends not only on actual uniform treatment, but the perception of uniform treatment of the regulated industry. Failing that, regulated handlers will be faced with the following choices: continuing to comply with the regulatory program while others do not; joining the ranks of the favored few; or looking to enforce their equal protection and statutory uniform treatment rights as they may separately determine. The enormous question before the Secretary then is nothing short than a matter of survival for the FMMO system. The industry is watching and waiting (somewhat) with baited breath. Will the Secretary have the will and desire

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<sup>1</sup> Equal and exact justice to all men, of whatever state or persuasion, religious or political; peace, commerce, and honest friendship with all nations, entangling alliances to none. . . They should be the creed of our political faith, the text of civil instruction, the touchstone by which to try the services of those we trust; and should we wander from them in moments of error or alarm, *let us hasten to retrace our steps and to regain the road* which alone leads to peace, liberty, and safety. Thomas Jefferson, *First Inaugural Address* [March 4, 1801] (emphasis supplied).

to retrace her steps and fix the problem, or will the Secretary and industry through a failure of determination, lack of political will or misapplied legal analysis fail to fix this unjustified and extralegal regulatory loophole?<sup>2</sup> And if the regulatory loophole is not filled, “a house divided against itself cannot stand.” Abraham Lincoln, *Speech at the Republican State Convention, Springfield, Illinois* (June 16, 1858).

## II. SUMMARY OF CRITICAL FACTS

- Producer-Handlers at 3 million can have substantial impact on the market.
- Producer-Handlers selling to major retail customers that set the market price have substantial impact on the market.
- Large producer-handlers are few and can be regulated with administrative efficiency.
- Large producer-handlers in the west, particularly in Arizona have surplus disposal opportunities not available to smaller processors located in other areas.
- Regulatory Fact - California has been found by USDA to operate a system of marketwide pooling that provides the opportunity for returns to in-state and out-of-state dairy farmers that are a blend price, not a surplus disposal price; since May 11, 2004, by court injunction, California has been restored to its pre-1997 rules that permit out-of-state farmers, particularly those in Arizona and Nevada to receive a plant blend price at Class I operations.
- Provisions regarding sales of the same or similar product to the same customer are not adequate to regulate large scale producer-handlers selling to large scale retail customers when, for instance, the Secretary’s designees determine that each store is a retail customer rather than the integrated retail customer.
- The Heartland Dairy proceeding is distinguishable on the following grounds:
  1. Heartland was located in Central Arizona, not Western Arizona and did not have surplus disposal opportunities into California;
  2. Heartland balanced itself using regulated handlers through a store with common ownership;
  3. Sarah Farms has ability to bring in additional supplies of milk from its additional farms; and
  4. The proceeding was resolved and mooted after Heartland Dairy ceased operating as a producer-handler under the order thus undercutting the significance of any decision.

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<sup>2</sup> Or will Winston Churchill’s derisive commentary regarding Stanley Baldwin apply? “Decided only to be undecided, resolved to be irresolute, adamant for drift, solid for fluidity, all-powerful to be impotent.” *While England Slept* [1936].

**III. PROPOSED FINDINGS OF LAW**  
**THE LEGAL FRAMEWORK AND REGULATORY HISTORY**

*At sea it is good sailing to run before the gale, even if the ship cannot make harbor; but if she can make harbor by changing tack, only a fool would risk shipwreck by holding to the original course rather than change it and still reach the destination.*

*Cicero, Letters to His Friends (Ad familiares) (ed. Shackleton Baile , 20 (I 9)(emphasis in original)*

Shamrock and Dean Foods respectfully request that the Secretary reach the following conclusions of law pursuant to 5 U.S.C. § 557(c):

**A. The Agricultural Marketing Agreement Act Of 1937**

**1. “Uniform” class payments by handlers (including handlers that are also producers) to producers.**

The only place to begin this analysis and discussion of producer-handlers is the enabling legislation. At the outset, the unassailable legal fact is that there is no provision within the Agricultural Marketing Agreement Act of 1937 (7 U.S.C. § 601 *et seq.*) for any exemption whatsoever for any handler. In fact just the opposite is true. Prices shall be “uniform” as to “all handlers.” 7 U.S.C. 608c(5)(A). Congress did not say that prices “may” be uniform or “ shall be similar.” Congress did not say that such prices shall apply only to “some” handlers. Instead, from adoption of this provision, Congress directed that: “[s]uch prices shall be uniform as to all handlers” subject to an express list of limited “adjustments.” *Id.*

Commonly accepted rules of statutory construction require the plain meaning be applied to these words. *Texas Food Indus. Ass’n v. United States Dept. of Agric.*, 81 F.3d 578, 582 (5<sup>th</sup> Cir. 1996) (elementary rules of statutory construction require that “the words of a statute will be given their plain meaning absent ambiguity.”). Black’s Law Dictionary 1530 (6<sup>th</sup> ed. 1990), defines uniform: “[c]onforming to one rule, mode, pattern, or unvarying standard; not different at different times or places; applicable to all places or divisions of a country.” What is striking about this definition is that the term “uniform as to handlers” ought to mean the same thing as

“uniform as to all handlers.” The fact that Congress went out of its way to say “all handlers” after the word “uniform” leaves no room for doubt whatsoever under the statutory construction doctrine that all words in the statute are to be given their plain effect and meaning. *United States v. Menasche*, 348 U.S. 528, 538-539 (1955); *Coyne & Delaney Co. v. Blue Cross and Blue Shield*, 102 F.3d 712, 715 (4<sup>th</sup> Cir. 1996) (“Absent clear congressional intent to the contrary, we will assume the legislature did not intend to pass vain or meaningless legislation”). But Congress went a step further providing an express list of exceptions to the “uniform as to all handlers” rule. Congress provided a list of “adjustments.” Note again that the existence of the word “adjustment” as opposed to “exceptions” means that the initial calculation shall be uniform and then that uniform calculation is adjusted. The Black’s Law Dictionary definition for adjust is “[t]o determine and apportion an amount due.” Black’s Law Dictionary 43 (6<sup>th</sup> ed. 1990). For instance, two handlers (with identical uses of milk and all other things being equal except one handler’s plant is in Phoenix and the other plant is in Yuma) will pay a uniform class price adjusted only for the difference between the locations of the two plants (i.e., 25 cents per cwt – the difference between \$2.35 and \$2.10). Congress did not use the term “exception” anywhere in the statute.

Using standard rules of statutory construction (*Reiter v. Sonotone Corp.*, 442 U.S. 330, 338-339 (1979) (strained construction cannot rob words of their ordinary meaning or convert nouns into adjectives), the fact that Congress expressly defined a list of adjustments (rather than exceptions) and no where included an exemption or even a reference to producer-handlers, leads to the conclusion that no such exemption was contemplated. This doctrine “expressio unius est exclusio alterius” is defined as follows:

A maxim of statutory interpretation meaning that the expression of one thing is the exclusion of another. Mention of one thing implies

exclusion of another. . . . Under this maxim, if statute specifies one exception to a general rule or assumes to specify the effects of a certain provision, other exceptions or effects are excluded.

Black's Law Dictionary 581 (6<sup>th</sup> ed. 1990) (internal citations omitted). This leads to the conclusion that producer-handlers were never exempted by Congress from full regulation. But just to be certain, Congress added yet another term in another paragraph of 7 U.S.C. § 608(c)(5):

(C) In order to accomplish the purposes set forth in paragraphs (A) and (B) of this subsection (5), providing a method for making adjustments in payments, as among handlers (including producers who are also handlers), to the end that the total sums paid by each handler shall equal the value of the milk, purchased by him at the prices fixed in accordance with paragraph (A) hereof.

Leaving to the next section in this Brief the definition of the term “purchased by him,” Congress’ inclusion in the minimum price setting (and pool creation) of “producers who are also handlers” reinforces the only conclusion that producer-handlers will be subject to the same regulation as handlers who are not producers. Else the language in the parenthetical must be read out of the statute. And, again, under standard, uncomplicated rules of statutory construction, every word is to be given effect and meaning. *Menasche, supra*.

## **2. The Secretary’s Administrative Convenience Exemption Of Producer-Handlers.**

So just where does the producer-handler definition come from since it is clearly not authorized by statute? The simple answer is that it has evolved from the rule “de minimis non curat lex” – literally “[t]he law does not care for, or take notice of, very small and trifling matters.” Black’s Law Dictionary 431 (6<sup>th</sup> ed. 1990). Or as Cicero might have noted: “cui bono fuerit.”<sup>3</sup> It was to the advantage of the Secretary and even the regulated industry not to bother with those processors who were *de minimis*. And that is precisely what happened in the beginning of the federal order program. The USDA publication *Early Development of Milk*

<sup>3</sup> “To whose advantage was it?” *Pro Milone*, IV, 11.



*Marketing Plans*, Marketing Research Report No. 14 (May 1952) (an official publication of the Secretary and not produced for this proceeding more than 50 years later), makes abundantly clear that administrative difficulties in the early years prevented USDA from pursuing small processors (who at that time were almost all also producers). Three hundred and thirty five producer-distributors (the alternative term for producer-handlers) represented 50% of the Greater Kansas City sales area. *Id.* Imagine without computers and all of our other technology that has developed since then how impossible this made any enforcement of the program. Even then, legal critics (within the Department itself) recognized that the exemption was unfair to the other dairy farmers and **discriminated** against those distributors who were subject to the order. *Id.* p. 39.

Thus, the USDA created “exemption” has no statutory basis and must be understood in the context of the *de minimis* rule. And the Secretary knows (or should know) that this is the real rule since her predecessor enunciated it in 1965:

The need for regulating producer-handlers in this [Puget-Sound] market has been considered at a public hearing on previous occasions. At those times, it was not found necessary to pool and price the milk of such persons to achieve the purposes of the statute authorizing Federal orders. *It should be made clear at this point, however, that the Secretary is empowered by the Act to impose through an order regulation of producer-handlers in their capacity as handlers, if justified by prevailing market conditions.*

30 Fed. Reg. 15152, 15154, c. 2-3 (December 9, 1965) (emphasis supplied). Without using the phrase, the Secretary applied a *de minimis* exception to the general rule for uniform pricing. Moreover, as discussed in Exhibit 18 (letter from Attorney Syd Berde to USDA in 1996), the legislative history (since the clear statutory language leaves no room for doubt resort to such history is unnecessary, but perhaps instructive) corroborates this analysis. Handlers who were also producers were expected to pay just like any other handler: (1) if they had an impact on the

market (1933 Agricultural Adjustment Act (“AAA”)); or (2) as a hard and fast rule (1935 and 1937 AMAA).

But the opponents of regulation point to oft repeated Congressional statements in a number of AMAA amendments: “The legal status of producer-handlers under . . . the [AMAA] shall be the same after the amendments made by this title take effect as it was before the effective date of such amendments.” So what? Leaving aside the fact that the language has not been included in the last two Farm Bills (such that if the language did mean something that meaning has been reversed), the language is nothing more than a statement that the AMAA is not amended as to producer-handlers. Since the original AMAA clearly contemplated regulation of producer-handlers just as all handlers, the statement has no legal bearing on today’s proceeding.<sup>4</sup> If anything it reinforces, as Mr. Berde noted in his 1996 letter, Chester R. Davis (the original Administrator of the AAA from 1933): “If the volume is large enough to be an important factor in the market, then they would be expected to come under the market plan.” Hearings on H.R. 5585, 74<sup>th</sup> Cong. 1<sup>st</sup> Sess. at 14. “If . . . he became a large enough commercial operator he would have to be subject to the same regulation.” *Id.* at 44.

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<sup>4</sup> In this regard, the author of this Brief confesses error from the past. The actual words of Congress do not constitute a recognition of the exemption and are merely a restatement that their status is “unchanged.” Unchanged from what? Unchanged by the statute from the fact that uniform pricing applies to all handlers. The provision merely is an expression that nothing in that particular enactment affects producer-handlers. But it does not create an exemption either. In this respect, and with all due respect to the Secretary, the statement in Federal Order Reform that gives this statement more credence is also wrong. See 63 Fed. Reg. 16025, 16135, c. 3 (1999). Regardless, even if Congress was somehow blessing the “exemption”- the only exemption that could be blessed was *de minimis non curat lex*.

3. **“Sale of milk” as meaning “Acquired for marketing” - Rock Royal Co-op and its progeny.**

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The next complaint of the opponents and at least one of their experts is that producer-handlers cannot be said to “purchase” milk from themselves. This comment runs counter to the same legislative history referenced in Mr. Berde’s letter (Exhibit 18, incorporated by reference herein in its entirety) in which it was made abundantly clear on the floor that producers who were also handlers would have to participate just as any other handler. However, we need not rely merely on legislative history for this conclusion. Decades of case law reaches the same conclusion. The opponents’ assertion and the incredible assertion by an otherwise respected dairy economist flies in the face of all of this legislative history and case law (casting doubt as discussed below on the entire testimony of this once notable expert).

Opponents would thus have the Secretary ignore 50 years of case law. This they cannot do. In the early days of the federal milk order program, cooperatives that acted merely as their members’ agents, and did not take title to milk (as with almost all cooperatives today) in the sale of their members’ milk, asserted that they did not “purchase” milk under § 608c(5)(A) and (C). Thus, they concluded they were not required to pay minimum prices or account to any federal order equalization fund. But in language heretofore unknown apparently to opponents’ expert, the U.S. Supreme Court disposed of this argument: “[a]s here [§ 608c(5)(A)] used the word ‘purchased’ means ‘acquired for marketing.’” *United States v. Rock Royal Co-operative, Inc.*, 307 U.S. 533, 580 (1936). The cooperative was thus required to account to the equalization fund putting it on an equal footing with other regulated handlers.

Not surprisingly, an earlier rendition of producers who were also processors took umbrage at being regulated as handlers. However, the enabling statute also makes clear (beyond § 608c(5)(C)) that these persons are handlers. Section 608c(1) defines “handlers” as being

“processors, associations of producers, *and others engaged in the handling of any agricultural commodity* or product specified in subsection (2) of this section.” (Emphasis supplied). Thus, when a U.S. District Court in California was confronted with this issue it concluded that a brewer who consumed all of the hops which it grew in the brewing of its beer was a handler. *Acme Breweries v. Brannan*, 109 F. Supp. 116, 118 (N.D. Cal. 1952) (the specific exemptions for producers and retailers “indicates that it was intended that . . . regulation should fall upon those who do something with . . . hops other than to grow them or to sell them at retail.”).

The final piece of the overwhelming legal evidence supporting regulation remains Congress’ inclusion in § 608c(5)(C) of the special parenthetical “(including producers who are also handlers).” As interpreted correctly by both the Third and Fifth Circuits over 40 years ago, “[t]he more reasonable construction [of the section] is that the parenthetical phrase was meant to reach a producer-handler who handles or distributed milk which he himself produces.” *Ideal Farms, Inc. v. Benson*, 228 F.2d 608, 615 (3d Cir. 1961), *cert. denied*, 372 U.S. 965 (1963); *accord Freeman v. Vance*, 319 F.2d 841 (5<sup>th</sup> Cir. 1963), *cert. denied*, 377 U.S. 930 (1964).

Congress has known for 40-50 years that USDA’s interpretation (and the Court’s) was that producer-handlers could (and in many cases should) be regulated. Given Congress’ interest in the overall subject of the dairy industry and given the insertion of language regarding producer-handlers, if this interpretation were incorrect or the Court’s conclusion wrong, Congress has had plenty of opportunity to fix it. It hasn’t, and thus the Court’s construction must stand. *Burlington Indus. v. Ellerth*, 524 U.S. 742, 763-4 (1998) (Congress’ failure to alter legislation interpreted by earlier judicial decision, binds court to follow such previous judicial interpretation); *Neal v. United States*, 516 U.S. 284, 295 (1996) (“ . . . we give great weight to *stare decisis* in the area of statutory construction [because] ‘Congress is free to change this

Court's interpretation of its legislation."'), citing, *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977).

**B. The U.S. Constitution's Due Process And Equal Protection Clauses As Applied In *In Re: Kraftco, AMA Docket No. 4-15 (1974) Require Immediate Action***

Thirty years ago, the Secretary was faced with a similar uniform price problem.

Processors who purchased from a cooperative obtained "free" quality control work for raw milk while Kraftco, purchasing milk from independent farmers, paid the minimum price for milk, but then deducted a charge for the quality control work that it performed. The financial impact on the handlers was the same, and Kraftco argued that the financial impact on the producers was likewise the same. However, the market administrator filed underpayment notices against Kraftco, but served none on the processors receiving the milk from the cooperative together with the "free" quality control services. Kraftco responded by filing a 15-A proceeding asserting, *inter alia*, that the imposition on it of minimum prices resulted in non-uniform prices since its competitors received the same service for free. Thus, Kraftco argued the Secretary was improperly ignoring the statutory mandate to impose uniform prices in derogation of both the AMAA and the U.S. Constitution.

After Kraftco prevailed before the Administrative Law Judge, the Secretary appealed. The Judicial Officer (who at various times described himself as the *alter ego* of the Secretary), in the only recorded instance of its kind in the history of the much litigated federal order program, issued a Tentative Decision and Order vacating the underpayment notices and remanding the proceeding back to the Administrative Law Judge. *In re: Kraftco Corp.* AMA Docket No. M 4-15 (January 7, 1974). The case then settled largely, if not entirely, on Kraftco's terms. The question is why? Because the Judicial Officer recognized that the uniform pricing and payment provisions were not being uniformly enforced. Even though the general rule is that Kraftco

could not defend on the grounds of others' failure to abide by the law, the Judicial Officer recognized the fundamental unfairness of the situation and in striking language applicable to today's situation concluded:

However, if through a mistaken interpretation of the Order, or otherwise, the Market Administrator enforced the Order properly only against one handler, or a small number of handlers, and failed to enforce the Order properly against most of the handlers subject to regulation, a serious question would arise under the Due Process Clause of the Fifth Amendment to the Constitution and under the uniformity provisions of the Agricultural Marketing Agreement Act of 1937.

To use an extreme illustration, if the uniform minimum Order price required to be paid for the month of January 1970 was determined by the Market Administrator to be \$5, but all handlers paid producers only \$4.98; and the Market Administrator sent an underpayment notice only to one handler in the market; that would raise a serious question under the Due Process Clause and under the uniformity provisions of the Act.

*Id.* at 100. The Judicial Officer concluded, as a matter of law, that a difference of 2 cents per cwt or 0.4% of the total price not being paid by all handlers was *an extreme* illustration of a non-uniform price. This 2 cents per cwt is far less than the actual amounts in controversy today in this proceeding and compares favorably to Mr. Paul Christ's discussion (addressed more fully below) that a one cent per cwt impact on the pool is significant.

But the Judicial Officer, in this decision, went even farther. The Secretary (through the Market Administrator) had argued that there was nothing wrong with the producers performing the quality control work themselves or hiring someone on their behalf to perform those services. As applied to this proceeding the Judicial Officer's rebuke to the Secretary (his *alter ego*) is a knock-out punch to the opponents herein:

If the Market Administrator were correct . . . then producers could themselves perform any other handler function, or hire someone else to perform any other handler function without violating the

Order's minimum price requirements. Carrying that view to its *ultimate extreme, the producers could completely run a handler's milk plant*, substituting themselves for the handler's employees engaged in processing or distributing milk; or the producers could hire someone else to perform all of such handler's functions, without violating the Order's minimum price requirements.

Such a construction of the Act and Order would completely destroy the uniformity of pricing required by the Act. The Agricultural Marketing Agreement Act expressly requires that all handlers be treated uniformly under a milk Order. The Act requires all Orders to fix 'minimum prices for such use classification which all handlers shall pay \* \* \*. Such prices shall be uniform as to all handlers' (7 U.S.C. 608c(5)(A)). The Act also provides for the 'payment to all producers and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered' (7 U.S.C. 608c(5)(B)(ii)).

'The Congressional policy of uniformity of pricing as expressed in sections 8c(5)(A), (B) and (C) of the act is applicable to all handlers subject thereto unless expressly exempted by the provisions of the act. A handler is not to be allowed to gain a competitive advantage by virtue of a disregard of the minimum uniform pricing provisions of an order.' *In re Bay State Ice Cream Company*, 23 Agric. Dec. 1043, 1055 (1964).

*Id.* at 95-96 (italics emphasis supplied). And yet, Sarah Farms has been permitted to substitute for the handler's functions and has been allowed to gain a competitive advantage by virtue of a disregard of the minimum pricing provisions of the order. The Secretary's Judicial Officer's decision 30 years ago was right then and, if applied now, cries out for implementation immediately of a realistic limitation on producer-handlers.

Therefore, the failure of the Secretary to implement and enforce the uniform pricing provisions violates the AMAA and the due process and equal protection clauses of the United States Constitution. The failure of the Secretary to act, especially in light of the proposed findings of fact below, would also sound disturbingly like *Kraftco* in light of the obvious

discrimination arguments.<sup>5</sup> Nonetheless, the Secretary's failure to act after this hearing (if not already based upon certain failures of the Market Administrator to enforce the common customer provisions of the Order 131 Marketing Area. Tr. 133-134 (William Wise) and 558 (Mike Krueger) would demonstrate beyond peradventure that there is no intention to implement and enforce minimum pricing provisions against proponents' competitors (particularly Sarah Farms); and therefore, Shamrock and Dean would be actively discriminated against at that time. There is nothing in the AMAA that permits this result.

The uniformity requirements of the Agricultural Marketing Agreements Act would be rendered null, void and meaningless if the Secretary (or a Market Administrator) is permitted by mistake, or otherwise, to enforce one provision or another against only one handler or a against only a group of handlers. *Kraftco* at 100. Ultimately the federal order system stands for uniformity, and a lack of uniformity caused by the very officers sworn to implement and enforce it would render the program meaningless.

The constitutional arguments are no less formidable to the opponents' position. As early as 1886, the United States Supreme Court has consistently and repeatedly held that the government cannot be permitted to enforce its laws with an unequal hand so as to discriminate between persons in similar positions to their detriment. In *Yick Wo. v. Hopkins*, 118 U.S. 356 (1886), an unanimous Supreme Court struck down enforcement against Chinese operators of wooden laundries of a San Francisco ordinance which made it unlawful to operate a laundry without the consent of the board of supervisors except in a brick or stone building. Not

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<sup>5</sup> For instance, like *Kraftco*, proponents are prepared, absent evidence to the contrary, to assert that they believe that the Secretary has acted or failed to act regarding producer-handlers under the mistaken belief that minimum payments to and by producer-handlers can be treated differently (or not regulated fully) than minimum payments by Shamrock and Dean to their dairy farmers (including Shamrock Farms, a corporation related to Shamrock Foods). Therefore, they conclude that the Secretary as in *Kraftco* has acted and is acting without actual malice. Discrimination in this legal setting does not necessarily equal actual malice, but it is nonetheless pernicious and proscribed.



surprisingly given that era and the discrimination against Chinese, the only facilities against whom the ordinance was ever enforced were Chinese. All but ten of the 320 facilities in San Francisco were wood. Only the 240 Chinese owned wooden facilities were subject to enforcement actions of the city while the 70 other wooden laundries were left undisturbed. The court first easily disposed of the spurious argument that aliens (like corporations) were less protected. "The rights of the petitioners. . . are not less because they are aliens and subjects of the emperor of China." *Id.* at 368.

The Court next disposed of the enforcement against one class of persons only:

In the present cases, we are not obliged to . . . pass upon the validity of the ordinances complained of, as tried merely by the opportunities of their terms afford, of unequal and unjust discrimination in their administration; for the cases present the ordinances in actual operation, and the facts shown establish an administration directed so exclusively against a particular class of persons as to warrant and require the conclusion that, whatever may have been the intent of the ordinances, as adopted, they are applied by the public authorities charged with their administration, and thus representing the state itself, with a mind so unequal and oppressive as to amount to a practical denial of that equal protection of the laws which is secured to the petitioners. . . . Though the law itself be fair, yet, if it is applied and administered by public authority with . . . an unequal hand, so as practically to make unjust and illegal discriminations between persons in similar circumstances, material to their rights, the denial of equal justice is still within the prohibition of the constitution.

*Id.* at 373-374.

Proponents are persons entitled to U.S. Constitutional protection with respect to these equal protection and due process arguments. *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (state may not lawfully impose greater tax burden on out-of-state corporation as opposed to in-state corporation). Just as Metropolitan Life could not be taxed by Alabama as a non-resident corporation differently from a resident corporation, the Secretary may not continue to

cause proponents to pay minimum prices or contribute to the federal order equalization fund when their competitor does not face the same obligations merely because the competitor is both a producer and a handler. In fact, Shamrock could merely reorganize if this were so and acquire its milk from the producer side and then avoid obligations. The statutory analysis above, however, demonstrates that there is no legal basis for the producer-handler exemption, thus thrusting the equal protection and due process claims to the fore.

Since the AMAA requires all handlers, including producers who are handlers, to make payments to the equalization fund, the opponents are incapable of making any kind of showing regarding a rational basis for any continuing discrimination against Shamrock, Dean, Kroger, Safeway and Wilcox Farms. See *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359-360 (1973); *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 526-527 (1959). Based upon the underlying legislation and discussion regarding the statutory authority above, the dual treatment of handlers and producers who are also handlers cannot be sustained by the underlying legislation or the U.S. Constitution. *Western & Southern Life Ins. Co. v. State Board of Equalization of California*, 451 U.S. 648, 674 (1981).

**C. “Uniform” Application Or Treatment Under Other Federal Regulatory Programs**

It comes as no surprise that other regulatory programs involving price or rate setting with similar statutory mandates regarding uniform pricing have reached litigation results that bolster the arguments made above. This is important because the dairy industry tends to think of itself in isolation from the remainder of the legal world, because it is not. The same principles apply in American jurisprudence generally. The most striking example is the Federal Energy Regulatory Commission (“FERC”) which is charged with rate setting for electrical and gas companies delivering service through common or company owned lines or pipelines. In its rate setting, FERC is mandated to require that customers be treated uniformly. So for instance, when a power

company attempted to charge new customers for the cost of expansion of service, the D.C. Circuit affirmed a FERC order that allocated the costs of expansion across all pipeline capacity so that the unequal treatment would not inure a benefit solely based upon how long customers had been receiving gas. *Battle Creek Gas Co. v. Federal Power Comm'n*, 281 F.2d 42 (D.C. Cir. 1960).

Similarly, FERC rejected a gas company's method for service interruption which would have only interrupted direct, not indirect customers. The direct customers had brought a claim of discrimination before FERC and the Commission agreed. *See Sebring Utilities Comm'n v. Fed. Energy Regulatory Comm'n*, 591 F.2d 1003 (5<sup>th</sup> Cir. 1979). A notable exception in differential treatment under FERC rules is actually supportive here. In *Newark, New Castle & Seaford v. Fed. Energy Regulatory Comm'n*, 763 F.2d 533 (3d Cir. 1985), differential treatment of cooperative and municipal customers was found permissible on the grounds that the differential treatment was temporary and there was no evidence of competitive harm. But the producer-handler exemption has been hardly temporary and as discussed in the Findings of Fact cannot be shown to have "no competitive harm." Note that under FERC rules the burden appears to have been on FERC and the supplier to establish that there was no competitive harm since uniform treatment is the rule and the exception must be justified. While the court in *Newark* does not expressly so hold, it would appear that the justification in this instance is merely a restatement of *de minimis non curat lex*.

In at least one other regulatory setting involving an extreme example, the equal protection doctrine has been applied. *Bannum, Inc. v. Louisville*, 958 F.2d 1354 (6<sup>th</sup> Cir. 1992) (holding that it was unconstitutional to require landowner to obtain special use permit to operate a landfill employing felons, where other landfills were not required to obtain such a special use permit).

*See also Massachusetts v. Daley*, 170 F.3d 23 (1<sup>st</sup> Cir. 1999) (holding that federal state-by-state quota system for limiting amount of fish caught unlawfully discriminated (no mention of equal protection), noting that no scientific data supported state-by-state quota and that quota actually harmed state that was intended to be benefited). Here the producer-handler exemption as presently set forth in current order provisions, despite the plain statutory requirement for uniform treatment of all handlers and producers, harms Shamrock Farms and other dairy farmers, all of whom are intended beneficiaries of the program. Under *Daley*, the present exemption is unlawful.

Nothing in this discussion can change the plain meaning of the AMAA; however, the Secretary and the industry need to recognize that uniform treatment of all regulated industry players is a central and prevalent theme in American jurisprudence. It is long past time to treat producer-handlers, at least those with significant retail customers, uniformly as required by statute.

**D. Disorderly Marketing Conditions**

The Secretary is obligated to maintain orderly marketing conditions. 7 U.S.C. § 602(1). At its most fundamental core, non-uniform prices among handlers has created a disturbingly disorderly marketing condition. This is nothing more than a statement that handlers who affect the market must be regulated in order to meet both the uniform pricing and orderly marketing conditions goal.

Nor do we have to reach far back in the history of federal orders to find the Secretary agreeing with this concept. Most recently as to an unique regulatory provision that existed in the then Western order, processors found themselves able (and did) to purchase milk for Class I needs at less than federal order minimum prices. When this issue was presented at a hearing, the Secretary had no difficulty concluding that these relatively small (1 to 1.5 million pound per

month) operations *must* be treated equally. “The record evidence also provides strong evidence that the *Proprietary bulk tank handler* provision gives rise to disorderly marketing conditions because the order is unable to establish minimum prices that are uniform among regulated handlers, a requirement of Section 608c(5) of the AMAA.” 68 Fed. Reg. 49375, 49383, c.2 (August 18, 2003 – Tentative Decision regarding Pacific-Northwest and Western Marketing Orders). That is to say, lack of uniform class pricing among handlers equals disorderly marketing conditions.

Under the circumstances discussed in the Proposed Findings of Fact that follow, proponents urge the Secretary to make a legal finding that there is a lack of uniform prices among handlers. This ought to be a foregone conclusion since a producer-handler has “[t]he incentive . . . [of] the additional return which he may receive by marketing his production through his own processing and distribution facilities rather than through a regulated handler. The blend price . . . of the market represents the return that he as a producer may expect for his milk under the order. . . [A] producer handler would have available the price differential between the utilization value of his own production and the order blend price which he could retain to enhance his returns as a producer or, as a handler, could use as a price incentive to maintain or increase fluid sales.” 30 Fed. Reg. at 15154, c. 3 (December 9, 1965 – Puget Sound Order). In other words, by definition there is a lack of uniform pricing that gives the producer-handler an advantage over his producer and handler competitors. And, leaving aside for a moment the *de minimis* exception, this is disorderly marketing. Thus the Secretary cannot permit disorderly marketing to continue without violating yet another section of the AMAA.

## **E. The Proposed Limitation As Applied To The Law**

And so the proponents have proposed a “hard cap” or bright line test for determining when the perhaps permissible *de minimis non curat lex* should apply and when it should come to an end.<sup>6</sup> This is not actually a request to change the regulations or the application of the law *per se*, rather it is and ought to be viewed as an attempt to properly apply existing law. The exemption is not found in the statute and thus it exists as an extra-statutory creature that can and should be adjusted based upon any evidence that the *de minimis* threshold has been crossed. The other changes proposed are linguistic in an effort to deal with specific situations that plainly suggest that a producer-handler has crossed the line into the competitive arena of regulated handlers. But as discussed below, proponents have no illusions that the proposed linguistic changes will work precisely because there appears to be an inability or indecision by employees of the Secretary to enforce those rules as presently written (e.g., the same product sold in the same store for the same month limitation does not appear to cause anyone at USDA any alarm – Tr. 558 (Michael Krueger)).

So the central thrust is a bright line test that makes the rules clear for everyone, and proponents have chosen and justified at the hearing and in this and other briefs a limit of **no more than 3,000,000 pounds per month**. The justification for a bright line test is precisely a restatement of what it is, a cross-over from *de minimis* to competitive harm. For all the

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<sup>6</sup> Proponents do not concede that the *de minimis* exception actually ought to exist at all. Moreover, it is interesting to note that in 7 C.F.R. § 1000.8(e)(4), the Secretary has adopted a 150,000 pound a month rule as to exempt plants that are not producer-handlers. During Federal Order Reform, the Secretary expressly stated that such plants “because of their size, do not significantly impact competitive relationships among handlers in the market. This regulatory fact means that USDA has already for its part determined that the *de minimis* rule applies up to 150,000 pounds. The exemption should (and does as to non-producer-handlers) end there. As discussed in the statutory analysis, there does not appear to be a legal justification for treating a 1,000,000 pound non-producer-handler differently than a producer-handler. With the hearing notice as it is, the only way to address this issue would be to limit all producer-handlers to the same 150,000 pound threshold. However, proponents are not actually urging this result so much as recognizing that pursuant to *Alto Dairy v. Veneman*, 336 F.3d. 560 (7<sup>th</sup> Cir. 2003), it would be permissible.

foregoing legal reasons and all the subsequent facts, the 3,000,000 pound limit (as a maximum threshold) is wholly justified.

#### **IV. PROPOSED FINDINGS OF FACT**

*Facts are stubborn things; and whatever may be our wishes, our inclinations, or the dictates of our passions, they cannot be alter the state of the facts and evidence. John Adams, Argument in Defense of the [British] Soldiers in the Boston Massacre [Spring 1772]*

Shamrock and Dean respectfully request that the Secretary make the following findings of fact pursuant to 5 U.S.C. § 557(c):

##### **A. The Parties**

1. Shamrock Foods Company operates as a fully regulated handler under the Arizona-Las Vegas marketing area. Ex. 6, Table 1. Shamrock Farms Company operates a dairy farm with its milk acquired for marketing by Shamrock Foods. Both Shamrock Foods Company and Shamrock Farms Company are family owned businesses with common ownership. Tr. 534-535 (Krueger) and 643 (Norman McClelland). Another farm, Parker Farms, is owned and operated by another family member related to the owner of Shamrock Farms and Shamrock Foods. Tr. 643 (McClelland). The milk from Parker Farms is also acquired for marketing by Shamrock Foods. By definition under the regulations, when Shamrock Foods Company, as a fully regulated handler, acquires raw milk from its related farms, it must pay those farms the applicable uniform price for the raw milk received. Tr. 537 (Krueger). Shamrock Foods also incurs an equalization fund obligation on that milk so acquired and pays such money to the equalization fund.

2. Dean Foods Company is a national dairy processing company with multiple plants throughout the United States. Tr. 655 (Ernest Yates). Dean Foods does not operate any fully regulated plants in either the Arizona-Las Vegas or the Pacific-Northwest federal orders. Ex. 6, Table 1 and Ex. 5, Table 1. Dean Foods does, however, operate plants outside these

marketing areas with sales into the marketing areas which are either partially regulated distributing plants (Ex. 6, Table 1 and Ex. 5, Table 1) or are other-order plants fully regulated by another federal milk marketing order (Ex. 6, Table 2 and Ex. 5, Table 2). In either case, Dean Foods is subject to the pricing provisions of a federal order and the pooling provisions of another federal order, a state order (California or Montana), or, at the date of the hearing, the state minimum pricing provisions of Nevada (Model Dairy). Tr. 655-656 (Yates) and Ex. 6, Table 2. Dean Foods Company is presently building a fluid milk plant in Las Vegas. Tr. 656 (Yates). That plant is being built primarily to service the rapidly growing Las Vegas metropolitan market. *Id.* At various times in the last 2 [now 3] years, Dean Foods has served Las Vegas from up to 6 plants. *Id.* Obviously, that is not an efficient system. The new plant will permit Dean Foods to streamline the service for Las Vegas. *Id.* Dean Foods also submitted plans to the Nevada Dairy Commission for their consideration that do not include the necessary equipment for standardizing milk to California's fluid milk standards. Tr. 656-657 (Yates). Dean Foods has no present intention, and no one within Dean Foods has seriously discussed the issue, to add such equipment. Tr. 656 (Yates). Therefore, that plant will not have the ability to serve the California market. Tr. 657 (Yates). However, that plant can and may well sell packaged fluid milk in Arizona. *Id.* Dean Foods certainly recognizes, for the equal raw product reasons discussed during this hearing, that that also poses an issue of fairness in competition. It is for that very reason, that Dean Foods wholeheartedly supports a legislative change that would require plants located in Nevada with sales into federally regulated territory to be treated identically to any other federally regulated fluid milk plant. *Id.*

3. Sarah Farms, owned and operated by Hein and Ellen Hettinga, operates a fluid milk plant in Yuma, Arizona as a producer-handler under Order 131. Ex. 6, Table 1. Various



exhibits and witnesses for proponents testified as to the size of the plant operation. While given the opportunity to contradict this testimony in its own direct and cross-exam, Sarah Farms provided no contrary data. Tr. 2617-2745 (Hein Hettinga). On the other hand, we do know the following: (1) in 1994, Sarah Farms told the Secretary that the farm produced 15,835,086 pounds over 90 days (averaging approximately 5.3 million pounds per month) and the plant produced 4,290,627 pounds of Class I milk over that same 90 day period (on average, 1.43 million pounds per month). Ex. 17. This 1.43 million pounds is approximately 2/3 of the 2,249,000 total producer-handler pounds on Order 131 for December 1994. Ex. 10. There was growth by December 1996 when the total producer-handler volume for the same three plants rose to 6,235,000. Ex.10. There is no reason to believe that the other two plants grew during this time and no one so testified. The data then becomes restricted as to producer-handlers.

**B. The Market Impact Of Sarah Farms**

4. The industry estimates of Sarah Farms' size are credible and uncontradicted by Sarah Farms. Even though the Secretary is unable, for legal confidentiality reasons, to provide restricted data as to total producer-handler volume, the industry has made their own efforts based upon data that is provided and sales information. United Dairymen of America ("UDA") as the chief dairy farmer competitor of Sarah Farms estimated that Sarah Farms volume is 18 million pounds. Tr. 147 (Jim Boyle). UDA further testified that using Ex. 9, the impact on the equalization fund was 10-14 cents per cwt over the period January 2000 through July 2003. Tr. 146-147 (Boyle). The post federal order reform losses to UDA could thus be measured at \$11.6 million compared to \$3 million for a comparable pre-federal order reform period. *Id.*

5. The losses to Shamrock Farms with 14 million pounds in the most recent 12 month period and Parker Farms producing 85 million pounds for the same 12 month period can also be measured at \$170,000 and \$100,000. Tr. 643-644 (McClelland).

6. Mr. Krueger for Shamrock provided the record with detailed information regarding contemporaneous sales information regarding Sarah Farms. Mr. Krueger is an experienced dairy salesman and plant manager. Tr. 534, 540-545 (Krueger). He knows the Arizona wholesale and retail market as part of his day to day duties. *Id.* and Tr. 573. His employees are charged with knowing the market and reporting to him. In many cases, Shamrock bid on the same business, had the business that was lost to Sarah Farms, took the business off of Sarah Farms, is in the same store with other products, or simply as a matter of sound business judgment did product reviews in stores where Sarah Farms had the product. Tr. 540-550 (Krueger). Even private label milk (e.g., store brand) can be and is examined for plant production purposes based upon plant codes that are state and plant specific. Tr. 539 and 550 (Krueger). Thus, the public and certainly this witness can always know what plant is actually supplying milk, making a store survey like the one done by Shamrock credible because the information is so readily obtained. Exhibits 22 and 23, created under Mr. Krueger's direction and control, are highly credible documents admissible under both the Federal Rules of Evidence and the more generous rules governing these proceedings. *See* Part XI, below.

7. Moreover, the data for 2001 corresponds (may actually be more conservative) to information released by the market administrator and found in Ex. 6, Table 11. For the month of March 2001, the Market Administrator published data for "other plants" that for the first time included producer-handler data. Comparing that data to either the year before for March (when producer-handler data was excluded) and for the immediately preceding month (February 2001) and adjusted for the difference in days reveals the following: an increase of 15.2 million pounds from March, 2000 to March, 2001 and an adjusted increase of 13.4 million pounds from February to March 2001. Ex. 6, Table 11. Obviously, inventory and product production based

upon pricing and timing issues can affect these numbers, but on average there is an increase of over 13 million pounds using other months as well. *Id.* With only one other producer-handler (and there is no suggestion in the record that that entity is significant) and the inclusion of producer-handlers being the only change in methodology for that column of data (Tr. 44-45 (John Mycrantz)), Sarah Farms must account for almost all of that difference. Tr. 574-575 (Krueger). Thus, it can be seen that an estimate of 17-18 million pounds for the size of Sarah Farms is entirely logical and reasonable.<sup>7</sup>

8. Mr. Krueger's testimony and Exhibits 22 and 23 provide a list of customers, a list of products (an incredible line of products for a producer-handler) and volumes for the customers together with a total volume. Tr. 540 *et seq.* (Krueger). For 2001, Mr. Krueger's gallon volume monthly estimates would put Sarah Farms at 12.5 million pounds (50% more than in 1997 for any data the Secretary would have had for federal order reform). Thus, logic dictates that Mr. Krueger's testimony is quite accurate. Mr. Krueger further testified about the enormous growth both in products and volume from 1997 to 2003, with very significant growth again occurring in 2002 and 2003. Tr. 567-569 (Krueger) and Exs. 22-23. Mr. Krueger's 2003 estimates for Sarah Farms volume, now including the important outlet of Costco and Sams Club, is in excess of 17.2 million pounds per month. Ex. 23.

9. The product line growth is in high volume and therefore bigger dollar items. Tr. 566-567 (Krueger). A producer-handler doesn't grow into this kind of product line from a "jugger" (gallon jug operator) without a real financial incentive. Tr. 566-570 (Krueger). That

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<sup>7</sup> Sarah Farms never provided its own data to counter the data submitted by UDA, Shamrock Foods, or the estimates calculated based upon Exhibit 6. Thus, proponents have more than carried any so-called burden of coming forward with evidence. Finally, the precise total number of pounds processed by Sarah Farms is not actually relevant. What is relevant is that it processes and sells in competition with regulated handlers a significant quantity of milk certainly well in excess of the proposed 3,000,000 limitation cap, and most certainly in excess of 15,000,000 pounds.

incentive is no secret. It is the failure to account for and pay equal raw product costs, the failure to account to the pool, and the failure to share revenues with other producers who don't have that Class I market. Tr. 562, 566, 572 and 578-579 (Krueger).

10. Mr. Krueger testified without contradiction that the disadvantage he faced in the marketplace based upon his years of experience in the industry, discussions with customers, accounting analysis, and business judgment is six to eight cents per gallon. Tr. 563-573 (Krueger). Shamrock has national customers which have "benchmark" pricing. Customers have thus reviewed Shamrock's direct costs (raw milk, processing direct costs and distribution only) for milk and have concluded that Shamrock cannot meet the direct costs of Sarah Farms. Tr. 564-565 (Krueger). The premium paid by Shamrock blended out over all of its milk can only account for a minimal amount of the difference (4-5 cents per cwt) as compared to six to eight cents per gallon (correctly stated as being 70-93 cents per cwt). *Id.* Thus, the only conclusion can be that Sarah Farms successfully uses its remaining 65-89 cent per cwt advantage out of its raw milk costs.<sup>8</sup> *Id.*

11. There have been significant changes in the Arizona-Las Vegas marketing area since federal order reform. Since federal order reform was published on April 1, 1999, almost certainly no data from 1999 was included. Thus Sarah Farms' doubling in Class I sales since 1998 (even assuming that data was used even though USDA's preliminary rule issued January 1998 did not include any proposal to deal with the issue) to 2003 could not have been known to the Secretary. In addition to the tremendous increase in size, the Secretary could not know in 1999 that Sarah Farms would build an associated facility (G&S Processing) for sales of fluid milk into California, thus providing a new opportunity for disposal of surplus milk in fluid form.

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<sup>8</sup> Mr. Hettinga for Sarah Farms performs the same analysis on his competitors and believes his analysis is correct. Tr. 2702 (Hettinga) ("not a big trick").

Tr. 569-572 (Krueger) and Tr. 659-660 (Yates). The change in customer mix from 1997 to the present must also be considered. While Sarah Farms was obviously already in the market, what was not known to the Secretary in 1999 (or earlier) was that large box stores or warehouse style operations would be major outlets for Sarah Farms milk. Tr. 235-237 (John Hitchell), 560-570 (Krueger) and Ex. 22. The Secretary did not know in 1999 that these stores are price setters for all retail outlets. Tr. 236-237 (Hitchell), 2625 (Hettinga) and 578 (Krueger). The Secretary did not know that integrated operations such as Kroger and Safeway would face price competition from Costco and Sams created by the producer-handler sales. Tr. 215-216; 235-237 (Hitchell), 560-575 (Krueger), 2625 (Hettinga) and Ex. 22. The Secretary could not know that these warehouse store operations could only sell their milk at the prices that they do based upon producer-handler sales at prices that cannot be matched by regulated handlers. Tr. 560-580 (Krueger). Indeed the Secretary did not know that the price difference, exceeding any over-order premiums paid in the marketplace, would be 6 – 8 cents PER GALLON. Tr. 573 (Krueger). The Secretary could not know that losses to the pool would increase by a multiple of almost four from the pre to post-federal order time period. Ex. 9.

12. By definition, an 18 million or 17 million or 16 million or 3 million pound producer-handler has a market impact. The \$0.10 impact (lower than the overall average) for the first 7 months of 2003 was 0.94% of the total uniform price paid to farmers. Extrapolating the impact from a 3,000,000 pound plant as being 1/6 the impact, that would have been 1.7 cents per cwt or 0.16% of the total uniform price. The Secretary's Judicial Officer in *Kraftco* determined as a matter of law that an *extreme example* of non-uniformity of price would be a difference of 2 cents per cwt equaling on that price level (\$5.00) 0.4%. *Kraftco, supra* at 100. The Judicial Officer had to be saying that as an extreme example 2 cents per cwt or 0.4% was not only non-

uniform, but was market disruptive. Otherwise he would not have concluded, as he did, that enforcement of the underpayment notices against Kraftco only was unlawful. *Id.* at 110.

13. Moreover, Mr. Paul Christ (testimony discussed at greater length below) testified that a one cent per cwt impact on the pool is significant. Tr. 1597 (Paul Christ). Alternatively, from the handler perspective, he endorsed Mr. Herbein's testimony (Tr. 1597-1598 (Christ)) that a half-cent a gallon impact (5.8 cent per cwt) impact on handlers is significant. Tr. 1597-1598 (Christ). Using "[t]he \$1.84 per hundredweight potential cost advantage of a producer-handler in the Arizona-Las Vegas market" results in a difference "31 times the \$0.005 level of significance." *Id.* "It is not negligible." *Id.*

14. The Secretary should not ignore the judicial history regarding her own program and should conclude that market impact must be less than the Judicial Officer's "*extreme example.*" Rather the 3,000,000 pound limit is consistent, if not higher than, levels of significance testified to by Mr. Christ. It is also 40% on a percentage basis and 80% on an absolute cost basis of the difference found to be extreme by the Secretary's Judicial Officer.

15. Kroger testified about the market disruption caused by Sarah Farms' being a producer-handler. Tr. 213 *et seq.* (Hitchell). As an integrated operation with retail store outlets, Kroger knows first hand that the customers of Sarah Farms are able to offer milk at prices based upon Sarah Farms' financial opportunities resulting from its failure to pay equal raw product costs. Tr. 214-216 (Hitchell).

16. Shamrock and Sarah Farms are the only significant fluid milk plant operations located in Arizona that do not have their own "captive" stores. Tr. 538 (Krueger). As a result, Shamrock and Sarah Farms go head to head in competition for private label business and independent store operators. *Id.* Shamrock thus knows, because Mr. Krueger makes it his

business to know, what prices are causing business to move to Sarah Farms. Tr. 546 and 563 (Krueger). Moreover, both Mr. Krueger and a customer served by both Shamrock and Sarah Farms testified that Shamrock's milk quality is excellent (Tr. 557 (Krueger) and 3063 (Tom Swanson)) and that it is price that drives Sarah Farms' business. Tr. 563-5699 and 573 (Krueger). Shamrock has lost business to Sarah Farms based upon Sarah Farms' pricing. Tr. 562 (Krueger). Shamrock has been unable to pick up business held by Sarah Farms because of Sarah Farms' pricing. Tr. 563-573 (Krueger). Shamrock is unable at its direct cost to compete with Sarah Farms' pricing. Tr. 570-573 (Krueger).

17. A customer of both Sarah Farms and Shamrock insisted on the need to have two suppliers (in only some stores of course). Tr. at 3061 (Swanson). Of course, one of these suppliers is a producer-handler. By definition, there is balancing going on to the detriment of the pool producers.

18. On the very last day of the hearing, Mr. Krueger reviewed a price offer from Sarah Farms to Veterern's Market. Exs. 62-63. This exhibit was presented by UDA, not Shamrock, and Mr. Krueger reviewed it for the first time on January 21, 2004 (the day before). Tr. 3087 (Krueger). For the particular month the price offered to this relatively small account (Tr. 3089 (Krueger)) was \$1.73 per gallon. Tr. 3087 and Ex. 63. Mr. Krueger performed an analysis of the raw milk costs and other direct costs (that have been benchmarked as being as low or lower than anyone in the country – Tr. 3091 (Krueger)) and concluded that he would be unable to price milk at that account at that level. Tr. 3086-3091 (Krueger). This alone establishes disorderly marketing when a regulated handler cannot even bid on business against a producer-handler.

19. The only conclusion that can be drawn, and the Secretary should draw this conclusion, is that Sarah Farms is able to use its producer-handler status, including its ability to avoid paying equal raw product costs and its ability to dispose of surplus milk at far better than surplus milk prices, to disrupt the market.

20. Every sale in Arizona (or elsewhere for that matter) of Class I milk by Sarah Farms is a sale that can and should have been part of the regulated market. The blend price loss is the measure of this loss, but the loss is very real nonetheless. Every pound that does not go into Class I that must now be disposed of as surplus by UDA adds to the burden carried by UDA and the remaining dairy farms such as Shamrock Farms and Parker Farms. Tr. 578-579 (Krueger).

21. Other examples of market disruption caused by relatively small or smaller operations in other orders are also instructive for purposes of market disruption consideration here. In Idaho, two relatively small (significantly smaller than 3 million pound) handlers were at the time of this hearing's beginning obtaining milk under the proprietary bulk tank handler provision unique to that order. Tr. 657 (Yates). As acknowledged in that hearing record by the handler involved, and as was clear from the competitive impact in the market, those Class I handlers (not producer-handlers) were receiving substantially all if not all of their milk at prices below federal order minimums. Tr. 657-658 (Yates). Dean Foods' plant manager testified at that hearing about the significant competitive impact and USDA accepted, correctly, that this constituted disorderly marketing. Tr. 658 (Yates). Dean Foods' plants in Idaho are larger than the Class I operations receiving below-minimum priced milk. *Id.* However, those operations running as jugger operations, realized significant benefits that permitted them to take away Dean Foods' customers and sales. *Id.* Lost customers and lost sales happen every day, but those



losses occurred at prices that simply could not be met by Dean Foods since it was paying regulated minimum prices. *Id.* USDA concluded that the provision should be eliminated:

The record evidence also provides strong evidence that the *Proprietary bulk tank handler* provision gives rise to disorderly marketing conditions because the order is unable to establish minimum prices that are uniform among regulated handlers, a requirement of Section 608c(5)(A) of the AMAA. The record clearly reveals that this pooling feature of the Western order is being used to pool milk that could not otherwise be pooled and allows for the sale of milk for Class I milk below the order's minimum Class I price. While this provision served its function in the pre-reform Southwest Oregon-Eastern Idaho, its purpose and usefulness for the larger consolidated Western order can no longer be justified.

68 Fed. Reg. 49375, 49383, c.2 (August 18, 2003) and Tr. 658-659 (Yates). Now is the time to take that decision's conclusion and logic, substitute the term producer-handler for proprietary bulk tank handler, and provide realistic limitations to producer-handlers who have or will in the future substantially disrupt the market order system just as the relatively small juggers in Idaho caused market disorder. Tr. 659 (Yates). As in the Western order proceeding, Dean Foods is not calling for elimination of the producer-handler provision, rather for its realistic limitation. *Id.*

22. Other relatively small fluid milk plants can be and are highly efficient and able to sell milk (as regulated handlers) in competition with larger operations. There is a relatively small fluid milk operation in Bryan, Texas, owned and operated by a family. The Bryan operation processes, packages and distributes in the Bryan, College Station, and Brenham, Texas areas. Most recently, this plant successfully bid on Texas State Prison business in Waco, Texas, Sugarland, Texas and Brazoria, Texas. It submitted a bid of \$0.1175 at the prisons for 1/2 pint 1% milk that was significantly lower than Dean Foods' bid per 1/2 pint. Tr. 660-661 (Yates).

23. Oak Farms (in Texas) lost over \$1.5 million in sales for the 2003-2004 bid year. In addition, Dean Foods lost a customer, A&M Consolidated ISD, to Lilly with a bid of \$0.1400

on 1% lowfat chocolate that was significantly lower than Dean Foods' bid on the same item.

Dean Foods lost additional sales that were replaced at Bryan ISD. Dean Foods is of the opinion that this Lilly plant is able to compete with Dean Foods because it has less overhead expense as a result of approximately 25 employees compared to Dean Foods' several hundred employees at Oak Farms Dairy/Houston, Texas. It is also Dean Foods' opinion that this operation is debt free on equipment, property and other assets. This operation packages Branded Gallons, 1/2 gallons, quarts, pints and 1/2 pints in their plant to distribute to grocery stores, C-stores, institutional accounts, schools and state business. Tr. 651 (Yates).

**C. Producer-Handler "Surplus" Milk Disposal**

24. There is no reason to believe that the Secretary considered (as an individual order issue as opposed to a global federal order reform issue) that producer-handlers in the west have unique opportunities to dispose of "surplus" milk either as packaged fluid milk (otherwise Class I to a regulated handler and intended for the benefit of the equalization fund) or in state orders at a blend price or even at a plant blend price to Class I operations in California. Sarah Farms admitted that some of its farms market or have marketed raw milk through a cooperative. Tr. 2669-2672 (Hettinga). Sarah Farms admitted that it has opportunities to dispose of milk in Mexico, California or even Texas. Tr. 2672, 2693-2694 (Hettinga).

25. When Sarah Farms disposes of milk from its multiple California farms (Tr. 2642 *et seq.* (Hettinga)) in California pool plants, it receives at least the overbase blend price for its milk. Tr. 317 (Mike Marsh). When Sarah Farms "disposes" of any non-California milk from its Arizona farms in California, it had the opportunity to receive, based upon contracts with the processors to whom it delivers its milk, a modified quota price for that milk. Tr. 319 (Marsh) and 662 (Yates) (may receive "a form of the blend price"). Sarah Farms follows the Class I price and meaning that it is benefiting from federal order pricing without sharing in the cost of the

pool. Tr. 2691 (Hettinga). As of May 11, 2004, when United States District Judge Garland Burrell issued a permanent injunction, *Hillside Dairy v. Lyons*, 317 F. Supp. 3d 1194 (2004), Sarah Farms has the opportunity to receive as much as the plant blend price at a Class 1 facility (essentially the Class 1 California price) for its milk. *Official Notice of Judicial Decision Requested*.

26. There is a new operation related to Sarah Farms, G&S Processing, operating out of Yuma, Arizona. Tr. 569-571 (Krueger) and 659-660 (Yates). This new, large unregulated fluid milk plant is now operating in western Arizona and selling all (or nearly all) of its packaged fluid milk direct to a customer in California. This hearing will not resolve that issue, but the fact of its existence is raised to point out the impact on California's regulated industry from this large unregulated milk plant. Since it began selling milk in Southern California in early June, it has expanded its sales from the San Diego market northward. Dean Foods' Swiss Dairy lost the business solely on the basis of price, a price that could only be based upon the fact that while Swiss Dairy pays regulated prices in California, this operation does not. This serious disruption has substantially undermined both the minimum uniform prices paid to dairy farmers in California and the competitive market for fluid milk processors. To the knowledge of hearing participants, this operation remains smaller than the existing producer-handler in Arizona, so it is not at all surprising to hear the significant testimony here about the disruption caused by the large producer-handler in this Arizona market. Tr. 660 (Yates). This plant also creates a new opportunity for Sarah Farms to dispose of its "surplus" milk in fluid form, or to balance itself, it is capable of acquiring for marketing raw milk from its own or other farms to balance that and the Sarah Farms plant combined. Tr. 2642 *et seq.* (Hettinga).

27. From its' ideal location in Yuma, Arizona, Sarah Farms has permanently solved any surplus disposal issues. The Secretary should find that an operation exceeding 3,000,000 pounds in Arizona can and does have no surplus disposal issues (indeed, can actually make even more profits on so-called surplus).

28. An efficient plant at 3 million pounds can certainly compete very effectively against Dean Foods and Shamrock. Tr. 661 (Yates) and 640-670 (Krueger). A producer of that size is in the top ½ of 1% of the producer size in this country. Tr. 661 (Yates). Dean Foods opines that such an operation is likely to be extremely efficient. *Id.* Indeed in the Arizona market area, such an operation has significant opportunities to dispose of its surplus milk in packaged form in Mexico or as bulk milk to California where it will receive a form of the blend price. Therefore, the costs of surplus disposal in this market are minimal. Indeed, surplus milk can, we believe, result in the opposite of a disposal cost in the west. Tr. 662 (Yates). Moreover, Mr. Christ testified that these kinds of producer-handlers have surplus disposal costs certainly no higher than and likely lower than other producers. Tr. 1602-1603 (Christ).

29. Pacific-Northwest producer-handlers also have California, Canada and Alaska available to them. Alaska is a prime source of "surplus" disposal as what would otherwise be classified as Class I milk. Tr. 2551-2552 (Duane Bransma). The Secretary should determine that producer-handlers in the Pacific-Northwest also have no surplus disposal issues.

**D. A Comment On Witnesses**

The Secretary must consider the credibility and value of witness testimony. Prepared statements subject to cross-examination have long been a staple of these rulemaking proceedings. However, the role that the witness plays in preparation of testimony and the role that the attorney or consultant plays for factual testimony is important. Mr. Krueger testified without a prepared statement in a true "courtroom style" direct examination where he and his

counsel had a conversation in which the witness truly testified. At the other extreme, the Sarah Farms' testimony was prepared and read into the record by counsel for Sarah Farms. Under the circumstances, this much was not terribly objectionable. But then on cross-examination it became crystal clear to all participants that the witness did not even understand the testimony that had been given on his behalf by his counsel. Tr. 2703-2706 (Hettinga). Mr. Christ wrote his testimony in its entirety subject to review and consultation with others. But it was his words. Tr. 1591 (Christ). Mr. Yates worked with others to write his testimony, but in the beginning and the end they were his words, not counsel's. The Secretary should find that the testimony of Sarah Farms was not wholly credible.

**E. The Risk Of Inaction**

30. For the Federal Order system to survive, plants need to be on a level playing field from a raw milk cost prospective. Historical understandings of producer-handlers no longer apply given their size, market position and ability to dispose of surplus milk. Today's producer-handlers are causing disorderly marketing. Tr. 662 (Yates).

31. If a large producer-handler's cost of disposal of surplus exceeded the advantage of not being regulated, it would not make any sense to remain a producer-handler. Tr. 577 (Krueger). Logically, then the Secretary should conclude that the very benefits discussed throughout this Brief and others (at least as to a plant like Sarah Farms, but realistically as to any plant larger than 3,000,000 pounds) must outweigh the cost of surplus disposal. Tr. 1602-1604 (Christ).

32. If changes are not made, the market will be further eroded and adversely affected. The more producer-handlers like Sarah Farms can do, the more they will do. The only way to survive in this environment is to take on the characteristics of the unregulated entity because the system will not permit a regulated entity within the system to survive. Tr. 578 (Krueger). If the

present set of circumstances remain in place, Sarah Farms will continue to grow at the expense of everyone else in the marketplace. Even the captive plants will have to evaluate their make and buy decision analysis. Tr. 579 (Krueger).

33. Dean Foods and Shamrock have lived within the system. Tr. 656 (Yates) and Tr. 579 (Krueger). They have believed in the system. They are attempting to fix, not undermine, the system. Tr. 656-663 (Yates) and Tr. 579 (Krueger). But if the Secretary takes no action, Shamrock will not be the only loser. Tr. 579 (Krueger). Perhaps Shamrock will not be a loser at all if it is forced to take alternative action. But the system will lose. Ultimately this [Arizona-Las Vegas] federal order is in jeopardy if it cannot resolve the uniform price to producers and paid by handlers issue because then only unregulated entities will be able to survive. Tr. 577-579 (Krueger).

## V. THE EXPERTS

*'When I use a word,' Humpty Dumpty said, in a rather scornful tone, 'it means just what I choose it to mean – neither more nor less.'*

Lewis Carroll, *Through the Looking Glass [1872], ch. 6 (emphasis in original)*

This Brief will comment on and briefly summarize six of the experts, although there were a number of experts who testified: (1) Paul Christ; (2) Carl Herbein; (3) Daniel Morrison; (4) Dr. Roger Cryan; (5) Dr. Ron Knutson; and (6) Joe Albright.

Paul Christ attended virtually every hearing session. He has over 40 years of experience working with federal milk orders with USDA, Land O'Lakes and today as a consultant. Mr.

Christ noted the purposes and objectives of Federal Orders and then concluded:

The critical features of these activities that insure the effectiveness and equity of Federal milk orders is that they be applied universally and uniformly. Without universality and uniformity, some participants in the market will enjoy competitive advantages over other participants that arise from regulatory laxity rather than from business acumen.

Tr. 1593 (Christ). He continued that there were several exemptions to the rule of uniformity, but noted that only one category (plants located in Clark County, Nevada) are statutorily permitted to be excluded from federal regulation (although they are subject to Nevada state regulation). Tr. 1593-1595 (Christ) and Nevada Revised Statutes Chapter 584 and Nevada Regulations NAC Chapter 584. *Official Notice Requested of the Statutes and Regulations of the State of Nevada, Chapter 584 and Marketing Areas and minimum prices issued pursuant to NAC § 584.5551 et seq.* He also corroborated the Secretary's own conclusions from 1965 (Puget Sound decision) that producer-handlers have a regulatory advantage that is equal to the difference between the local Class I price and the local blend price. Tr. 1594 (Christ). That gap was \$1.84 in 2002 for a producer-handler. Finally, and perhaps most importantly, Mr. Christ, after 40 years of experience as a raw milk marketer concluded that "anything more than \$0.01 per hundredweight reduction in the local blend price is not trivial." Tr. 1597 (Christ). That farmers respond and are sensitive to such price differences. *Id.* And that a \$0.005 cent per gallon difference in costs for handlers is also not negligible (based upon Mr. Herbein's testimony). *Id.* Note that Mr. Herbein's \$0.005 difference per gallon is actually higher than the Judicial Officer's conclusion in *Kraftco* that two cents per cwt (\$0.0017 per gallon) is significant (in fact, an extreme example) to a handler. The differences as to Order 131 are dramatic. Mr. Christ's conclusions would lead one to regulate a producer-handler at 950,000 pounds when considering the producer side of the equation (thus, a 3,000,000 pound limit would "permit" an even more significant difference of over 3 cents per cwt return). Alternatively, on the handler side, the 2002 difference of \$1.84 means that the producer-handler has an advantage of 31 times over the \$0.005 price level difference that is deemed significant. Tr. 1597-1598 (Christ). The 3,000,000 pound limit

certainly leaves significant leeway for a producer-handler in the Arizona-Las Vegas market. Mr. Christ's testimony was provided calmly, without rancor and was not contradicted by anyone.

Mr. Herbein, who attended significant portions of the hearing in addition to his own actual testimony, testified using both his existing database developed after many years of experience and audits and reviews of dairy companies and his years of providing expert testimony to the Pennsylvania Milk Marketing Board. Tr. 761 (Carl Herbein). In addition to concluding that \$0.005 per gallon was a significant price difference for handlers (a fact more than sufficiently corroborated by the Secretary's own Judicial Officer in *Kraftco*), Mr. Herbein testified about the various cost structures regarding plants of various sizes. Tr. 764-789 (Herbein). His testimony established (especially after thorough and credible review by Dr. Cryan) that 3,000,000 pounds was a true "break point" in handler costs analyses. Mr. Herbein's testimony established that Sarah Farms' sales to major box stores (*see Proposed Finding of Fact ("PFF") 8*) could only occur based upon prices that regulated handlers cannot possibly match. Tr. 764-789 (Herbein). Despite being mercilessly attacked for his testimony, Mr. Herbein stood his ground. Tr. 800 *et seq.* (Herbein). Perhaps most importantly, Mr. Herbein's chief "expert" opponent, Mr. Daniel Morrison, literally corroborated the most significant of Mr. Herbein's findings after having to correct substantially his testimony and "CPA generated" calculations not once, but twice after getting on the witness stand. Tr. 1909-1912 and 1919-1936 (Daniel Morrison). Mr. Morrison, like Dr. Knutson a short time later, showed up for the shortest possible time for the hearing. And it showed. Mr. Morrison's testimony, except to the extent that it ended up corroborating Mr. Herbein's (after his substantial corrections during both direct and cross-examination) (Tr. 1932 (Morrison)) should be wholly discounted by the Secretary.



Dr. Roger Cryan was, like Mr. Christ and Mr. Herbein, wholly credible. His analysis and commentary, coming as it did from someone who has actually served in USDA and had participated in Federal Order Reform undercut much of the opposition. The 3,000,000 pound cap is indeed reasonable when one examines his (admittedly somewhat complex) digression analysis. The 3,000,000 pound cap is also justified under Congress' recently adopted minimum threshold for payments to the Fluid Milk [processor funded] Promotion Program.<sup>9</sup> Dr. Cryan was unflappable and provided cogent testimony that only supports the adoption of the 3,000,000 pound cap.

Dr. Ron Knutson is a respected and well known dairy economist. For reasons that only his clients, or their attorneys, and he may be aware, the Dr. Knutson who showed up for this proceeding was ill prepared, unstudied, unwavering only in his error, and unyieldingly wrong. Dr. Knutson, an economist, based most, if not all, of his testimony and conclusions on the legal "fact" in his opinion that a producer-handler could not be made to pay money to the equalization fund for milk that he acquired from himself on the grounds that such milk was not "purchased." The existence of federal court opinions and USDA decisions to the contrary ("as used here the word "purchased" means "acquired for marketing" (*Rock Royal, supra*, at 580) were of no account to him. In fact, he had never bothered to read any of these decisions. In fact, he was unaware of the existence of these decisions. Tr. 2163-2194 (Ron Knutson). He was unaware that processors who happen to have their own farm milk, but not enough to qualify as producer-

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<sup>9</sup> 7 U.S.C. §§ 6401-6417; in particular 7 U.S.C. § 6402(4). That section, and the corresponding regulation 7 C.F.R. § 1160.108 (2004) issued pursuant to that section, provides an exclusion to fluid milk products for "fluid milk products delivered directly to the place of residence of a consumer." This is not an issue as to Sarah Farms, but appears to have been an issue for at least one of the producer-handlers in the Pacific-Northwest. If the 3,000,000 pound limitation is adopted, Congress' logic for excluding fluid milk products delivered directly to the place of residence of a consumer may well also make sense. Note that home delivery cannot be made through a third party (e.g., Giant Food in the Washington, D.C. metropolitan area delivers directly to residences through its "Peapod" operation and that kind of delivery is not contemplated by the statutory exemption. Thus, a producer-handler with 2,900,000 pounds of sales through commercial or distributor routes and 3,000,000 pounds of direct home delivery could nonetheless remain unregulated.

handlers have routinely for decades accounted to the various federal order pools for that milk. Tr. 418 (Paul Arbuthnot). In fact, after he was made aware of these decisions and facts, he concluded that they are *all wrong!* Tr. 2163-2194 (Knutson). Of course, Dr. Knutson was forced to retreat to this untenable and indefensible ground because he, as a very prolific writer, has said over and over again that a “primary equity function performed by FMMO’s is to guarantee that a milk producer will receive the same minimum price regardless of the identity of the processor buying that producer’s milk.” *Envisioning a Deregulated Dairy Industry*, AFPC Policy Issues Paper 97-1 (May 1997) (written with others). When not being paid by these clients, he has said in publications that the longer decisions that favor particular segments to the detriment of others “remain in place, the greater the distortions created and the more difficult it is to remedy the regulatory mistakes.” Ron Knutson, *Fostering a Dynamic Dairy Policy*, AFPC Issue Paper 02-1 (November 2002). When being paid by another handler client in a proceeding regarding chocolate crumb, he has testified under oath: “[o]ne of the principal goals of the Federal Milk Marketing Orders is to prevent a situation in which some regulated handlers will have a competitive advantage over other regulated handlers producing the same products.” Testimony of Dr. Ron Knutson before the United States Department of Agriculture, *In the Matter of: Milk in the New England and Other Marketing Areas*, Case No. AO-14-A64, etc, p. 117, lines 4-8 (November 14, 1990). Precisely.

Moreover, he did not hear for himself the testimony of the Shamrock witnesses and thus reached far reaching factual conclusions that are, charitably speaking, pipedreams. They are also legally irrelevant to uniform pricing. He concluded for instance, that dedicating an operation to the service of one or two large customers was unique to producer-handlers. This is untrue. He concluded that Sarah Farms had a unique advantage in selling to Hispanic customers by

developing bilingual labels. Since Dr. Knutson never talked to Shamrock he could not and did not know that Shamrock has had such labels for years. Tr. 2163-2194 (Knutson) and 3082-3086 (Krueger). These are but two examples in a list of factually inaccurate and legally irrelevant “rationales” for permitting market savvy producer-handlers to remain unregulated despite the fact that a failure to act “would result in significant inequities [among handlers], and would tend to produce disorderly marketing conditions.” 1990 Hearing, *supra*, p. 114, lines 4-7. Dr. Knutson concluded, without having actually studied the market from Texas, that without Sarah Farms, the Arizona-Las Vegas market was too concentrated even though at least 15% of the total sales come from other plants that actually report their Class I sales. Tr. 2302-2305 (Knutson) and Ex. 6, table 11. And unbelievably, except for the fact that this is what happens when one does drive-by testimony and doesn’t actually know the market data, the witness was wholly unaware of the existence inside the marketing area of a plant that is not federally regulated and whose sales do not appear on Exhibit 6 (Anderson Dairy).<sup>10</sup> Tr. 61 (Mycrantz), 114 (Wise) and Ex. 6, Tables 1, 2 and 11. There is the smug tone from Dr. Knutson and at times from Sarah Farms that the federal order program is inherently wrong because it isn’t perfect capitalism; in fact it appears to be socialist. It is the system that Congress gave us and until it is changed statutorily or voted out voluntarily by dairy farmers, it is what we have.<sup>11</sup> Dr. Knutson even unsuccessfully tried to play word games with the words equity and equal. Tr. 2181-2183 (Knutson). Like Mr. Morrison’s testimony, Dr. Knutson’s should be wholly disregarded, including his purported attacks on the credibility and value of Dr. Cryan and Mr. Herbein’s testimony.

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<sup>10</sup> Even if Dr. Knutson had actually known the data for the Arizona market and even if (as is not the case) the market could be deemed “concentrated” for oligopoly definitional purposes, this is yet another red herring issue. The AMAA doesn’t provide for uniform pricing among handlers with an exception for concentrated markets.

<sup>11</sup> “The inherent vice of capitalism is the unequal sharing of blessings; the inherent virtue of socialism is the equal sharing of miseries.” Attributed to Winston Churchill.

Mr. Joe Albright, to his credit, attended significant, if not significantly all, of the hearing sessions. His testimony, which appeared to be on behalf of opponents, provided background and commentary, but in the end, except for perhaps appearing to blame the underlying problems on other pricing and pooling issues, was simply irrelevant to this proceeding. Tr. 2486 *et seq.* (Joe Albright). His testimony thus is non-objectionable, but does not add to the discussion. It was unfortunately irrelevant. If opponents had wanted to address alternative issues, they had their opportunity to submit alternative proposals; moreover, while liberal pooling and so-called “higher of” Class III and Class IV pricing for Class I may result in somewhat larger Class I price and blend price differences, they do not account in any way for the failure of federal orders to maintain orderly marketing conditions through uniform prices paid by all handlers to all producers.

## VI. THE PROPOSED SOLUTION

Although the language issues are important to reign in problems before a producer-handler reaches 3,000,000 pounds, the bottom line solution supported by Shamrock and Dean Foods is a limit on the exemption. Opponents objected to a fixed number and asserted, incorrectly, that there is no basis in regulatory law for such a bright line test.

However, as Mr. Christ said in his testimony, “fixed numerical standards are common and have been found to be necessary in all forms of regulation.” Tr. 1599 (Christ). Moreover, the Secretary in adopting federal milk orders has long used fixed numerical standards or their equivalent in a variety of ways. For instance, the Secretary has adopted the 150,000 pound “real” *de minimis* standard for an exempt plant. 7 C.F.R. § 1000.8(e)(4). The Secretary has throughout the federal order system fixed percentages of route disposition so as to determine whether a plant qualifies for partial or full plant regulation. 7 C.F.R. §§ 1001.7(a) through 1131.7(a). With respect to product classification, the Secretary defines fluid milk products as

being less than 9 percent butterfat (7 C.F.R. § 1000.15), while fluid cream products are those with 9 percent or more butterfat (7 C.F.R. § 1000.16). Concentrated milk is defined precisely at not less than 25.5% nor more than 50% total milk solids. 7 C.F.R. § 1000.15.<sup>12</sup> The Secretary has drawn over the decades many, many lines for marketing areas. The Secretary has adopted numerous pooling provisions for supply plants and reserve supply plants with numerical bright line tests. The notion that the Secretary cannot draw one more line is simply absurd.

And the 3,000,000 pound limit is amply justified. Tr. 567 (Krueger). It is higher than the “significant” level established by Mr. Christ. Moreover, Mr. Herbein’s analysis supports it; Dr. Cryan’s analysis supports it; the Congressional adoption of a threshold for processor contributions to the processor promotion fund supports it; the entire industry (absent the producer-handlers of course who would be affected) supports it; and Mr. Christ’s analysis supports it or even a lower limit. Finally, and most tellingly, it is a far better, although far higher than the existing 150,000 pound exemption for all handlers, measure of the *de minimis* rule and is substantially more in compliance with the AMAA than the present rules.

As stated in the testimony, Shamrock and Dean support the proposed language changes for the reasons stated in Mr. Hollon’s testimony. However, the concern remains that as was decided by the Judicial Officer: “[i]n the past, elaborate and ingenious schemes have been employed to achieve apparent producer-handler status and thus to circumvent regulation.” *Independent Milk Producer-Distributor’s Assoc.*, 20 A.D. 1, 28 (1961) at 28 (and cases cited therein). Without being critical of the Market Administrator, hearing evidence established that same store milk with the same label for the same month was being distributed by both Shamrock and Sarah Farms. Tr. 133-134 (William Wise) and 558 (Krueger). And this was not a carry-over

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<sup>12</sup> The issue of a 6.5% by weight minimum non-fat solids standard is also in the regulations, although recent enforcement of the “weight” provision (subject to dispute) is admittedly somewhat in doubt. 7 C.F.R. § 1000.15(b).

of inventory. Tr. 558 (Krueger). And yet, the producer-handler rules in existence should lead to disqualification of the producer-handler status, but it hasn't. Ex. 6, Table 1. Dean Foods is similarly concerned about the present usefulness of the "wholesale" account provision. Dean Foods asserts that this should be stricter to prevent future abuses. The provision needs to be changed by using the word "similar" products, sizes and labels instead of "same" products, sizes and labels. Tr. 661-662 (Yates).

Thus, the language isn't enough. It needs to be strengthened to cover similar labels and similar products. It needs to be clear that a retail store chain can balance by putting 100% of the producer-handler's milk in one store and 100% of a regulated handler's identical product in another store using the same label. And most importantly, assuming that a producer-handler does ever lose its status, it should take time to reestablish. Otherwise, as we have seen in other pooling of milk settings, a producer-handler could cause itself to lose qualification conveniently in a month where it could draw from the pool and then jump back off in a future month.

But even then the language is not enough. The only true limit is a poundage limit. And Mr. Christ's testimony amply justifies a 1,000,000 pound limit and certainly thus a 3,000,000 pound limit.

## VII. LEGALLY IRRELEVANT “FACTS” AND THE ANTI-DEAN FOODS SCREED

The hearing which lasted over a period of three weeks spread from September 2003 to January 2004 was acrimonious and difficult for all. But the evidence cannot be diverted, through a frolic and detour, by irrelevant discussions or attacks on industry players based upon alleged market share calculations sometimes thrown out as if by a cheap magician pulling a rabbit out of a hat. For instance, given the clear statutory meaning and the limited *de minimis* exception that may apply, there is simply no relevance to a discussion of a producer-handler’s cost of production. 23 Fed. Reg. 6050, 6053, c. 2 (“These reasons as justification for an exemption are not valid. Cost of production cannot be used as a sound basis for granting an exemption from pricing and pooling. . . .”).<sup>13</sup> Similarly, the AMAA does not provide a basis for a decision based upon how many hours a producer-handler works versus a regulated handler or a producer under the order. The AMAA does not provide for such an “adjustment” based upon that or whether an extended family owns the farm as opposed to a single individual be she a widow or an unmarried person. The AMAA does not permit an exclusion for creative marketing (assuming that the marketing even is creative or at least more creative than Shamrock’s – *see to the contrary* Tr. 3083 (Krueger)). The AMAA does not say that raw milk packaged into fluid milk products with a 4-6 day longer shelf life may be priced non-uniformly (assuming again that the supposition is even true – *see to the contrary* Tr. 3085 (Krueger)). The AMAA does not say that a handler located closer to the farm in the desert or in the mountains is not regulated, only perhaps that it will be (as it is likely to be) subject to a location adjustment. The AMAA speaks to “uniform prices” applied “to all handlers.” And the question of a potential *de minimis* exception does not

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<sup>13</sup> In 1958, the producer-handlers asserted and the Secretary rejected as relevant criteria: (1) higher labor costs; (2) maintenance of ‘show places’ from which the industry in general benefits by promoting the sale of more milk for fluid use; (3) use of land with higher value and taxation; and (4) maintenance of more even seasonal pattern of production. *Id.*

open the door to novel discussions of why a producer-handler should not be regulated. The shoe is on (or ought to be on) the other foot – the producer handlers, seeking exemption from plain statutory construction rules that ought to lead to their wholesale regulation ought to prove their right to and exemption. All of these other things are legally, if not factually irrelevant.

The most obvious and pernicious example of this *ad hominem* form of argument was the legally irrelevant and usually factually inaccurate portrayal of Dean Foods Company. It wasn't just that the discussion focused on Dean Foods' alleged business and alleged market share in areas such as New England (2,000 miles from the marketing area in issue). It was the implication and insinuation that somehow Dean Foods' existence justified a wholesale violation of the AMAA. Whatever the facts as to Dean Foods (and none alleged by Sarah Farms or its counsel are admitted herein), they are irrelevant to any determination in this proceeding. Once again, we turn to the words of the AMAA. There is nothing in the AMAA that permits USDA to take into consideration the alleged size of one handler to *negate* regulation of another. When we discuss Sarah Farms' handler size in this brief it is solely to show, if such showing is legally necessary, that Sarah Farms' fails to meet the *de minimis* test. All else is irrelevant and should be excluded by the Secretary in making her decision herein.

Nor is the situation in Las Vegas relevant. Sarah Farms argued at the hearing that it is unfair that plants located in Las Vegas are not subject to federal milk order regulation. In the first instance, this exception exists only as a result of Congressional action, not administrative fiat. Congress has spoken (Congress may be wrong, Congress may change its mind, Congress may or may not have had a rational basis for this distinction), but Congress has drawn a distinction. Again, the AMAA does not draw a distinction for producer-handlers. In the second instance, the resulting situation is different in that the Nevada Dairy Commission



regulates the prices paid by handlers to producers. This is not a case where regulated operators are facing competition from unregulated operators in Arizona. Indeed, no one at the hearing gave any example of having competitive issues with the one plant then operating in Las Vegas. As of the close of testimony, the complained of Dean Foods' plant had not begun operations. There is thus no factual record for concluding that such a plant will have any competitive impact as a result of its regulatory status. Finally, Dean Foods is actively supporting legislation that would result in federal order regulation (partial or full depending on circumstances) if the new plant in Las Vegas sold milk in Arizona (thus creating equality with any other like facility located anywhere in the United States). Tr. 656-657 (Yates). Ironically it is Sarah Farms that is opposing passage of that legislation. *Id.* Sarah Farms cannot on the one hand complain in this hearing that a future plant to be located in Las Vegas that will be subject to full Nevada state regulation may sell into Arizona and could, under yet to be determined facts and legal circumstances, have a competitive advantage when it is Sarah Farms standing in the way of resolving that problem.

But the Dean Foods frolic and detour discussions also distract one from the central fact that regulated handlers of all sizes (including those now out of business in the Pacific-Northwest thanks in no small measure to the producer-handler exemption – Tr. 467 *et seq.* (Daryl Vander Pool)) are complaining, not about Dean Foods, but about producer-handlers. The complaint is not about competitors who are on an equal regulatory footing; the complaint of Shamrock and others is that they play by the rules that are inapplicable to their highly successful competitors. The Secretary should not be distracted by this fog of war especially when the victims in the Pacific Northwest and Arizona of the existing (legally unsupported) exemption is *not* Dean Foods.

Opponents also argued that it is unfair, or perhaps even an unlawful taking of property, to change the rules after plant and farm investment has been made on so-called reliance of the regulatory facts. The only obvious relevant regulatory fact in federal milk orders is that the regulations often change. There is no legal right to rely on existing regulations. *Rose Acre Farms, Inc. v. United States*, 2004 U.S. App. Lexis 13447 \*14 (2004),<sup>14</sup> citing, *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124, 130 (1978) (“Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law...” and “the submission that [the claimants] may establish a ‘taking’ simply by showing that they have been denied the ability to exploit a property interest that they heretofore had believed was available is quite simply untenable.”). While courts will consider reliance in evaluating whether compensation for a taking is due, reliance is one of three factors, including extent of economic deprivation, reasonable investment backed expectations, and character of government’s actions, that must be considered and balanced. *Id.* at \*15-\*16. And importantly, for reliance to be factor, if at all, such reliance must be reasonable. *Id.* at \*35 (analyzing whether such regulation could have been reasonably anticipated).

Federal Milk Orders are by their nature voluntary associations of producers (majority vote) that can be terminated (i.e., the Western Order) or amended at any time. A handler that builds a brand new plant facility in Conroe, Texas knows that the Secretary can, may and did change the location adjustment (higher) after the plant has been fully planned and almost completely built. 50 *Fed. Reg.* 12766 (April 1, 1985 – Texas proceeding). Congress has adjusted Class I differentials twice (1985 and 1999). Plants in federally regulated territory may become unregulated (i.e., Clark County plants) or may face future regulation with little or no notice. “Pooling provisions” are amended causing a shift in regulation from one order to another

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<sup>14</sup> The status of any appeal to the U.S. Supreme Court is unknown at this time.

or even full regulation when partial regulation existed prior to the change. 16025 Fed. Reg. at 16046. The only thing constant in the federal order system is change. And anyone in this industry who makes business decisions without considering the risk of regulatory change is either uninformed or sought and received inadequate legal advice. This red herring can be thrown out immediately.

There is more than the hint by opponents that they view full regulation by federal orders as an unlawful taking without compensation prohibited by the U.S. Constitution. There is no case law to support this thesis; indeed the opposite is true. By definition, if regulation of these producer-handlers amounts to an unlawful taking, so to does the entire system of FMMO pricing and pooling. Regulation of cooperatives as in *Rock-Royal, supra* and its progeny, dispels this myth. Regulation of producer-handlers can only be a taking if the entire FMMO system is unlawful. Given the high number of U.S. Supreme Court cases that have recognized and upheld the FMMO system, the likelihood of such a judicial result is highly unlikely and must be discounted by the Secretary. In a June 30, 2004 decision, the Court of Appeals for the Federal Circuit reiterated the long-standing recognition that courts traditionally reject regulatory takings claims in the absence of evidence showing that economic deprivation exists which is so severe that it is tantamount to condemnation or appropriation of real property. *Rose Acre*, 2004 U.S. App. LEXIS at \*50. Indeed, the complaining producer-handlers must show that their facilities are devoid of any value whatsoever. *Id., citing Andrus v. Allard*, 444 U.S. 51, 65-66 (1979) (showing that even when a regulation prohibited commercial transactions in eagle feathers, but did not bar other uses or impose any physical invasion or restraint upon the complainant, there was no taking). It simply cannot be said that the facilities of the producer-handlers that would be subject to full regulation would be devoid of all value; there are numerous handlers that have

been operating under full regulation and yet their facilities still have value and in fact many of them thrive. In any event, the Supreme Court has held that “loss of future profits – unaccompanied by any physical property restriction – provides a slender reed upon which to rest a takings claim. Prediction of profitability is essentially a matter of reasoned speculation that courts are not especially competent to perform.” *Allard*, 444 U.S. at 65-66.

Although a comparison of values before and after a regulatory imposition is relevant, it is by no means conclusive. *Rose Acre*, 2004 U.S. App. LEXIS at \*38, citing, *Goldblatt v. Hempstead*, 369 U.S. 590, 594 (1962). Rather, the nature of the government’s interest in the regulation is a critical factor. *Id.* at \*39. As demonstrated herein, Congress and the numerous court cases that have reviewed the Federal Milk Marketing Order Program have repeatedly recognized the legitimate and important interest in maintaining uniform prices among handlers. This alone should tip the scale away from any suggestion that a decision to fully regulate would be a taking. Moreover, “the Fifth Amendment’s guarantee ...[is] designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole....” *Penn Central*, 438 U.S. at 124. In this case, it simply cannot be said that producer-handlers would be alone with any burdens that full regulation creates; regulated handlers have and will for the foreseeable future share the burden of pooling. Indeed, if there is a takings argument, it is that regulated handlers pay the equalization fund, while producer-handlers have avoided such regulation until now.

#### **VIII. FEDERAL ORDER REFORM DECISION NOT TO ALTER REGULATORY STATUS AND THE APPLICABILITY OF MOTOR VEHICLE MANUFACTURERS**

Opponents also repeatedly challenged the Secretary’s authority to act at this time with respect to the producer-handler issue on the grounds that proponents allegedly cannot demonstrate changed circumstances since the completion of the process known as Federal Order

Reform in 1999. Proponents disagree: (1) there is no justification for the exemption in the statute thus obviating the need to show changed circumstances under the standard enunciated in *Motor. Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29 (1983); (2) the Secretary affirmatively chose not to change the regulatory status of any producer-handler in Federal Order Reform regardless of the facts or circumstances; (3) the Secretary chose a different Class I pricing option than that eventually adopted by Congress; no one today can say that the Secretary, had he known that Congress was going to adopt a different (higher) Class 1 pricing structure that makes the economics of being a producer-handler more attractive, would not have taken a new and different look at producer-handlers under those *subsequent* circumstances; (4) the Secretary did not have before him the evidence in this administrative record regarding the impact of producer-handlers on the Arizona-Las Vegas or Pacific-Northwest Marketing Areas; and (5) the Secretary today has both factual and legal arguments regarding Sarah Farms as to growth, sales to major retail outlets with market price-setting impact and ability to dispose of surplus as Class 1 in California. As such, proponents, and thus the Secretary, need not demonstrate any change in circumstances post-2000, but such change can be and has been demonstrated regardless.

Returning yet again to the theme that there is no statutory exemption whatsoever, it is not up to proponents to demonstrate that producer-handlers should not be exempt, rather, given the statutory requirements, opponents must demonstrate that an exemption is allowable. They cannot for all of the foregoing reasons. Moreover, if the evidence of market impact as a result of Sarah Farms' operations (PFF 4 - 20) is insufficient to overcome the arguably permissible *de minimis* exception, then to put it bluntly there will never be regulation of producer-handlers. And the industry knows this "regulatory" fact. Repeated reference at the hearing demonstrates

that the industry awaits the outcome of this proceeding with all but bated breathe. Tr. 228 (Hitchell) and 578-9 (Krueger). Without asserting or threatening that it can or will happen, can anyone doubt, based upon the testimony of the Shamrock Foods witness, that Shamrock and others will be forced to change their operations or proceed economically, regulatory or judicially in order to become competitive because uniformity is denied them? The problem of unregulated or under-regulated raw milk competing with fully regulated raw milk prices cannot and should not be underestimated. As *Kraftco* demonstrates, regulated market players must and will find ways to compete with those who act outside the rules. And the result is never pretty.

Federal Order Reform was a global consolidation and review of class prices. It was not, and indeed could not have been given its complexity, a review of each individual tree in the very large forest. In this regard, the Secretary simply chose to treat marketing areas, pricing, pooling and other uniform language issues globally rather than individually. It is for this reason that the Secretary chose not to intentionally fully regulate any handler that was unregulated before Federal Order Reform. 16025 Fed. Reg. at 16046, c.3. Moreover, the only proposal put forward would have eliminated the exemption in its entirety, not create a poundage limit (bright line test) as is proposed today. Thus, the refusal to consider that proposal (again looking at the forest and not the trees) is legally irrelevant to this entirely different proceeding today. Again the Secretary took a global position: “[h]owever, no changes have been made that would intentionally regulate a producer-handler that is currently exempt from regulation under their current operating *procedures*.” *Id.* at 16135, c.2 (emphasis added) (note the term *procedures* and not size or market impact).

This leads to the crucial difference beyond the Secretary’s global rather than individual examination in Federal Order Reform. Mr. Berde’s 1996 letter submitted to the Secretary’s

designee, references a 6 million pound plant in Texas, but provides none of the rich and full detail of the 16-22 million pound plant in Arizona today that sells to major box stores and other major supermarket outlets. The Secretary's statements in 1999 thus were not based upon the actual Class I price levels post-1999 Decision or any of the facts discovered in 3 weeks of hearings during 2003 and 2004. In 1999 (the data relied upon for the 1999 decision of course ended mostly with 1997 and 1998), the Secretary could not know how a producer-handler had grown so substantially in the interim in Arizona. (PFF 3 - 5). In 1999, the Secretary could not know that a producer-handler would supply a major box store that can set the retail price for all retailers. (PFF 8). In 1999, the Secretary did not know that this same producer-handler had disposal outlets including a brand new (summer 2003) fluid milk operation with "surplus" disposal as Class I fluid milk products in California. (PFF 24 - 27). In 1999, the Secretary did not know that this producer-handler would have the ability shift its farm milk supplies so as to dispose of any remaining surplus at California's blend price (prior to April 2004) and at Class 1 prices (post April 2004 based upon a U.S. District Court injunction *Hillside Dairy v. Lyons*, 317 F. Supp. 3d 1194 (2004) (injunction issued May 11 affected final pool calculation for April milk since April pool obligations were not finalized by that time). In 1999, the Secretary did not have the benefit of the expert testimony upon which the proposed 3,000,000 pound cap is based. In 1999, the Secretary in fact had no specific proposal save the proposal to eliminate the exemption entirely.

Thus, the decision in 1999 in Federal Order Reform has no legal significance under the *Motor Vehicle Mnfs. Ass'n* standard except to the extent it stands for the following principle that is in support of proponents' proposal: "We have frequently reiterated that an agency must cogently explain why it has exercised its discretion in a given manner." *Id.* at 48-49 (citations

omitted). The statute provides no discretion once USDA decides to implement a milk order. Once it does so, subject to adjustments that are not relevant to this proceeding as discussed above, USDA must provide uniform prices paid to all producers by all handlers. Assuming, without conceding, there is any discretion, it is the *de minimis* discretion only. No other discretion exists. None. And if the Secretary is going to continue to exercise this dubious ground for discretion, it must under the case law cogently explain why. *Id.* Indeed if *Motor Vehicle Mnfrs. Ass'n* stands for anything more, it is that the agency rule “would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, *entirely failed to consider an important aspect of the problem*, offered an explanation for its decision that is counter to the evidence [of the law] before the agency, or is so implausible that it could not be ascribed to a difference in view or product of agency expertise.” *Id.* All of this is by way of saying that proponents have no obligation or duty to prove, as they have anyway, that circumstances have actually changed since federal order reform.

Moreover, and again with all due respect to the present Secretary’s predecessor, a misstatement of the law (that the exemption exists or was blessed by Congress) cannot be a basis for asserting *Motor Vehicle Mfrs. Ass’n*. The Secretary (like any other federal agency) is not estopped by a misstatement or misapplication of the law. *Reinhart v. United States Dept. of Agric.*, 39 Fed. Appx. 954, 956 (6<sup>th</sup> Cir. 2002) (even a clear agency violation of law did not allow for waiver of time limit for filing appeal). The exemption has no legal foundation save potentially as a statement (inconsistent as it is with the 150,000 pound exemption) of *de minimis non curat lex*. As such, the prior statements are not binding on the Secretary in the slightest.

#### **IX. PRIOR REGULATORY PROCEEDINGS**

Opponents point to recent federal order rulemaking proceedings as evidence that the Secretary should not (or even cannot act) in this instance. We would be the last to argue that



prior proceedings are irrelevant, but they must be put in context and fully understood. Moreover, one cannot look at those two proceedings in isolation when there is a wealth of regulatory and judicial history regarding producer-handlers. The Texas (1988) producer-handler proceeding involving Gore, Inc. (54 Fed. Reg. 27179-27184) (June 28, 1989) (Recommended Decision) and (54 Fed. Reg. 34986) (Sept. 6, 1989) (Final Decision) and the Arizona (1993) producer-handler hearing involving Heartland Dairy (58 Fed. Reg. 67703-67708) (Dec. 22, 1993) (First Recommended Decision); 59 Fed. Reg. 56414 (Second Recommended Decision); and 60 Fed. Reg. 55989-55991 (Nov. 6, 1995) (Final Decision and Order) are relevant only to a point. But so too are all of the earlier proceedings and resulting court decisions from the Puget Sound and the eastern United States. But the Gore and Heartland proceedings differ from the earlier proceedings in material respects. Both these proceedings resulted in Recommended Decisions, but the Gore proceeding was terminated after the Recommended Decision without any Final Decision and Heartland Dairy ceased operations as a producer-handler (and eventually ceased handler and finally producer operations entirely) after the hearing but before the Recommended Decision. In the Gore case, with the proceeding terminated, the Recommended Decision, having never become final, has no legal significance. 7 C.F.R. §§ 900.12-13.

The Heartland Dairy situation created a change in circumstances that then permitted the Secretary to reach different conclusions. Assuming, without agreeing, that the Recommended Decision in Heartland remains relevant, the Heartland Dairy proceeding is nonetheless distinguishable on at least the following grounds:

1. Heartland was located in Central Arizona, near Phoenix (in Tollison), not Western Arizona. Thus Heartland did not have surplus disposal opportunities into California that could result in either a blend price or a Class 1 price paid on “surplus” milk. (PFF 24 - 27). In fact,

according to the Secretary at the time, unlike Sarah Farms' opportunities for sales in California and Mexico, as to Heartland "there is only one place to economically dispose of surplus milk for manufacturing use: UDA's butter-powder plant at Tempe." 58 Fed. Reg. at 67704, c.2 and 67705, c.2.

2. Heartland thus chose to balance itself using a regulated handler through a store with common ownership with that regulated handler and disposing of fluid milk products outside of the marketing area when extra milk is available. 58 Fed. Reg. at 67704, c.3. Joint accounts have been found by the Secretary to be a way in which the market ends up bearing the surplus disposal costs of unregulated handlers. While there is no evidence that Sarah Farms has participated in such a plan involving shared ownership, it can and does share accounts, even to the point of the same label being used in the same stores in the same month notwithstanding 7 C.F.R. § 1131.10(e), with Shamrock. Tr. 133-134 (Wise) and 558 (Krueger). Moreover, Sarah Farms does have the opportunity (and uses it) to dispose of otherwise surplus milk outside the marketing area in Mexico or California both in fluid milk product form and as raw milk capable of achieving a price in excess of surplus disposal costs. (PFF 24-27).

3. Heartland had only one realistic opportunity to purchase supplemental supplies in the market – United Dairymen of Arizona. 58 Fed. Reg. 67705, c.2. On the other hand with a number of farms in California and Arizona, Sarah Farms has the ability to bring in additional supplies of milk from its additional farms. Tr. 2642 *et seq.* (Hettinga). These additional farms, if in California, can also ship to California plants and achieve a blend price. (PFF ). If in Arizona, prior to April 2004, they achieved a blend price and after May 1 (when sold to California Class 1 operations) achieve a plant blend price that is in excess of surplus disposal opportunities in the federal order market. (PFF 25).

If Heartland taught the industry anything, it was the already well worn lesson, that any regulatory provision may be used to the fullest extent to create private opportunities at the cost to society as a whole, all of which is contrary to the central thesis of our Republic. J. Madison, *Federalist Papers, supra*.

Not surprisingly the history of federal order treatment of producer-handlers (sometimes producer-distributors and sometimes exempt handlers with their own farm production) is far richer and more complete than the somewhat attenuated proceedings involving Gore (terminated) and Heartland (ceased producer-handler operations while proceeding pending). To see why the present situation is so objectionable, one should review the following proceedings (recognizing that the statutory provisions for “uniform prices” paid to all producers by “all handlers” has never varied in 67 years:

In some districts, exempt handlers have cut retail and wholesale prices below prevailing prices of fully regulated handlers in efforts to increase their fluid milk sales with the result that fully regulated handlers have lost some fluid sales to handlers with exempt own farm milk. In some districts, such practices have tended to detract from the effectiveness of the order in promoting orderly and stable marketing conditions and these practices and resultant undesirable conditions may be expected to expand into other districts and magnify in intensity in the near future unless the order is appropriately amended.

23 Fed. Reg. 6050, 6051, c.2 (Aug. 8, 1958). If one substitutes the words “Arizona-Las Vegas and Pacific Northwest Marketing Areas” for “some districts,” this 46 year old decision applies perfectly to the facts propounded at this hearing. This is hardly a change in regulatory policy necessitating a *Motor Vehicle Mfrs. Ass'n* analysis. In a stunningly perceptive and prospective look at Sarah Farms, the Secretary in 1958 continued:

Under the present order language a multiple farm operator can produce exempt milk from one farm while delivering milk to regulated handlers from any number of other farms and receive the

uniform price for the milk. Cows can be shifted or the milk may possibly be shifted in a concealed manner from the farm or farms from which milk is delivered to regulated handlers to the farm on which exempt milk is produced. Such practices enable an exempt-handler to balance from the pool the day-to-day and seasonal surplus associated with the fluid sales exempt from pricing and pooling while producers under the order receive no benefits from the exempt handler's fluid sales.

*Id.* at 6051, c.3. The very reason that a bright line test as proposed by proponents is required is that at some point all of these abilities to avoid regulation become too valuable to ignore and too difficult for the Secretary to uncover. "In the past, elaborate and ingenious schemes have been employed to achieved apparent producer-handler status and thus circumvent regulation." *In re: Independent Milk Producer-Distributor's Assoc., supra.*<sup>15</sup>

These decisions remain equally valid and applicable today and proponents urge their application (as not being a change in policy at all) immediately.

**X. THE REGULATORY FLEXIBILITY ACT CLEARLY PERMITS ADOPTION OF  
THE PROPOSALS**

Opponents to the proposals suggest that the Regulatory Flexibility Act, 5 U.S.C. § 601 *et seq.*, may affect the Secretary's adoption of proposals herein. As conclusively demonstrated below, the Regulatory Flexibility Act ("RFA") does not require additional analysis or special review in this matter, but even if it does, the regulatory problem that needs to be solved, the proposals presented and the alternatives offered all meet the requirements or guidelines of the RFA.

The Small Business Administration, the agency charged with enforcement of RFA, has described the major purpose of the RFA as being:

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<sup>15</sup> Opponents throughout the hearing complained that they are already regulated because in order to achieve exemption they have to maintain their operations in a certain way and must file supporting documentation. There is simply no legal support for the conclusion that this constitutes "regulation" as the term has been used consistently in the federal order program for 67 years. Instead as in the *Independent Milk Producers* case just cited, the term is "circumvent regulation" or "exempt handler." Moreover, as noted in the section on legal relevance, these so-called costs of being a producer-handler are not justifications for the exemption from regulation. 23 Fed. Reg. at 6053, c.2.

[T]o establish as a principle of regulatory issuance that federal agencies endeavor, consistent with the objective of the rule and applicable statutes, to fit regulatory and informational requirements to the scale of entities subject to regulation.

*The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies*, U.S. Small Business Administration, Office of Advocacy, Washington, D.C., 1998, p. 1.

Importantly, the RFA does not exempt small businesses from regulation. There is no basis to conclude that small businesses based upon that fact alone are exempt from pooling and pricing provisions of federal orders. At no time in the history of the AMAA has USDA, Congress or the Courts concluded that being a small business exempts one from minimum price regulation entirely, except to the extent USDA has adopted a uniform definition for exempt plants that is size based, but is far smaller at 150,000 pounds than the operations in question here.

Instead, under the RFA the agency must, when it determines that there will be a substantial economic impact on a significant number of small entities, conduct additional analysis regarding the impact on small businesses. And as stated in the Hearing Notice (Ex. 1), the Secretary will, within the statutory authority of the program, ensure that the regulatory and informational requirements are tailored to the size and nature of small businesses. But the limitations are clear:

The RFA does not seek preferential treatment for small entities, require agencies to adopt regulations that impose the least burden on small entities, nor mandate exemptions for small entities. Rather, the RFA *encourages* agencies to examine public policy issues using an analytical process that identifies, among other things, barriers to small business competitiveness; and seeks a level playing field for small entities, not an unfair advantage.

*The Regulatory Flexibility Act*, at 2 (emphasis added).

The first question then is does the RFA require any additional or special analysis. The clear answer here is “no” as to these proposals. As to the Arizona-Las Vegas Order 131,

proponents concede that there would be a regulatory impact on one business which may or may not be small based upon a determination by USDA as to whether the producer or the handler numbers count for this purpose. We do not concede that Sarah Farms is a small business for Regulatory Flexibility Act purposes. As to the Pacific-Northwest Order 124, there appear to be up to three affected parties (subject to how the Secretary comes out on the home delivery issue addressed in footnote 9).

Second, by definition, no producer-handler exceeding 3,000,000 pounds per month can possibly be a small business as a producer because its 360,000 cwt must exceed the \$750,000 threshold for small business status as a farm unless the price of milk returns to pre-1960 levels. It is possible that they could qualify as a small business handler, but recall that they are called producer-handlers for a reason. Put together as one small business and one non-small business, the overall business cannot be a small business for RFA purposes. This is consistent with the fact that the Secretary has taken the position (e.g., *Milk in the Mideast Marketing Area, Proposed Rule*, 67 Fed. Reg. 30871 *et seq.* at 30871, c.3 (June 11, 2002)) that if a plant is part of a larger company operating multiple plants, the local plant will be considered a small business only if the business taken as a whole has fewer than 500 employees. Otherwise Shamrock Foods Company could designate its plant as a separate business from its other operations and Shamrock dairy operations could further subdivide, dividing up the various plants so each “handler” has fewer than 500 employees. There is no justification to treat Sarah Farms, perhaps the largest dairy farmer (through its various affiliates) in the United States, if not the world (PFF 25), as a small business for RFA purposes.

Regardless, the proposals do not require Initial or Final Regulatory Flexibility Analyses because there cannot be shown to be a substantial economic impact on a significant number of

small businesses. Even assuming that the number of small businesses impacted is one for Order 131 and three for Order 124 or even four overall (negating the purpose of having separate notices for proposals and separate marketing areas), the term “significant number of small businesses” simply cannot mean either. Beyond this, Sarah Farms is estimated to be almost as large as the regulated handlers on Order 131 and far larger than most of the handlers on Order 124. Therefore, there is no special imposition of regulation on some small businesses that is not also imposed on all other businesses, all of which in Arizona tend to be well above the national average.

Finally, with respect to the Regulatory Flexibility Act, proponents request that the Secretary make an express finding that the solution adopted addresses the regulatory problem presented in this Record. Again, while not definitive given the lack of express requirements by the RFA, such a finding surely is justified given the extensive discussion in the hearing record, the number of proposals in the Hearing Notice intended to deal with the issue, and the conclusion, espoused by almost every proponent witness, that there is no more critical problem than the lack of uniformity in the application of the prices out there in the marketing area. (PFF 32 - 33). The proposed solutions in the proposals are plainly designed to fix the defined regulatory problem.

#### **XI. COMMENTS ON ADMISSIBILITY OF EVIDENCE IN RULEMAKING PROCEEDINGS**

Various objections were made, primarily by counsel for Sarah Farms, to the admission of evidence, especially as to evidence observed by industry as to Sarah Farms. Since Sarah Farms was not willing to disclose their data (as is their right) and since the Secretary is, for confidentiality reasons, also unable to disclose data, the industry had to present their best estimates. Exhibits such as 22 and 23, prepared under the direction and control of Mr. Krueger

ought to be admissible under Federal Rule of Evidence 803(6) (Business Records). Mr. Krueger was in charge of the preparation of these documents. In many instances he performed the underlying analysis or sat in on the meetings when the analysis was performed. Tr. 541-559 (Krueger). The assertion that the material was put together for litigation purposes (Tr. 547 (Ricciardi)) is spurious. Mr. Krueger testified that the underlying data is regularly collected by him because Sarah Farms is a major competitor and that as a businessman it is his job to know his competition. So is he and Shamrock to be penalized because he does what any businessperson would do on a regular basis? Of course not. F.R.E. 803(6) is more liberally construed than that. For instance, in *United States v. Reese*, 568 F.2d 1246 (6<sup>th</sup> Cir. 1977), a government exhibit consisting of xeroxed copies of newspaper articles, which were dated by a hospital employee, placed in a hospital scrapbook, and which purported to show the visiting hours of patients at a hospital, were admitted under F.R.E. 803(6) through the testimony of an employee of the hospital with knowledge of the hospital's practice of keeping these records. This exhibit was admitted in this criminal action to show that the appellant could not have been visiting his wife at a certain time. In *United States v. Bowers*, 593 F.2d 376, 380 (10<sup>th</sup> Cir. 1979), *cert. denied*, 444 U.S. 852 (1979), a postal service report concerning security procedures was properly admitted in a criminal case even though the custodian who testified as to the report's origin had not prepared it.

A USDA case is itself instructive. In *United States v. Mendel*, 746 F.2d 155 (2d Cir. 1984), *cert. denied*, 469 U.S. 1213 (1985), a USDA technician's Market Cattle Testing Program report was admitted even though the underlying report had been prepared by a slaughterhouse, not USDA.



But the test for administrative proceedings is not even as stringent as the test under the Federal Rules of Evidence. Hearsay is and has been since at least 1938 wholly admissible in such proceedings so long it is “the sort upon which responsible persons are accustomed to rely.” *National Labor Relations Board v. Remington, Rand, Inc.* 94 F.2d 862, 873 (2d Cir. 1938), *cert. denied*, 304 U.S. 585 (1938). In fact, hearsay (even if Exhibits 22 and 23 are hearsay which is not conceded), “if reliable and credible” can constitute *substantial* evidence in a variety of administrative settings. *Richardson v. Perales*, 402 U.S. 389 (1971) (overruling in agency action “legal residuum rule” and inviting agencies to admit evidence that would be inadmissible in court); *Calhoun v. Bailar*, 626 F.2d 145, 149 (9<sup>th</sup> Cir. 1980), *cert. denied*, 452 U.S. 906 (1981) (hearsay as substantial evidence); *Hoska v. United States Department of Army*, 677 F.2d 131, 138 (D.C. Cir. 1982) (relevant and material hearsay is “admissible in administrative proceedings and in adverse action proceedings in particular”) (emphasis supplied); *Veg-Mix, Inc. v. USDA*, 832 F.2d 601 (D.C. Cir. 1987) (administrative law judge in Perishable Agricultural Commodity Act enforcement action permitted to consider company invoices even though no custodian was offered to represent their authenticity).

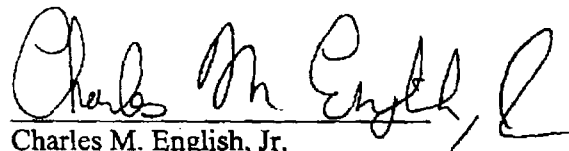
Mr. Krueger’s documents produced under his direction and control are far more credible than these examples. Moreover, an obvious purpose for the rule in administrative settings is to permit them to move along. This hearing took three weeks over five months. Can anyone imagine how long these AMAA hearings would last if, assuming they were not followed here, federal rules of evidence had to be strictly followed? The evidence presented especially by Mr.

Krueger is definitely the kind of evidence regularly relied upon by the Secretary in the past 67 years of this program. They should be considered as substantial evidence.

## XII. CONCLUSION

For all the foregoing reasons, proponents urge immediate adoption of all of the proposals considered in this proceeding.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Charles M. English, Jr.", written over a horizontal line.

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