UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

IN RE: **MILK IN THE NORTHEAST AND** **OTHER MARKETING AREAS;** **Class I and II Pricing** **71 Fed. Reg. 67489 (Nov. 22, 2006)** **Hearing: Pittsburgh, Pa.,** **Dec. 11-15, 2006**	**Dockets: AO-14-A76, et al.** **DA-07-01**

POST-HEARING BRIEF OF MIDWEST DAIRY GROUP

The Midwest Dairy Group, an ad-hoc coalition of farmer-owned cooperative associations, trade organizations, and state government agencies, sharing common interests in opposition to regulatory proposals advanced in this proceeding, consists of: Alto Dairy Cooperative; Associated Milk Producers, Inc.; Bongards Cooperative Creamery; Burnett Dairy Cooperative; Ellsworth Dairy Cooperative; Family Dairies USA; First District Association; Manitowoc Milk Producers Association; Midwest Dairy Coalition; Mid-West Dairymens Cooperative; Milwaukee Cooperative Milk Producers; Prairie Farms Dairy, Inc.; Wisconsin Farm Bureau; and Wisconsin Department of Agriculture, Trade & Consumer Protection.

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Before the Secretary are proposals by NMPF system-wide increase in *regulated* Class I and II milk prices in federally-regulated milk markets, and to alter the relationship of such prices to supply and demand market signals embodied in Class III and IV prices. This post-hearing brief is submitted in opposition to the NMPF proposals on behalf of farmer-owned cooperative associations, trade organizations, and state government agencies appearing collectively and referred to herein as "Midwest Dairy Group".[1] Our opposition is driven by conclusions, as echoed by non-party university dairy economists, that the NMPF proposal "knocks the small producers in the Upper Midwest in the gut" by reduced net income conservatively estimated at $104 million. Knutson, Tr. 1187 – 1199; Gould, Tr. 478-88. On the merits, NMPF's proposal fails because current and projected milk supplies equal or exceed system-wide demand for milk in fluid and dairy product uses.

[1] The Midwest Dairy Group includes: Alto Dairy Cooperative; Associated Milk Producers, Inc.; Bongards Cooperative Creamery; Burnett Dairy Cooperative; Ellsworth Dairy Cooperative; Family Dairies USA; First District Association; Manitowoc Milk Producers Association; Midwest Dairy Coalition; Mid-West Dairymens Cooperative; Milwaukee Cooperative Milk Producers; Prairie Farms Dairy, Inc.; Wisconsin Farm Bureau; Wisconsin Department of Agriculture, Trade & Consumer Protection

I. INTRODUCTION AND STATEMENT OF THE ISSUES

USDA called this hearing at the request of the National Milk Producers Federation (NMPF). NMPF proposed "to raise producer prices" by increasing regulated Class I and II milk prices in the federal milk order system. NMPF Request for Hearing, published at http://www.ams.usda.gov/dairy/class_I_II/classI_II_pr_for.htm at p. 1. In support of its proposal, NMPF alleged that producers' supply and production costs have increased, and a regulated price increase is therefore necessary to restore a proper "relationship between product prices and the Class I and II milk prices." Id. p. 15. NMPF's petition for hearing asserted that failure to increase Class I and II prices, as proposed, "will undercut the ability of the pool to attract a stable supply of milk to these higher uses, and lead to increased de-pooling and more disorderly milk markets."

The issues of law, policy and evidence raised by the NMPF proposal, as refined by its direct testimony (Tr. pp. 16-67), are encompassed in the following broad questions.

> On application of the supply and demand pricing standards of the AMAA, 7 U.S.C. §608c(18), as construed and applied by USDA for seven decades…
>
> (A) Has NMPF made *prima facie* allegations of fact in support of system-wide increases in regulated Class I and II milk prices? [2]
>
> (B) If the answer to (A) is "yes," did NMPF meet its burden of proof, by a preponderance of evidence, that regulated Class I and II milk prices should be increased, as proposed?

This exercise, of course, must start with review and summary of factors relevant to Class I and II price increases and regulatory policy expressed by the Secretary of Agriculture in the

[2] Some of the facts and conclusions advanced by NMPF might, if supported by evidence, justify adoption or modification of handler Class I location adjustments, producer location adjustments, market-wide service payments, or Class I differentials in individual markets. If merited, those alternative regulatory remedies, with better focus on supply, demand and "orderly marketing" in individual markets, are beyond the scope of this system-wide hearing for identical, across-the-board Class I and II price increases in all markets.

past. After these are identified, if NMPF's proposal (or any part thereof) meets *prima facie* standards supporting a system-wide Class I price increase, consideration must be given to the supporting evidence (if any) under the "burden of proof" standards imposed upon a rule proponent by section 556 of the Administrative Procedure Act, 5 U.S.C. §556. Only after these burdens of rulemaking pleading and evidence are met may USDA begin the process of evaluating whether the proposals, in any part, should be adopted as a matter of regulatory policy.

The proposals should be promptly rejected, and this proceeding terminated, because NMPF's petition and direct testimony fail to support a *prima facie* case for system-wide increase in Class I and II prices. If considered on the merits, NMPF has failed to meet its burden of proof supporting the proposal as a whole, or any factual component thereof as they relate to factors relevant to system-wide increases in regulated prices. Finally, the NMPF proposals fail the test of equity, consistently applied by USDA to system-wide Class I price proposals in the past, because they would result disparate harm and benefit by region, and significant economic harm to Upper Midwest producers in particular.

II. THE SUPPLY AND DEMAND STANDARDS OF 7 U.S.C. §608c(18), AS CONSTRUED BY USDA IN PAST DECISIONS AND POLICY STATEMENTS AND APPLIED TO CLASS I AND II PRICE PRICING ISSUES.

The principal, albeit ambiguous, objective of the AMAA is maintenance of "orderly marketing conditions" for farm products. 7 U.S.C. 602(4). For milk marketing orders, regulatory tools available to meet this objective are limited, and enumerated in 7 U.S.C. §608c(5), one of which is equitable regulation of minimum classified prices handlers must pay for milk. *Id.* §608c(5)(A). Legislative guidance for fixing milk prices or price formulas is contained in a later section, 7 U.S.C. §608c(18). *See* 64 Fed. Reg. 16026, 16109 (April 2, 1999). This section authorizes use of a parity price standard ***or*** a supply and demand standard, as follows:

> (18) Milk prices. The Secretary of Agriculture, prior to prescribing any term in any marketing agreement or order, or amendment thereto, relating to milk or its products, if such term is to fix minimum prices to be paid to producers or associations of producers, or prior to modifying the price fixed in any such term, shall ascertain the parity prices of such commodities. The prices which it is declared to be the policy of Congress to establish in section 602 of this title shall, for the purposes of such agreement, order, or amendment, be adjusted to reflect the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk or its products in the marketing area to which the contemplated marketing agreement, order, or amendment relates. Whenever the Secretary finds, upon the basis of the evidence adduced at the hearing required by section 608b of this title or this section, as the case may be, that the parity prices of such commodities are not reasonable in view of the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk and its products in the marketing area to which the contemplated agreement, order, or amendment relates, he shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk,[3] and be in the public interest. Thereafter, as the Secretary finds necessary on account of changed circumstances, he shall, after due notice and opportunity for hearing, make adjustments in such prices. [Footnote added].

In this 1937 provision, "Congress adopted a supply-demand pricing standard to replace parity pricing."[4] Since then, USDA has eschewed use of parity pricing for milk,

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[3] In some publications of §608c(18) the phrase "to meet current needs and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs" is included at this place in the text. It is not current law. The phrase was first inserted by Pub. L. 93-86, 87 Stat. 222, Aug. 10, 1973, and continued or extended three times thereafter, expiring on December 31, 1996, by operation of Pub. L. 103-66, 107 Stat. 317, Aug. 10, 1993.

[4] 61 Fed. Reg. 49081, 49083 (Sept. 18, 1996)(Second Amplified Decision). Elsewhere, the Secretary has explained that "the parity concept has been a dead issue under the milk order program since its inception…. Since the inception of the Federal milk order program, the Secretary has found that [milk] parity prices are unreasonable, and has established prices to 'reflect such factors (i.e., the price of feeds, etc.), insure a sufficient quantity of pure and wholesome milk, and be in the public interest." *In re Borden, Inc.,* 46 Agriculture Decisions 1315, 1456 (1987), *citing* findings of the Secretary in promulgation of the New York Milk Order, 3 Fed. Reg. 1945,1946 (1938). The "parity price" is a reference to Depression-era purchasing power of a production unit of an agricultural commodity. The mid-2006 "parity price" for milk was, for example, was calculated to be $38.60 per hundredweight – three times the May 2006 all milk price of $12.00. NASS (Washington Field Office), USDA, *Agri-Facts* (July 14, 2006) at 3. The Secretary has consistently concluded that "calculated parity price levels relative to the all-milk price would be excessively high because more than ample supplies of milk were available for all uses at prices far below the parity price level, and thus, the parity price is not reasonable." 59 Fed. Reg. 42422 (Aug. 17, 1994).

authorized by the first two sentences of §608c(18), and instead fixed milk prices authorized by the third sentence, based on "economic conditions that affect supply and demand for milk," as the Secretary finds will "insure a sufficient quantity of pure and wholesome milk, and be in the public interest."

The problem facing producers of milk and many other commodities in the early 1930's was over-production in relation to reduced Depression-era purchasing power of consumers, large surpluses and consequent depressed farm prices. The "adjustment" sought by the Agricultural Adjustment Acts of 1933, 1935, and the AMAA of 1937 was to reduce production and supplies of agricultural commodities so as to increase farm prices in better tune with demand. *See,* Nourse, Edwin, *Report to the Secretary of Agriculture by the Federal Milk Order Study Committee* (USDA, 1962); Nourse, Davis and Black, *Three Years of the Agricultural Adjustment Administration* (Brookings Institution, 1937); Nourse, *Marketing agreements under the AAA* (Brookings Institution, 1935). Congress and agricultural economists understood then, as USDA and economists have learned with even greater clarity since, that production is stimulated by, or tempered by, commodity price increases and decreases. Accordingly, for many decades USDA has consistently judged proposals for regulated Class I prices, or price changes, against a measure of need, as evidenced by adequacy or inadequacy of milk supplies to the regulated market. For example….

USDA Supply and Demand Pricing Decisions During the '50s Through '70s

- More than a half century ago, in the Western Michigan Market, USDA provided an automatic supply-demand adjuster in the Class I price – higher prices when raw milk supplies were short, lower prices when supplies relative to demand increase. 16 Fed. Reg. 8896 (Sept. 1, 1951).

- In a 1964 northeast regional, multi-market hearing on Class I and surplus milk pricing formulas, USDA reaffirmed the established supply and demand pricing standard: "A primary consideration in determining appropriate price levels under the pricing standards of the Act is adequacy of supply available for the market's needs." 29 Fed Reg 1646, 1650 (Feb 1, 1964). The decision went on to affirm that *lower Class I prices* would be a reasonable regulatory solution to surplus production and low milk prices: "[I]f surpluses of milk become excessive to the fluid market and thereby burdensome to producers or cooperatives which have them in their possession, then Class I price correction may be required to reduce total milk supplies and thus to ease the burden on producers generally of their own surplus." *Id* p. 1649.[5]
- In 1965, USDA rejected major cooperatives' proposals to increase Class I price by $0.20/cwt in Michigan: "In view of the supply of milk in excess of bottling needs..., and no indication of milk shortage in the foreseeable future, an increase in the minimum Class I price above current levels would not be warranted." 1965 Southern Michigan – Muskegon market merger decision. 30 Fed. Reg. 7903, 7911 (June 18, 1965).
- When the Upper Midwest Order was created by consolidation of four smaller markets during 1974-1976, USDA reaffirmed the supply and demand touchstone for Class I price fixing: "In establishing a pricing structure for the proposed marketing area, it is necessary to focus on two primary considerations: (1) What Class I price level is necessary to "insure a sufficient quantity of pure and wholesome milk"; and (2) What price structure is needed to insure Class I price alignment with neighboring marketing areas?" The major cooperative proponents had argued in that case (as does NMPF in

[5] Writing during a previous milk price downturn, Cornell's Dr. Mark Stephenson put this economic truism more succinctly: "The solution to low milk prices will be low milk prices." Mark Stephenson, *Managing in These Times* (Northeast Dairy Business, Oct. 2000).

this one) that the Class I differential should be higher because "producers are now experiencing increased hauling costs." USDA responded: "While it is true that hauling costs have increased since the present Class I differentials were adopted, this cannot be a basis for increasing the Class I differential in this combined market." **** As previously indicated, the amount of Grade A milk in this area has been increasing relative to demand, as shown by declining Class I utilization. Hence there is no necessity for raising the Class I differential above the average level now existing in these markets." 41 Fed. Reg. 12436, 12459 (March 25, 1976).

- During the same period of time, the New England Order was created by market merger. As in the Upper Midwest, USDA rejected higher prices proposed by cooperatives: "The present supply-demand relationship in the New England area does not suggest that additional returns to producers are needed to assure an adequate supply of milk for fluid use." Specifically rejecting higher hauling costs as a basis for higher Class I price adjustments, the Secretary said: "In view of the apparent adequacy of milk supplies at distributing plants, there is no justification for adoption of a higher transportation rate under the order." 41 Fed. Reg. 4456, 4469 (Jan. 29, 1976).

USDA Supply and Demand Pricing Decisions During the '80s and '90s

- On promulgation of the Southwest Idaho-Eastern Oregon Order, proponent cooperatives asked for a $1.75 Class I differential, in part to cover Class I supply costs. USDA adopted a differential of $1.50, concluding that this price "can be expected to maintain adequate supplies of Grade A milk for the marketing area." In so doing USDA expressly rejected proponents' theory that balancing or supply costs should be included in the Class I price: "In establishing the appropriate minimum price that is to paid by regulated handlers, it is not intended that the order Class I price reflect or include the costs that cooperatives incur in supplying handlers." 46 Fed. Reg. 21944, 21965 (April 14, 1981)

- During 1990 – 1993, USDA conducted extensive system-wide review of federal milk order pricing policies and regulatory structure, including 35 proposals addressing Class I pricing, and five proposals addressing Class II pricing, on system-wide, regional or local market basis, including higher or lower price levels, pricing floors, butterfat differentials, transportation credits, and balancing credits. Among factors argued by proponents of higher Class I and II prices in that proceeding (like this one) were the existence of high premiums and service charges, costs of supplying Class I and II handlers, transportation costs, and producer costs of production. In its final decision, Decision 58 Fed. Reg. 12634, 12646 (March 5, 1993), USDA declined to make changes in Class I pricing structure, citing §608c(18) supply and demand standards. "The underlying basis for the level of Class I prices under the order program is the statutory pricing standard which requires that prices reflect supply and demand. Within this context, the present Class I differentials appear to be set at a reasonably satisfactory level."   USDA observed, however, that "there might be a basis for some downward adjustments in certain… heavy production areas," but left that issue for later consideration in response to better focused, individual market, hearing proposals. Adequacy of milk supply, under then-existing combinations of regulated and negotiated over-order prices, also disproved a need to increase Class II prices, as explained by the Secretary.

> Handlers want a regular supply of Grade A milk for such [Class II] uses, which requires essentially all of the costly supply services associated with procuring the milk long distances from the milkshed to city processing plants and balancing milk supplies with demand. *** A Class II price that is only 10 cents higher than the Class III price does not cover the cost of these services. *** Most handlers are

> already having to pay substantial over-order prices to obtain milk for Class II use. Such pay prices in conjunction with Class I prices are generating adequate supplies of Grade A milk for both Class I and II uses…. Thus, it is concluded that an increase in Class II differentials under all orders is not needed.

- The Secretary's 1993 decision to maintain the then-existing Class I price structure was challenged in court by Upper Midwest farm groups who claimed that Class I prices were too high in some markets. The federal district court ordered the Secretary to provide further justification for his decision, with specific reference to the individual market supply and demand standards of §608c(18). *Minnesota Milk Producers Ass'n v. Espy*, 851 F. Supp. 1389 (D.Minn. 1994). In two "amplified decisions," the Secretary provided details of his interpretation of the §608c(18) supply and demand pricing standards as applied to federal milk order minimum classified price regulation and achievement certain market performance goals. The Secretary also explained the evolution and history of Class I and III pricing policies. 59 Fed. Reg. 42422 (Aug. 17, 1994), and 61 Fed. Reg. 49081 (Sept. 18, 1996). The decision of the Secretary to maintain the then-existing Class I price structure was affirmed after eight years of litigation. *Minnesota Milk Producers Ass'n. v. Glickman*, 153 F.3d 632 (8th Cir. 1998). The contemporaneous decision of USDA to modify the Class III (M-W base) price under §608c(18) standards, published at 60 Fed. Reg. 7289 (Feb. 7, 1995), was also sustained by the Court of Appeals, which concluded that the M-W decision reflected "a consideration of relevant factors."
- In the M-W replacement hearing decision to which the Court of Appeals referred, the Secretary considered a variety of price-enhancing proposals, including a recurrent request for prices to be adjusted based on producers' cost of production. The Secretary observed that even though economic costs of producing milk as reported by ERS,

USDA, exceeded the M-W price by an average of $1.77 per hundredweight over the course of five years, the record revealed a reasonable balance of supply to demand under the existing M-W formula. A regulated price enhancement, therefore, could not be justified and did not comply with "the criteria specified in the Act." 60 Fed. Reg. at 7298. In adopting an M-W replacement that simulated price levels under the pre-existing formula, the Secretary concluded: "The hearing record indicates that current price levels are achieving a reasonable balance between supply and demand for milk. Present price levels are ensuring consumers of an adequate supply of milk while maintaining sufficient reserve supplies." [6]

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[6] Cost of milk production surveys are undertaken by a number of governmental, academic, and financial institutions. Reported survey costs include objective cash expenses, which are captured in similar manner in all surveys, as well as subjective imputed costs, which vary greatly from survey to survey. The record in the M-W replacement hearing included testimony by Dr. Mark Stephenson, then with the University of Wisconsin – River Falls, "that the price received for milk determines the cost of production. He cited historical data which he maintained proved that dairy farmers do adjust their inputs in response to milk prices." 60 Fed. Reg. at 7297. More recently, Dr. Stephenson reaffirmed: "Producers aren't helpless to respond to low prices. Over the past 40 years the New York Dairy Farm Business Summary has shown a high correlation between milk prices and the costs of producing milk. When milk prices are high, the cost of production is high as farmers spend more to produce even more milk. When milk prices drop so does the cost of producing milk. Nationally, marginal cows are culled from the herd and items that affect milk per cow, such as concentrate feeding and bST, are used with more moderation." Mark Stephenson, *Managing in These Times* (Northeast Dairy Business, Oct. 2000).

While Dr. Stephenson's opinion may be extra-record to this proceeding, his conclusions are supported by other evidence that producers respond to low prices by cutting costs. *Compare* NASS *Milk Production, Disposition and Income* (1992 – 2005) all milk price annual changes *with* corresponding changes in cash expenses reported in ERS *Costs of Production* for milk. These observations are also incorporated in ***USDA Baseline Projections***, World Agricultural Board, Office of Chief Economist, USDA, *USDA Agricultural Baseline Projections to 2015* (OCE-2006-1, Feb. 2006) < http://www.usda.gov/oce/commodity/ag_baseline.htm >at p. 54, and in the most recent (2000) reported ERS survey of milk production costs: "differences in animal performance, feed efficiency, and labor efficiency were critical in determining whether producers were in the low- or high-cost group for producing milk." Sara D. Short, *Characteristics and Production Costs of U.S. Dairy Operations* (ERS Stat. Bull. No. SB974, February 2004), published at http://www.ers.usda.gov/publications/sb974-6/ . of which official notice may be taken and is requested. *See also* Herring, Tr. 354-355 (in the Northeast, reported milk production cost differences between low-cost quartile of surveyed farms and the highest cost quartile of farms may range from $10 to $20/cwt).

- When the Southeast Order was first created by merger of smaller orders shortly thereafter, USDA reaffirmed that the "adequate supply" pricing standard included not only local production, but also imported milk. "In establishing the Class I price level, a primary consideration must be to attract an adequate supply of Grade A milk for fluid use, taking into consideration production within the marketing area relative to the demand for fluid milk by handlers regulated under the order and the cost of transporting bulk milk from surplus producing areas to supplement local production." 60 Fed. Reg. 25014, 25037 (May 10, 1995).

USDA Supply and Demand Pricing In Federal Milk Order Reform

- Consistent analysis and policy application by USDA continued in Federal Milk Order Reform decisions. One Class I pricing option (Option 5), advocated by Mid-America Dairymen (now part of DFA), proposed to raise Class I prices, decouple them from volatile commodity prices, and provide for cost of production and supply/demand adjustments (similar in some respects to the proposals in this hearing). USDA applied the proposal to its econometric model, and concluded that Option 5, though superficially attractive, was not justified under §608c(18) supply and demand standards. It would provide short-term revenue benefits offset by long-term price reduction due to price-stimulated increase in surplus milk.[7] Further, Option 5 risked "disorderly marketing" due to inter-market disparity in the effect of the proposal. "Producers in high Class I markets would benefit at the expense of producers in low Class I markets. In addition, flooring the Class I price will shift volatility to milk prices in

[7] Cooperative associations proposals to USDA may be understandably responsive to member pressures in seeking short-term revenue or competitive benefits from government regulation, with less regard to consequences in the long-term for members, for the integrity of the federal order program, or for other producer groups. It falls to the Secretary to objectively consider and balance long-term orderly marketing consequences for producers, including interests of other cooperatives and non-members, and the larger public interest, in response to such proposals.

manufacturing markets." 63 Fed Reg. 4801, 4903 (Jan. 30, 1998)(Recommended Decision).

- While the Federal Order Reform process was underway, the newly-created mega-cooperative, Dairy Farmers of America, requested an emergency, system-wide increase in regulated Class I and II prices by temporary use of a floor price in the formulas. Rejecting this proposal after hearing, USDA again (1) affirmed its supply-demand standards for regulated price increases, (2) confirmed that the relevant evidentiary inquiry in support of such proposals is whether there is any anticipated shortfall between milk production and milk demand, and (3) emphasized the significance of interregional equity considerations in the decision-making process. The Secretary concluded that DFA and co-proponents did not meet their evidentiary burden: "The petition for flooring the BFP is denied because there is no evidence of a national milk shortage, either for all uses or for fluid uses. Furthermore, flooring the BFP would have widely varying effects in different regions of the country unrelated to the financial need of farmers." 63 Fed. Reg. 32147, 32150 (June 12, 1998).
- The final Federal Milk Order Reform Decision, 62 Fed. Reg. 16026 (April 2, 1999), reviewed at great length USDA's pricing policies, and statutory supply-demand factors, in light of new analytical models available to the agency – Cornell's U.S. Dairy Sector Simulator (USDSS)(*id*. at 16108-09), which estimated the relative value of milk at numerous demand (plant) locations based on available supply at numerous raw milk production locations, for selected months during 1995 and 1997, supplemented by USDA's Multi-Regional Dairy Sector Model *(id.* at 16110-11). In the end, USDA adopted a new Class I pricing surface based on the Cornell and USDA models of 1995 and 1997 milk supply and demand locations, but is so doing reaffirmed its interpretation

of pricing standards under the Act, by consideration of each Class I pricing option with reference to the following, evidence-based objective criteria:

1. Ensure an adequate supply of milk for fluid use.
2. Recognize quality (Grade A) value of milk.
3. Provide appropriate market signals.
4. Recognize variable value of milk by location.
5. Facilitate orderly marketing with a coordinated (aligned) system of prices, and
6. Recognize handler equity with regard to raw product costs.

64 Fed. Reg. at 16109, applied in detail to pricing options 1A and 1B at 16109 – 16118.

USDA Supply and Demand Pricing in Post-Reform Decisions

- USDA's express reliance on current and anticipated milk supply as a measure of proper performance of regulated minimum prices, and as a measure of any need for regulated price adjustments, has continued in a consistent manner since Federal Order Reform. 67 Fed. Reg. 67905, 67911-92 (Nov. 7, 2002)(final Class III – IV make allowance decision). In its 2002 Decision, USDA affirmed its historical interpretation of §608c(18) supply and demand standards. USDA also rejected proposals for a raw milk cost of production ("COP") component in the minimum regulated price, because COP addresses only the supply side of the supply and demand standard and, if incorporated by regulation, would likely result in disorderly marketing conditions.
- Also conforming with established standards, the Secretary unequivocally denied requests for Class I and II price surcharge hearings during 2002-2003, in a previous post-reform cycle of low milk prices and high feed costs, because supply was sufficient to meet demand, and the proposal would unfairly allocate benefits and burdens of higher prices among regional markets. USDA letters of January 2003 to Congressmen Blunt and Sherwood, Hearing Exs. 46 and 47. See also June 16, 2003, letter of Under Secretary Bill Hawks to Congressman English (attached), denying a renewed request

for Class I and II price increases because "the current supply of milk continues to exceed demand."

We provide this rather comprehensive and illustrative history of USDA's Class I pricing policies, and of its consistent interpretation of the supply and demand standards of §608c(18) for over 60 years, to ensure that the current Secretary is made aware of his agency's policies and practices in light of the requirement of law that agencies must apply their own precedent unless they acknowledge a change of direction and provide a cogent explanation for the departure. *Motor Vehicle Mfgrs. v. State Farm Mutual*, 463 U.S. 29, 41-42 (1983); *Yale-New Haven Hospital v. Leavitt*, 470 F.3d 71 (2d Cir. 2006) (unexplained departure from Medicare reimbursement practices); *AT&T Corporation v. Federal Communications Commission*, 236 F.3d 729, 236 F.3d 729 (D.C. Cir. 2001)(departure from standards and weight given to economic factors in telecommunication price regulation); *Citizens Awareness Network Inc. v. United States Nuclear Regulatory Commission,* 59 F.3D 284 (1st Cir. 1995)(departure from procedural standards); *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1971).

Since the Secretary's Notice of Hearing did not articulate any new standards for Class I pricing, and all parties prepared for the hearing in reliance on existing standards, we can only address the merits of NMPF's claims on the basis of those standards.[8] By this measure, the NMPF proposal falls short on *prima facie* analysis as well as on the evidentiary merits.

[8] Under the APA and the Due Process Clause, an interested party "is entitled to know the issues on which a decision will turn, and to be apprised of the factual material on which the agency relies for decision so that he may rebut it. *Williston Basin Interstate Pipeline Co., v. FERC*, 165 F.3d 54, 63 (D.C. Cir. 1999). Since the agency did not advise to the contrary in its Notice of Hearing, we have structured our hearing presentation and this brief in reliance upon administrative and judicial precedent.

III. NMPF HAS NOT MADE A *PRIMA FACIE* CASE FOR SYSTEM-WIDE INCREASES IN *REGULATED* CLASS I AND II PRICES.

As illustrated by 60 years of regulatory history and policy, establishment or change in Class I prices is directly related to available supply, and the need for milk production. A request for higher prices must be supported by evidence (1) that current or anticipated milk supplies are short, or will fall short, of demand, and (2) that the price increase proposed will bring milk supply in better balance with demand in an equitable manner. *E.g.,* 63 Fed. Reg. 32147, 32150 (June 12, 1998); USDA letters of January and June 2003 to Congressmen Blunt, Sherwood and English.

Neither NMPF's petition for hearing, nor its evidence purporting to support the proposals, meet these basic standards of evidence and policy. NMPF's proposals should therefore be summarily denied and this proceeding terminated.

Each component factor cited by NMPF to support its proposals – increases in producer costs of production and costs of supplying or balancing milk demanded by Class I and II distributing plants – relate only to the supply side of the supply and demand equation. For over 60 years, USDA has consistently rejected regulated price increases that consider only the supply side of the supply and demand equation, even if evidence of increased supply side costs is overwhelming. For several of the specific cost factors claimed to support NMPF's proposal, USDA has unequivocally decided that they should ***not*** be included as part of regulated Class I or II prices. If the Secretary nevertheless proceeds to consider the merits of individual elements of the NMPF proposal, the record overwhelmingly demonstrates that NMPF has failed to meet its burden of proof.

IV. NMPF HAS NOT MET ITS BURDEN OF PROOF IN SUPPORT OF ITS PROPOSALS.

In formal administrative hearings, the burden of proof on the proponent or supporter of a new rule, equally applicable to private parties and government agencies, is essentially the same as the familiar "preponderance of evidence" standard applied to parties in most civil litigation. Although agencies and courts applied a less demanding evidentiary standard under §556 of the Administrative Procedure Act for many years, the Supreme Court now unequivocally requires the more demanding standard.

Section 7(c) of the Administrative Procedure Act says that "[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof." 5 U.S.C. §556(d). This law is similar to Rule 301, Federal Rules of Evidence. For several decades after passage of the APA, courts and agencies believed "burden of proof" to mean only the burden of production or "going forward" with evidence. *See NLRB v. Transportation Mgmt. Corp*., 462 U.S. 393, 404 n.7 (1983). However, only a decade ago, in *Greenwich Collieries* the Court concluded that the "burden of proof" in § 7(c) was more demanding, and additionally meant "the burden of persuasion." *Director, Office of Workers' Comp. Programs v. Greenwich Collieries,* 512 U.S. 267, 276 (1994). It is now understood that combination of "burden of proof" and "substantial record evidence" standards in formal "on the record" hearings under the APA – as is the case for this hearing -- impose a traditional "preponderance of evidence" burden on the party or agency proposing a rule or order.[9] Kenneth Culp Davis and Richard J. Pierce, Jr., Administrative Law Treatise §10.7 (3d ed. 1994). In other words, if NMPF's proposals are to be adopted and promulgated as

[9] USDA's marketing order decisions since 1994 do not, unfortunately, indicate whether or not USDA program administrators are aware of the *Greenwich Collieries* evidentiary standard, or whether the standard has been deliberately followed by the agency in its formal rulemaking proceedings.

law in any part by the Secretary, proponents must first provide the Secretary with essential and persuasive facts proving their case, *Fairmont Foods v. Hardin*, 442 F.2d 762 (D.C. Cir. 1971); *Puerto Rico v. Federal Maritime Commission*, 468 F.2d 872, 879-81 (D.C. Cir. 1972). Alternatively, the agency may come forward as proponent in the hearing with its own evidence to support the rule. *Abbotts Dairies Div. v. Butz*, 389 F. Supp. 1, 8-9 (E.D. Pa. 1975); *Hess & Clark v. FDA*, 495 F.2d 975 (D.C. Cir. 1974),

Proponents of Class I and II price increases fail to meet this burden on the merits of the proposals because (1) proponents rely largely on erroneous policy arguments rather than facts to support their claims, (2) proponents did not confront changes in pricing policy implicit in their proposals, nor provide evidence and legal analysis supporting any departure from past policy, (3) proponents admitted on cross-examination that they did not know of specific facts to buttress many of their bald conclusions, (4) the essential 'facts' they rely upon are not facts at all, but rather speculation about what might happen in the future,[10] and (5) their objectives run contrary to legislative policy, as construed and applied by the agency for many decades.

A. Individual Factors Claimed by NMPF to Support Class I–II Price Increases:

NMPF's proffered justification for an increase in regulated Class I and II prices is that certain producer input costs, which NMPF calls "Class I supply costs" (Ex. 5, p. 8), have allegedly increased. NMPF extracts these cost factors from the Federal Milk Order Reform *Recommended* Decision, 63 Fed. Reg. 4801 (Jan. 30, 1998), to which NMPF improperly refers as the "reform decision." Ex. 5, pp. 10-11. NMPF nowhere cites to the

[10] Speculation based on conclusory assertions that price increases were necessary to secure an adequate supply for a handler's "own good," was fatal to the pricing rule reviewed by the 7th Circuit in *Borden, Inc., v. Butz*, 544 F 2d 312 (1976).

final Milk Order Reform Decision, 64 Fed. Reg. 16026 (April 2, 1999), in its hearing statement.

1. The "Grade A" differential. NMPF maintains that the cost difference to produce Grade A versus Grade B (manufacturing grade) milk is $0.55, justifying $0.15 of its proposed increase in Class I prices. NMPF arrives at this increase (1) by assuming that alleged increases in non-feed milk production costs from 1998 to 2005 correspond with the extra costs to produce Grade A milk, and (2) by applying the calculated or indexed percentage increase to a Grade A differential of $0.40 estimated in the past. Cryan, Ex. 5, pp. 9-10. NMPF made no attempt to identify discrete differences in ***current*** Grade A versus Grade B production and quality standards, or to isolate and quantify production cost differences (if any) attributable to differences in these standards.

The evidence is clear that significant differences between Grade B and Grade A production and quality standards have been eliminated in recent years. *E.g.,* Tonak, Tr. 736-65; 789-92; Ex. 32 (Wisc. Ag. Code). The promulgation of Grade B standards much closer to Grade A standards suggests any Grade A differential in the Class I price should be *reduced* because the production cost differences are now less, not greater, than in the past. Although Grade A production costs were mentioned as a pricing factor in the Final Reform Decision (64 Fed. Reg. at 16109) – the only factor cited by NMPF to survive in the Final Decision – Grade A versus Grade B production costs are of questionable continuing relevance to federal order Class I pricing. Less than 2% of U.S. milk production is now Grade B milk. In most states, including the Northeast and Southeast markets that NMPF claims are suffering supply problems, no Grade B milk whatsoever is produced. NASS, Milk Production, Disposition and Income (April 2006), p. 12.

It is enough that NMPF has not met its burden of proof by offering reliable and objective evidence as to the production cost differences directly related to current Grade A and Grade B standards.

2. Marketing costs. NMPF relies on the FMMO reform ***Recommended*** Decision's description of historical Class I pricing as including a factor for "marketing costs," including balancing, transportation, procurement, give-up premiums, and other costs, in aggregate estimated to represent 60 cents of the historical Class I differential. Cryan pp. 10-11. NMPF used average manufacturing plant cost increases of 22% as a surrogate for objective evidence on increased costs attributable to this part of the Class I differential, claiming that a system-wide Class I price increase of $0.13 to improve producer revenue is therefore justified. Ex. 5, pp 10-11.

NMPF did not offer any survey of costs or cost changes attributable to each specific component of "marketing costs" such as USDA required for use in make allowance modification. Its proposal on this pricing component, in any event, is limited to alleged system-wide supply-side costs without addressing system-wide demand factors that USDA has consistently required prior to, during, and after Federal Order Reform. NMPF has failed to meet its burden of proof of any need for any Class I or Class II price increase on this element of its claim.

3. Transportation and assembly costs. Although the ***Recommended*** Reform Decision described historical "marketing costs" as including milk transportation and assembly (Ex. 5, pp. 10-11), NMPF urges that $0.10 should be added to regulated Class I and II prices to account for increased producer transportation costs Ex. 5, pp 11-12. The suggested price increase for transportation would therefore represent redundant cost recovery, even if additional transportation costs justify a system-wide increase in regulated prices.

NMPF's proposal is not just an effort to double-dip cost recovery, however; it is an effort to quadruple-dip recovery of any transportation cost increases. Higher transportation costs are currently included in transportation and assembly credits in several markets. Higher transportation costs are additionally included in over-order marketplace premiums (including hauling subsidies) paid for milk, the benefit of which is efficiently realized by the cooperative or other supplier of milk to distributing plants rather than diluted in blend prices payable to all producers. In addition to its failure to quantify transportation cost increases not already recovered by price regulation or by price negotiation in the competitive marketplace, NMPF has again failed to link its claim of supply-side cost increases with demand for milk and system-wide adequacy of milk production.

4. Competitive factor costs. In the ***Recommended*** Milk Order Reform Decision, USDA suggested that regulated Class I prices could include an estimated "competitive factor" of $0.60, reflecting a portion of "actual competitive costs incurred by fluid plants to simply compete with manufacturing plants for a supply of milk." 63 Fed. Reg. at 4909. NMPF observes that reported over-order premiums in Chicago, Milwaukee and Minneapolis increased by 65% between 1996 and 2005, and argues that this justifies the addition of $0.39 to the minimum regulated Class I price. Cryan, Ex. 5, p. 12. NMPF completely overlooks, however, the relevant factors and factual assumptions underlying possible inclusion of a "competitive cost" element in Class I prices in USDA's *Recommended* Decision. 63 Fed. Reg. 4909. These factors include whether the absence of a "competitive factor" in the regulated price, and reliance instead on marketplace premiums to adjust regulated prices, produces "a risk that handlers may not face equal raw product costs for various reasons." *Id.*[11] In other words, should regulated prices include a greater portion of marketplace premiums in order to advance price equity between Class I handlers? On this record, the answer is unequivocally "no."

First, NMPF and its members who testified in support the NMPF proposal provided no evidence or analysis to assure that premiums would correspondingly decline if regulated prices increase. The risk of any raw product cost inequity would therefore continue, and not be mitigated by NMPF's proposal. Second, NMPF produced no evidence to support the notion that inter-handler raw product cost inequity exists or how its proposal would restore equity. Third, Class I handlers, as revealed by testimony on behalf of IDFA and many of its member processors, uniformly opposed the NMPF proposal and offered objective evidence that the proposal would create new inequities between handlers and undermine the functional efficiency of over-order premiums to meet local market needs. Like the Class I price increase discussed, *Borden, Inc., v. Butz*, 544 F 2d 312 (1976), NMPF's proposal may not be adopted simply because it is claimed to be for Class I handlers' "own good."

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[11] Other factors included in the ***Recommended*** Decision's "competitive price" analysis were: (1) whether the regulated Class I price ensured "a sufficient supply of milk," and (2) whether inclusion of a competitive factor improved or interfered with marketplace signals to producers encouraging or discouraging milk production. *Id.* As to the first of these, there is a sufficient current and projected supply of milk without a Class I and Class II price increase (*See* Baseline projections in Dairy Program's *Appendix to Preliminary Analysis for Hearing Concerning Class I and II Price Formulas*). As to the second, the *Recommended* Decision concluded that marketplace signals function better in the absence of a "competitive factor" in the Class I price because "having a larger portion of Class I value pooled could mute price signals to producers" and "provide an incentive to overproduce for fluid needs." *Id.* In several regions of the country, the current Class I price structure has resulted in muted marketplace signals and overproduction for fluid, as described in the following pages of this brief. NMPF's proposed system-wide price increase would only aggravate these trends.

As repeatedly affirmed by USDA before, during, and after Federal Milk Order Reform, the function of regulated prices under the AMAA is served by "minimum" price regulation, and allowing the marketplace to determine "the" price. The higher the level of price regulation, the more regulation interferes with market forces. Under Secretary Bill Hawks reaffirmed this function in his 1993 letter to Congressmen Blunt and English, explaining: "The FMMO Program is a marketing tool, not a price support program." (Ex. 46, and attachment hereto). It is designed to provide a balance of market power between producer cooperatives and handlers. *Id.* The prevalence of marketplace premiums in response to variable supply and demand conditions in federal order markets, with premium benefits returned to those that incur costs, is demonstration that the system works, not that it is broken.[12]

B. NMPF's Claims of a System-Wide Problem Requiring System-Wide Class I and Class II Price Increases.

NMPF seeks system-wide increases in Class I and II prices, to enhance producer revenue, regardless of any particular local or regional need. By focus in its testimony on some markets, and stone silence about others, NMPF implicitly acknowledges that the solution it seeks is much larger than the problem it identifies. "The growing difficulty of

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[12] The turn-of-the-21st Century marked not only an attempt at milk order reform, but also consolidation of dairy cooperatives into organizations with much greater market power and political power. The prevailing level of premiums in some markets since that time suggests that federal milk order policy has unduly shifted the balance of market power to large cooperatives, and consideration should therefore be given to *reducing,* not increasing, regulatory interference with the market upon which that market power is built and exploited. As USDA stated on page 40 of its 2004 Report to Congress, *Economic Effects of U.S. Dairy Policy and Alternative Approaches to Milk Pricing*: "Consolidation among dairy cooperatives and their increased share of milk marketings may have gone a long way toward redressing the imbalance in market power between milk sellers (producers, through cooperatives) and buyers (milk processors and dairy product manufacturers)." The 2004 Report also observed that many of the marketing problems of milk perishability leading to need for milk orders in the early 20th Century have substantially reduced due to improved transportation, refrigeration and production technology. *Id.*

supplying local and regional deficit markets threatens orderly marketing in the Southeast and the Northeast, in particular. Current revenues are often inadequate to maintain efficient local supplies of fluid milk." Cryan, Ex 5 p 4-5. If ***local*** milk supply as generated by current farm revenue is the primary relevant inquiry, a proposition USDA has repeatedly disclaimed, NMPF itself disproves the need for sweeping, system-wide, price increases. In many markets, the current price structure of federal orders has stimulated rapidly-expanding local milk supplies, as illustrated in the following table.

Annual Milk Production (million pounds) in Selected States,
1995, 2000, and 2005, and Percent Change 1995 to 2005

Region and state	1995	2000	2005	'95 – '05 % change
MIDWEST				
Wisconsin	22,672	23,259	22,866	+ 1%
Minnesota	9,290	9,493	8,195	***- 12%***
MIDEAST				
Michigan	5,504	5,705	6,735	**+ 22%**
Ohio	4,750	4,461	4,743	-----
Indiana	2,174	2,419	3,166	**+ 46%**
CENTRAL				
Iowa	3,977	3,934	4,020	+ 1%
Kansas	1,166	1,540	2,276	**+ 95%**
Colorado	1,511	1,924	2,348	**+ 55%**
SOUTHWEST				
New Mexico	3,606	5,236	6,951	**+ 93%**
Texas	6,089	5,743	6,442	+ 6%
SOUTHEAST				
Florida	2,376	2,463	2,271	------
Missouri	2,645	2,258	1,875	***- 29%***
Georgia	1,540	1,433	1,398	- 9%
Kentucky	1,955	1,695	1,371	***- 30%***
NORTHEAST				
New York	11,425	11,921	12,078	+ 6%
Pennsylvania	10,384	11,156	10,503	+ 1%
Vermont	2,520	2,683	2,641	+ 5%
California	25,294	32,245	37,564	**+ 49%**
UNITED STATES	153,737	167,393	176,989	+ 15%

Source: NASS, Milk Production. States with significant (over 10%) 1995 – 2005 milk production increase are shown in **bold**; states with significant decrease are in ***italics.***

It is abundantly clear that the current Class I and producer price surface as adjusted by location, based upon 1995 milk supply and demand points in the USDSS model, deserves reexamination. With large (93%) milk production increases and cheese plant construction in New Mexico, for example, does it still make economic sense to pay as much (or more) in blend prices drawn from the Central pool for milk diverted to New Mexico cheese plants as for milk delivered to serve Iowa, Missouri and Illinois distributing plants? Shouldn't growing supply areas in Indiana, Michigan, Colorado, Kansas and New Mexico be factored into a new USDSS evaluation of the value of milk at all demand locations relative to new major supply locations? The answer to the first question is "no," and to the second question "yes," by consistent application of Federal Milk Order pricing standards. The multiple supply and demand Class I pricing surface, adopted by FMMO reform, reduced Class I prices at demand points in several markets below the traditional Midwest basing point (albeit to a lesser extent under Option 1-A). This was done in "explicit recognition that these other areas have adequate milk supplies to satisfy Class I demands at lower costs." 64 Fed. Reg. at 16114. There are regional local milk supply shortages, particularly in the southeast, as observed by NMPF. There are also regions with surging milk supplies – a fact ignored by NMPF.[13] The NMPF proposal would do more to provide a windfall and production stimulus for New Mexico producers than provide revenue salvation for Southeast producers.

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[13] Midwest producers have suffered lower Class III and IV prices as a result of regional production incentives in the Central, Mideast and Southwest markets, among others. At the same time, Midwest producers have faced new regulatory barriers in their efforts to market milk to such favored markets as USDA has apparently adopted new policies to allow dominant cooperatives in those markets to decide who should have access to local market pools. Tr. 1207 – 1211, 1343 (cross-examination by USDA Marketing Specialist). As a result, Midwest milk production has stagnated in Wisconsin and sharply declined in Minnesota, while production in Michigan, Indiana, Kansas, Colorado, and New Mexico had enjoyed increases of 22% to 95% between 1995 and 2005.

If USDA concludes that the marketplace response to local shortages in the form of premiums is not working, despite evidence to the contrary, the solution would be to increase handler and/or producer location-adjusted prices for milk delivered to the Southeast, while at the same time reducing adjusted minimum prices in the Southwest, West, and in parts of the Central and Mideast states,[14] to temper milk production at locations where supplies are expanding at a far greater rate than demand for milk in Class I and II uses. Although a location-specific examination of national milk supply to demand is beyond the limited scope of this hearing, the fact that less burdensome and better functioning alternatives are available to the Secretary, if the heavy hand of greater regulatory interference with the marketplace is needed at all, is reason enough to deny NMPF's sweeping proposal.

V. THE NMPF PROPOSAL, IF ADOPTED, WOULD SEVERLY HARM MIDWEST SMALL FAMILY DAIRY FARMS AND CREATE DISPROPORTIONATE BENEFITS FOR PRODUCERS IN OTHER REGIONS, INCLUDING RAPIDLY-EXPANDING PRODUCTION AREAS IN SOME SOUTHWEST, CENTRAL AND MIDEAST STATES.

In the Farm Security and Rural Investment Act of 2002, Congress directed the Secretary of Agriculture to conduct a "comprehensive economic evaluation of the … effects of the various elements of the national dairy policy." In its July 2004 Report to Congress, entitled *Economic Effects of U.S. Dairy Policy and Alternative Approaches to Milk Pricing*, at pp. 40-41, USDA reconfirmed several relevant economic truths about Federal Milk Order Class I and II pricing: (1) high Class I and II prices reduce

[14] The Secretary should not infer that Midwest Dairy Group opponents of the NMPF proposal would endorse (or oppose) such a proposal. Although not on the table, the Secretary may advance a proposal of this type to provide a means of some price adjustments that could be revenue neutral (or even enhancing) as to Class III and IV prices, because price-induced greater milk supplies to the Southeast and other deficit markets would be offset by price-induced production disincentives where milk supply growth has apparently been unreasonably stimulated under the current regulatory structure.

consumption of fluid milk and soft dairy products, and (2) production stimulated by high Class I and II prices causes reduced prices for Class III and IV commodity products.

USDA's pre-hearing economic analysis of the NMPF proposal confirms that higher system-wide Class I and II prices will stimulate production. It will also cause a decline in consumption of fluid milk and Class II products. The combined effect will be much more milk production surplus to Class I and II demand with consequent lower dairy product commodity prices and regulated Class III and IV prices. Because of regional differences in Class I utilization, there will be disparate benefits and burdens to producers, by region, unrelated to needs of individual producers or markets for financial assistance. In similar circumstances in the past, these circumstances have weighed heavily in USDA's decisions to deny system-wide Class I and II price increases. E.g., 63 Fed. Reg. 32147, 32150 (June 12, 1998); Exs. 46 and 47.

Under any analysis, producers in the Upper Midwest would enjoy the least benefit, or suffer the greatest harm, from the NMPF proposal due to the great dependence by producers on income from Class III and IV uses of milk. If the Secretary's analysis of the NMPF proposal survives evidentiary and policy hurdles described above, he will need to address the issues of interregional inequity that have been heavily weighed in prior decisions.

As starting point for interregional and small farm impact analysis, we refer to dairy baseline results from the econometric model developed by the Interagency Agricultural Projections Committee, World Agricultural Outlook Board, Office of the Chief Economist, USDA (see http://www.usda.gov/oce/commodity/ag_baseline.htm), which Dairy Program's economist, Howard McDowell, employed for preliminary analysis. By use of this model, Mr. McDowell projected national supply, demand and price responses from dynamic changes produced by NMPF's proposal (when that proposal called for a $0.73 rather than a $0.77 increase in Class I and II prices). *Appendix to Preliminary Analysis* and *National Econometric Model Documentation (Model Calibrated to USDA Ag. Baseline Projections to 2015*),http://www.ams.usda.gov/dairy/class_I_II/classI_II_pr_for.htm . The Baseline projections, built upon 2006 status quo in the baseline model, reveal steady national milk production increases from 184,123 million pounds in 2007 to 199,193 million pounds in 2015. A revised baseline, as adjusted by Dairy Programs econometric analysis for increased Class III and IV make allowances, also reveals steady (but moderated) production growth, from 184,082 million pounds in 2007 to 198,907 million pounds in 2015. *Economic Analysis, Class III and IV Make Allowances, Tentative Final Decision* (Nov. 2006) < http://www.ams.usda.gov/dairy/proposals/classIII_IV_make_all.htm >.

Changes in production and prices projected by Mr. McDowell from the NMPF proposal (at $0.73) reveal, on a national basis: an increase in milk production from baseline each year, from +46 million pounds in 2007 to +319 million pounds in 2015 (Analysis Appendix, Table A-2); a decrease in Class I marketings, from -81 million pounds during 2007 to -62 million pounds during 2015 (Table A-8); an increase in combined Class III and IV marketings, from +82 million pounds in 2007 to +213 million pounds in 2015 (*id.*); a reduction in Class III milk prices at test, from -$0.06/cwt in 2007 to -$0.18/cwt in 2015 (T. A-7); and a reduction in Class IV milk prices at test, from -$0.16/cwt in 2007 to -$0.24/cwt in 2015 (*id.*). If these results are accepted, notwithstanding substantial evidence of understated consequences raised by several witnesses, Upper Midwest producers will suffer significant losses in net income. Gould, Ex. 26; Knutson, Ex. 44.

While it is clear from Dairy Program's use of the Baseline Model that there will be increased milk production and reduced Class III and IV revenue from NMPF's proposal, the Model does not project regional responses. More importantly, there are important questions about Dairy Program's use of the model, what data was input for purposes of Dairy Program's preliminary analysis, and of non-transparent assumptions built into the model. Each of these questions related to projected price and production changes from the NMPF proposal as calculated by Mr. McDowell, not to the status quo baseline results. The answers to these questions would reveal whether the results reported by Mr. McDowell seriously understate milk production response to the NMPF proposals and therefore seriously understate adverse impact on producers, particularly small dairy farm enterprises located in the Upper Midwest and nearby markets.

The principal evidentiary issues with the reported model results from projected Class I and II price changes, and the consequences to producer harm and benefit analysis, are summarized in the record (by attorney Vetne,Tr. 1068 – 1070), as follows:

1. Whether Mr. McDowell's input of price increases for Class I and Class II milk were limited to the production in Federal Orders or whether they were also input for Class I and II use in non-federal markets which either adopt or respond to Federal Order price levels. The record reveals that state-regulated milk markets, as well as unregulated markets, adopt or respond to federal order price changes with corresponding price changes for such jurisdictions and markets. Kinser, Tr. 1005-06; 128-32. If (as it now appears) higher prices were not input for these markets in Dairy Program's use of the model, the national production response would be understated by about one-third, and Class III – IV prices projected by the model are too high.
2. Elasticities used in the model to measure milk production (yield and cow number) response to price, as well as consumer demand and wholesale demand for milk products, were questioned. There was considerable testimony that elasticities employed in the model may understate producer, processor, or consumer response to price changes. Testimony of Knutson and Gould. To address this issue, the elasticities used must be transparent, so that interested parties can respond with

evidence, supported by statistical science and general acceptance of experts in the field, that the price response of sellers and buyers along the supply chain are probably greater than that employed in the model.

3. Econometric models forecast probable future results based on past observations. The reported projected response is not an absolute, but rather represents the median of expected results within a range of results at certain confidence intervals. The confidence interval would reveal the likelihood of actual responses to input changes from baseline that are greater or smaller than projected. The model, as employed by Dairy Programs, does not disclose a transparent confidence interval.

Additionally, there is no doubt that the model understates production response from NMPF's proposal, and consequent lower Class III and IV prices, simply by its use of $0.73 as the measure of change rather than $0.77 as NMPF advocated at the hearing.

Counsel for the Midwest Dairy Group requested USDA to attempt to ascertain answers to the foregoing three questions, and post answers on its website in advance of briefing. Counsel for USDA advised that the request would be considered:

> Let me say for the record, your Honor, we have talked about this and we are willing to take that request back to the Department and review the request and if answers are forthcoming they will be put on the website and we will try to do that as expeditiously as we can. That's what I can offer.

Stevens, Dec. 14, 2006, Tr. 1072. The answers have not been posted as of January 25, 2007. For purposes of national as well as regional impact analysis, therefore, the Secretary should conclude that the production response, and adverse impact on Midwest dairy interests, is substantially greater than that projected by Mr. McDowell's preliminary analysis.[15]

[15] The author of the preliminary analysis, Mr. McDowell, did not appear as a witness to explain it or answer questions about his use of the baseline model. USDA counsel represented that Mr. McDowell did not come because no one asked him to: "I am here to tell you that no one contacted the Department and asked that an economist come to that hearing. No one asked for Mr. McDowell or anyone else to appear at this hearing to explain the model." Stevens, Tr. 1350. This statement was highly misleading. Undersigned counsel for Midwest Dairy Group emailed Mr. McDowell and

The regional harm to Midwest Dairy interests, well in excess of projections by McDowell, was addressed in testimony by Dr. Gould (Ex. 26), and by Dr. Knutson. Noting the apparent shortcomings of assumptions and input in the McDowell projections, Dr. Knutson estimated a loss in Class II and III marketings to Upper Midwest producers of $302 million over the nine years projected by McDowell, and $57 million in net losses, simply by adjusting the Class I and II price increase from $0.73 to $0.77 in the McDowell projections. However, Dr. Knutson cautioned that an adverse impact of at least twice that amount would result from employment of supply and demand elasticities commonly used by university dairy economists, although the timing of the hearing after notice did not allow econometric evaluation by other interested parties. Ex. 44, pp. 5-6; Tr. 1134 – 1135. The adverse impact on Midwest producers from the NMPF proposal may even be "much higher" if, as appears possible, USDA used a retail elasticity that is one-tenth of that employed by Cornell. Tr. 1199. By any measure, "this proposal knocks the small producers in the Upper Midwest in the gut." Knutson, Tr. 1187.

Finally, our arguments on the merits disprove any need for emergency rulemaking amendments, but support an expedited decision terminating this proceeding for the same reasons expressed by the Secretary in his 1998 Decision terminating a Class I and II floor price proceeding. 63 Fed. Reg. 32147, 32150 (June 12, 1998). The Secretary's analysis of small business impact in that proceeding also documents the need for a full Regulatory Flexibility Analysis in this case, if the Secretary decides grant any part of NMPF's request.

Gino Tosi on December 7, 2006, to inquire about Mr. McDowell's availability to answer questions at the hearing (email attached). In any event, parties reasonably assumed that Mr. McDowell would appear to explain his work, as he has done before and as has been USDA's consistent practice for data developed by agency employees. USDA has not established any protocol, sometimes employed by other agencies, requiring an affirmative request for opportunity to cross-examine a witness on disputed facts or undisclosed assumptions. Mr. McDowell's absence represents an unexpected procedural departure from past agency practice.

CONCLUSION

NMPF's proposal for a system-wide increase in regulated Class I and II milk prices is bad as a matter of policy, irrational as a matter of economics, unsupportable as a matter of evidence, and destructive as a matter of inter-regional equity. The Secretary has fulfilled his §608c(17) responsibility to NMPF by holding a hearing on a proposal that is virtually indistinguishable from similar proposals repeatedly rejected for reasons of policy and milk supply-demand balance during 2002 and 2003. The Secretary should now exercise his statutory responsibility under the AMAA to safeguard the welfare of producers as a whole, protect equity between processors, and protect the public interest, by denying the NMPF proposals and terminating this proceeding.

Respectfully submitted,
MIDWEST DAIRY GROUP

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January 30, 2007

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May 20, 2003

The Honorable Ann M. Veneman
Secretary, United States Department of Agriculture
14th Street & Independence Avenue, SW
Washington, DC 20250

35-4221535
AMS

Dear Secretary Veneman:

I write today regarding dairy farmers' cost of production and its impact on the dairy industry. With historically low milk prices, coupled by higher feed and transportation costs, dairy farmers are going out of business in record numbers.

Last Fall, your Department turned down the petition submitted by Dairy Farmers of America (DFA) and Dairylea Cooperative requesting an emergency Federal Order hearing to establish a Class I and Class II price adjuster under all Federal Milk Marketing Orders. This petition was filed in response to the drought conditions and increased feed prices that at that time had contributed to these farms' increased financial stress.

Farmers across my district and the nation are now in worse financial shape. The Boston Class I milk price for April was $12.89 per hundredweight, the lowest in twenty-five years. While I commend your Department for the steps taken to assist livestock owners, my farmers continue to be faced with a crisis. They struggle to care for their families while continuing to ensure daily production of fresh, safe, and wholesome milk for the nation's food supply.

Despite the efforts of USDA and the Congress, my farmers continually face high feed and transportation costs and other variables that challenge their ability to sustain their farms and rural communities. Therefore, I am asking your review of the 1937 Agricultural Marketing Agreement Act (AMAA), which takes into consideration the regional costs of feed, feed availability, or other region specific economic factors. The AMAA, Section 608c(18) clearly called for the consideration of the economic factors regarding the marketing of milk in regional orders across the country. Upon your review, I am requesting the full enforcement of the AMAA, which would eliminate the hardships inherent to the dairy farmers' cost of production.

Thank you for your time and utmost consideration of this important matter. I look forward to hearing from you upon your review.

Sincerely,

Phil English

Phil English
Member of Congress

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DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

JUN 16 2003

The Honorable Philip S. English
U.S. House of Representatives
1410 Longworth House Office Building
Washington, D.C. 20515-3803

Dear Congressman English:

Thank you for your letter of May 20, 2003, to Secretary Veneman. The Secretary has asked me to respond on her behalf.

Indeed this has been a difficult time for dairy farmers and, as you mentioned, the Department of Agriculture (USDA) has taken steps to aid farmers. However, the current supply of milk continues to exceed the demand of milk and dairy products. Until the rate of growth in the use of milk and dairy products is greater than the rate of growth in milk production, farm level milk prices are expected to remain low.

In your letter, you ask for a review of the 1937 Agricultural Marketing Agreement Act (AMAA) with respect to regional costs of production. As you know, the AMAA authorizes the Federal Milk Marketing Order (FMMO) program. We at USDA believe that our administration of the FMMO program is consistent with the authorities provided in the AMAA. The FMMO program is a marketing program with the objective of assuring that fluid (drinking) milk markets are adequately supplied and is not intended to be a price support program.

Within the FMMO program, a national classified pricing network has been established that enables milk to move to more urban fluid consumption and milk processing areas from more rural milk production and dairy product manufacturing areas. Section 608c(18) of the AMAA requires USDA to consider the parity price for milk when setting the level of minimum prices under the FMMO program. The section further provides that if USDA finds that the parity price for milk is not reasonable based upon evidence submitted during a rulemaking proceeding, a price should be established that is reflective of available supplies of feeds and other economic conditions which affect market supply and demand for milk. Based on our review of the AMAA, we believe that these factors have been appropriately incorporated into the FMMO program.

Thank you for your continued interest and leadership on dairy issues. We look forward to working with you on this and other issues.

Sincerely,

Bill Hawks

Bill Hawks
Under Secretary
Marketing and Regulatory Programs

Main Identity

From: "John Vetne" <john.vetne@verizon.net>
To: <howard.mcdowell@usda.gov>
Cc: <gino.tosi@usda.gov>
Sent: Thursday, December 07, 2006 11:15 AM
Subject: Pittsburgh hearing

Mr. McDowell

Will you be presenting testimony in Pittsburgh next week on your preliminary economic analysis? It would be very helpful for interested parties and for a good record.

John H. Vetne
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