

BEFORE THE SECRETARY OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

<i>In the matter of:</i>)	
)	
Recommended Decision of Tentative)	Docket No.
Marketing Agreements and Orders)	A0-14-A78, <i>et al.</i>
)	
(Producer-Handlers and Exempt Plants))	DA-09-02
)	

Comments and Exceptions of the National Milk Producers Federation

The National Milk Producers Federation (NMPF) hereby submits its comments and exceptions in the above-captioned proceeding. NMPF is a national association that represents the interests of 31 dairy cooperative associations and the 40,000 of America’s estimated 60,000 dairy farmers who own and supply those cooperatives.

The Agricultural Marketing Service (AMS) of the U.S. Department of Agriculture (“USDA”) initiated this proceeding to consider proposals submitted by NMPF and the International Dairy Foods Association (IDFA) to eliminate the exemption that has previously been afforded to producer-handlers from certain pricing and pooling provisions of federal milk marketing Orders (“Proposal 1”); and to increase the size-based exemption afforded to small processing plants from 150,000 pounds per month in each market to 450,000 pounds per month in all markets (“Proposal 2”). NMPF also submitted “Proposal 26”, which recommended a qualified exemption from pricing and pooling provisions of federal milk marketing Orders for currently existing producer-handlers so long as their monthly volume of fluid milk sales does not exceed 3 million pounds.

These comments express NMPF's general support for the recommended decision. They also point out an easily-corrected potential deficiency in the recommended language. Finally, they restate crucial additional criteria that should be required of producer-handlers.

Recommended Decision is Major Improvement on *Status Quo*

USDA's recommended decision would accomplish a large part of what NMPF and IDFA intended when they filed their original petitions and, therefore, NMPF supports the recommended decision as a substantial improvement over the *status quo*.

Through petition, testimony, and briefs, NMPF and IDFA argued that the current, unlimited producer-handler exemption from pooling and pricing requirements was causing disorder in Federal order milk markets. USDA appears to have accepted many of these arguments in formulating its recommended decision, including NMPF's arguments regarding the pricing advantage enjoyed by producer-handlers as a result of the exemption. USDA has recognized that producer-handlers were originally granted the exemption from pricing and pooling requirements because regulators assumed that they would operate on a small scale and have little impact on the dairy markets. (74 FR 54409, 54411) USDA's decision chooses to mitigate, but not completely end, the impact of the exemption by limiting the size of producer-handlers who may be afforded the exemption.

USDA's decision takes an understandably direct and pragmatic approach: the decision would address the core problem by capping the exemption at 3 million pounds of route disposition. This largely reflects the precedent of the Arizona and Pacific Northwest markets; however, USDA's decision correctly applies the limit to total disposition, rather than disposition in a single milk marketing area.

This approach offers a simple and pragmatic compromise among the interests presented in this proceeding. USDA would regulate large producer-handlers who are currently having a significant impact on the market, while leaving substantially unregulated the smaller existing producer-handlers whose impact on the markets is small enough not to justify a potentially wrenching regulatory change. With respect to existing producer-handlers, then, the recommended decision substantially accomplishes

NMPF's goals in this proceeding, and even relies in some part upon NMPF's evidence and arguments with respect to Proposal 26.

NMPF remains concerned, however, that because the exemption will be available for new producer-handlers up to the 3-million pound limit, it will encourage a proliferation of producer-handler plants near that limit. If so, such plants could disorder marketing in the future, both individually and, especially, in aggregate. USDA may be forced, in a few years, to further mitigate this impact through a new hearing, with data derived from consequent experience.

NMPF hopes that these concerns will prove unfounded.

Expanding the capped volume to include packaged fluid milk sales

The recommended language capping the producer-handler exemption at 3 million pounds of route disposition may be inadequate to its purpose, and should be changed to avoid a potential and unintended problem. The exempt plant definition (7 CFR 1000.8 (e)) provides an exemption for:

(4) A plant that has route disposition and packaged sales of fluid milk products to other plants of 150,000 pounds or less during the month.

The underlined phrase above is crucial to effectively limiting this exemption.

The language in USDA's recommended decision sets the size limit for producer-handlers on route disposition alone, and does not contain the phrase "and packaged sales of fluid milk to other plants." This omission threatens to create a loophole that would allow a producer-handler to transfer unlimited volumes of packaged fluid milk products to another plant and still maintain its producer-handler status.

NMPF urges USDA to correct this oversight, and apply the precedent found in the exempt plant definition to the producer-handler limit. This correction is clearly in the scope of the hearing, since proposal 26 called for identical language in limiting the exemption for "grandfathered" producer-handlers, and USDA partially bases its general exemption for plants under 3 million pounds upon arguments offered in support of Proposal 26.

Additional criteria for producer-handlers

The recommended decision concludes that NMPF's advocacy of Proposal 26 implies its general acceptance of an exemption for small producer-handlers from normal pricing and pooling requirements: "A willingness to accept a 3-million pound per month limit on Class I route dispositions for current producer-handlers begs the conclusion that producer-handlers with Class I disposition at or below this level are not disorderly or, at the least, represent a tolerable deviation from strict application of pooling and pricing provisions." (74 FR 54410) NMPF contends, however, that it is incorrect to equate the acceptance of a continued exemption for the several small producer-handlers that now exist with the acceptance of an open door policy for new producer-handlers.

More importantly, NMPF's recommendation to accept a continued exemption for existing producer-handlers was specifically qualified: NMPF argued that the exemption for existing producer-handlers should be conditioned upon several additional criteria, most specifically, unique labeling and unique ownership. NMPF reiterates that recommendation: any exemption for producer-handlers should be conditioned on those two criteria, in addition to the size limitation.

USDA's recommended decision states that the current producer-handler definition sets "strict criteria that limit certain business practices including the purchase of supplemental milk. Given these limitations, producer-handlers bear the full burden of balancing their milk production between fluid and other uses." These criteria primarily address the burden that an unregulated handler may place upon the market by competing for an outside supply and disposing of surplus raw milk. However, the criteria in the definition do not adequately address the burden that the producer-handler imposes upon the market through its competition for customers.

The labeling and ownership limitations that NMPF proposed at the hearing – and which are supported by clear Federal order precedents – were intended to avoid horizontally integrated producer-handlers. These points have not been adequately addressed in USDA's recommended decision and NMPF contends that minor adjustments to the recommended decision should, therefore, be made. NMPF urges

USDA to adopt criteria that would effectively discourage the horizontal integration of multiple producer-handlers, through either common ownership or sale of packaged products to a common “integrator.”

Unique labeling

NMPF’s proposals for both size-exempted plants (Proposal 2) and grandfathered producer-handlers (Proposal 26) limited exemptions to plants with uniquely branded fluid milk products.¹ Clearly associating a producer-handler’s products with a plant-specific brand or brands would help to enforce the plant’s independent nature and substantially reduce the potential for the assembly of a supply of packaged milk by a price-focused milk “integrator” with substantial control of the plant’s product. Without such a limitation, a large retailer could recruit small exempt plants, organizing production in such a way as to remove the diseconomies of scale in marketing and distribution and even, through line specialization, of processing. As the recommended decision indicates, several witnesses testified that producer-handlers were able to impose balancing costs on pooled market participants through their packaging of products for retailers and distributors who relied on pool handlers to supplement the producer-handler supply with identically branded products. (74 FR 54391, 54397, et al.) When this occurs, the rest of the market is made to balance the supply of the producer-handler through providing supplemental milk directly to the retailer or distributor.

In addition to balancing issues, there are issues of economies of scale in distribution. Customers who can obtain products with the same brand from multiple sources are able to capture economies of scale in marketing and distribution at the same time that they capture the regulatory price advantage of the producer-handler. This is inconsistent with the recommended decision’s finding that “the size of the dairy farm...is the controlling factor of the volume that is processed by the plant and that is available for distribution.” (74 FR 54409) Where there is horizontal integration, and where the producer-handler can supply the same brand from multiple plants, the producer-handler is not limited with respect to the volume “available for distribution.”

¹ As was explained in Dr. Cryan’s testimony, “uniquely branded” is intended to mean a brand sold by the plant in question, and by no other plant. This does not limit such a plant from selling multiple brands, it simply limits a brand from being sold by such a plant if it is also sold by any other plant. (Transcript, pp. 1892-1893) That is, an exempt plant, including a producer-handler, should not produce any products under brands that are also produced by other plants.

With respect to both balancing and economies of scale, such an “integrator” arrangement violates the intent and spirit of the original producer-handler exemption, which was intended to accommodate small farm businesses unlikely to affect their market. Thus, it is essential that the “unique labeling” qualification be included in the definition of “producer-handler.”

The language regarding labeling offered at the conclusion of these comments is adapted from Proposal 26 (which also provides some of the foundation of USDA’s decision to limit producer-handlers to 3 million pounds of fluid milk sales); however, functionally similar language exists today in the producer-handler definitions in the Arizona Federal Order. That language provides: “The producer-handler does not distribute fluid milk products to a wholesale customer who is served by a [pool plant] that supplies the same product in the same-sized package with a similar label to a wholesale customer during the month.” (7 CFR 1131.10(a)(6)) This was adopted in 1995 in the current Arizona Order’s predecessor order to address directly a wholesale customer’s “manipulation” of the producer-handler provision by purchasing the bulk of its packaged milk from a producer-handler and receiving supplemental packaged milk, with the same label, from a pooled handler. In that hearing, other solutions were proposed to prevent a producer-handler’s sales being balanced by the rest of the market without compensation. USDA, however, devised and chose an effective labeling restriction that is “far simpler” than other proposed solutions. (60 FR 50141) We agree with USDA’s assessment in that decision and urge its application in this one.

NMPF asserts that the language that it now offers is more direct and concise; however, the concept has clear precedent in the Arizona provision.

Unique plant ownership

Ownership limitations are as important as labeling limitations to avoid horizontally integrated producer-handlers. NMPF, in Proposal 26, also called for restrictions on common ownership of “grandfathered” producer-handler plants with other plants, to avoid the same potential for horizontal integration. With no limit on entry for new producer-handlers, this restriction becomes even more important.

Again, USDA's recommended decision states that "the size of the dairy farm determines the production level of a producer-handler's farm operation and is also the controlling factor of the volume that is processed by the plant and that is available for distribution." (74 FR 54409) However, the horizontal integration of multiple producer-handlers through common ownership, like integration with shared labels, can substantially expand the "volume...that is available for distribution" in competition with pool participants.

The scale of distribution is also important. A string of producer-handler plants operated by a single firm would have the same impact on the market as a large individually-pooled handler. USDA's recommended decision specifically rejected individual pooling of handlers as contrary to decades of Federal order decisions. (74 FR 54409-10).

The language regarding plant ownership offered at the conclusion of these comments is adapted from Proposal 26 (which also provides some of the foundation of USDA's decision to limit producer-handlers to 3 million pounds of fluid milk sales); however, functionally similar language exists today in the producer-handler definition in the Pacific Northwest Federal Order. This language provides: "The producer-handler is neither directly nor indirectly associated with the business control or management of, nor has a financial interest in, another handler's operation; nor is any other handler so associated with the producer-handler's operation." (7 CFR 1124.10(a)(4)) This principle has been addressed and supported in previous cases, including *In Re: Yasgur Farms*. (33 Ag. Dec. 389, 1974) This is a clear precedent for restriction of common ownership by producer-handlers.

Ownership of multiple farms

NMPF also contends that the producer-handler exemption should be available only to a producer handler with a single dairy farm, and not to someone operating multiple dairy farms. Once again, NMPF notes that USDA has made a specific finding that the "the size of the dairy farm determines the production level of a producer-handler's farm operation and is also the controlling factor of the volume that is processed by the plant and that is available for distribution." (74 FR 54409) In light of this, the language stating that a producer-handler "operates a dairy farm and a distributing plant" (e.g., 7 CFR

1032.8(a)) should be interpreted to mean that, to qualify for the exemption, a producer-handler may operate only a single dairy farm and a single distributing plant. NMPF urges this interpretation, which is appropriate in the context of the new size restriction. Whether or not this interpretation has been specifically applied in the past, it should be clarified by this decision so that only one farm may be associated with each producer-handler.

Conclusion

NMPF generally supports USDA's decision. NMPF believes that it will address most, although not all, of the market disruption caused by existing producer-handlers.

NMPF remains concerned about the potential proliferation of producer-handlers processing between one million and three million pounds per month. This proliferation would be greatly encouraged if there was no curb on the horizontal integration of such plants united under common ownership or joint marketing. For this reason NMPF strongly urges USDA to adopt additional criteria, as set forth below -- language based on Proposal 26, that would require branding unique to the plant and restrict a producer-handler's ownership to that single producer-handler plant.

NMPF also urges the addition of "packaged sales of fluid milk products to other plants" to the definition of producer-handler size qualification. This is crucial to avoiding a loophole that would allow producer-handlers of unlimited size.

NMPF urges USDA to make these several improvements in the decision by adopting the following language into the producer handler definition:

(a) Operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, and from which total route disposition and packaged sales of fluid milk products to other plants during the month total 3 million pounds or less and are uniquely branded.

(b) Has no interest in any other distributing plant (except through membership in a Capper-Volstead cooperative association).

We thank USDA and USDA staff for holding this hearing, for their diligence in providing data, and for their adherence to statutory timelines. We look forward to a timely and positive result from this comment period.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Roger Cryan". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Roger Cryan, Ph.D.
Director of Economic Research
National Milk Producers Federation
2101 Wilson Boulevard, Suite 400
Arlington, Virginia 22201