AIDA

AMERICAN INDEPENDENT DAIRY ALLIANCE

October 6, 2009

Legal Policy Section
Antitrust Division
U.S. Department of Justice
450 5th Street, N.W., Suite 11700
Washington, D.C. 20001

Re: USDA/DOJ Public Workshops to Explore Competition Issues in the Agriculture Industry

Dear Sirs:

In response to your invitation to submit additional topics for these workshops, the American Independent Dairy Alliance ("AIDA") requests evaluation of the anticompetitive impacts of the Federal Milk Marketing Order system ("FMMO") adopted under the Agricultural Marketing Adjustment Act of 1937 ("AMAA"). Almost twenty years ago, the Department of Justice Antitrust Division ("DOJ"), characterized this program as arcane, anti-competitive, inefficient and costly to producers, consumers and taxpayers. While changes have been made to the system during the intervening time, the essential components remain the same.

Market distortions created by the FMMO system have, in fact, accelerated. They continue to undermine competition in national and international markets. The AMAA administrative procedures promote both monopoly and monopsony. They enshrine market conditions of the past rather than facilitating competitive opportunities in the current market. The future of the industry is at risk and the time for change is now. Effective change in the dairy industry is not possible without a fundamental change in the FMMO system.

I. BACKGROUND: DOJ Has Already Determined That the FMMO System Is Anticompetitive and Should be Terminated

Over twenty years ago, during a period of extremely low prices for dairy farmers, an extensive analysis by the Government Accounting Office determined that the FMMO system no longer effectuated the stated purposes of the AMAA.[1] In 1990 and 1992, DOJ recommended termination of the program.[2] DOJ characterized the FMMO system as an arcane system of

[1] Milk Marketing Orders Options for Change, GAO/RCED-88-9, March 1988.

[2] Comments of the Department of Justice on "National Hearing to Consider Possible Changes in the Federal Milk Marketing Order Program," May 31, 1990,

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regulation designed to address conditions that ceased to exist long ago. Rather than helping dairy farmers, DOJ determined that the system "hinders accomplishment of those goals and imposes significant costs on consumers, producers and taxpayers"[3] for the following reasons:

- The market conditions leading to enactment of the AMAA no longer exist;[4]
- The FMMO system imposes substantial costs and is inefficient;
- Reliance on the free market will provide more orderly marketing than the current regulatory system;
- Deregulated milk markets have been successful;
- The dairy industry, like virtually all other vital industries, should be freed from outdated and inefficient regulation.

The Department concluded that:

> Milk marketing, like virtually all other industries, should be allowed to operate in a free market. This will lower industry costs, result in a sounder dairy industry, and provide consumers with a dependable supply of milk in a more efficient and competitive way.[5]

II. Changes to the FMMO System Have Made The Situation Worse

During the intervening period, the competitive landscape in the dairy industry has continued to deteriorate. Concentration among buyers and sellers – or monopoly and monopsony - has increased. Large cooperatives have grown larger, as have large processors. The volatility of prices to dairy farmers has increased and the number of dairy farms continues to decline.

How does the current FMMO system produce such anticompetitive results? The FMMO sets minimum prices for milk based on how it is used (classified pricing). Fluid milk, for drinking, has the highest classified value and sells for the highest price, while milk used for cheese, ice cream and other dairy products has a lower classified value and garners a lower sales price. The FMMO regulates processors and requires them to account to the USDA-administered market "pool" for the value of the milk they use. Processors of fluid milk pay the most money

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http://www.usdoj.gov/atr/public/comments/200599.htm; "Public Comments to Assess the Future of Milk Marketing Orders", March 6, 1992 at 2, http://www.jsdoj.gov/atr/public/comments/200659.htm

[3] *Id.*

[4] Modern technology and resulting economic changes assure an adequate and dependable supply of milk. The vast majority of dairy farmers belong to large cooperatives that dominate the milk supply (marketing 76% of the milk in the market rather than 10% as in the 1930s). The seasonality of milk production has decreased significantly.

[5] *Id.*

into the "pool"; processors of manufactured products like cheese and ice cream typically "draw" money from the pool at the end of the monthly accounting period.

Pooling is intended to ensure that all dairy farmers get the same blend price for their milk, regardless of use. As a practical matter, however, all dairy farmers do not actually receive the same price for their milk. Large processors and dairy cooperatives exert market power to manipulate the price they pay the producing dairy farmers for their milk. Moreover, the blend price has no actual relationship to the farmer's cost of production and reasonable return on investment.

From a competitive perspective, processors who are sufficiently diversified to "match the market usage" experience no costs other than the administrative costs of regulation. Those with sufficient flexibility and operational scope to manage their milk usage and supply from month to month as prices change can actually enjoy pool subsidies at the expense of competitors who lack that flexibility and operational scope. This puts a processor specializing in fluid milk from value-added on farm production practices (organic, grass-fed, rBST-free, kosher, local) at a significant competitive disadvantage. That processor is producing for a specific market and is not shifting production and milk supplies to match the market pool.

This situation is exacerbated by the balkanization of the national market. The FMMO system is not a single national system. Reforms adopted in 1999 reduced the number of orders substantially but otherwise retained the characteristics described above. Some geographical areas, such as California, are regulated under state milk marketing orders. Some areas, such as Idaho and Utah, have no regulation whatsoever. Pricing is not transparent to anyone in the U.S. who does not spend their careers in milk marketing, and certainly is not to overseas buyers.[6] Instead, national processors manipulate both regulated and unregulated market areas and extract subsidies from their much smaller competitors because of these market distortions and the lack of transparent pricing information.

Thus, the pooling and pricing mechanisms of the FMMO distort the market by favoring the largest competitors – those who have learned the complex rules and use them to their market advantage and whose sheer scope permits the movement of milk and money to their advantage. As predicted by DOJ in 1992:

> The detailed and complex regulatory structure that controls the marketing of milk in the United States illustrates the difficulties inherent in the regulation of what would otherwise be a well-functioning competitive marketplace. Regulators must gather and analyze an enormous amount of information to reach decisions that would be made automatically by the price system. Competing firms then react to these regulatory decisions in ways that require even more detailed regulations in order to maintain the

[6] Demand is projected to grow for dairy products in the international market, but not necessarily for the dairy products of the past, which are the foundation of the FMMO pricing system. The fact that U.S. market pricing is not transparent to international buyers actually harms our competitive position.

"integrity" of the regulatory system. As the regulatory system becomes more complex, it becomes less able to adjust to changing economic circumstances. Thus, the distortions and inefficiencies associated with the regulatory system tend to expand greatly over time.[7]

III. The FMMO System Threatens the Right of Independent Dairies to Compete in the U.S. Marketplace

In the latest anticompetitive twist , the FMMO system is now focused on a proposal to eliminate the few (40 or so nationwide) independent dairy businesses – who produce and process the milk from their own cows – as competitors in the market as a matter of U.S. national policy. The processors and cooperatives who control the processing and milk supply have targeted these independents who control a total volume of 0.6% of the milk produced in the United States and 1.5% of the Class I fluid milk as the source of alleged "disorderly marketing conditions" and an administrative proceeding considering this request is under review within USDA.[8]

In its 1988 Report, GAO acknowledged independent producer-handlers as the primary source of competition in U.S. milk markets.[9] That source of competition has shrunk from about 50% in the 1930s to 0.6% today. A regulatory system that outlaws independent competition has demonstrably outlived its purpose. This is particularly so in a country where our collective "experience amply demonstrates that free markets best determine optimal production and price levels, allocating our Nation's resources to the benefit of both efficient producers and consumers."[10]

How has this happened? The procedures for modification of changes to the FMMO favor the holders of monopolistic and monopsonistic power – large processors and cooperatives. The FMMO regulatory system changes at the behest of the large processors – the only market segment "regulated" by the AMAA and FMMO – and the large cooperatives that supply them. USDA does not play the sophisticated modern role required by the Administrative Procedure Act and multiple Executive Branch Orders in adopting or modifying new regulations. That is, USDA does not propose new rules or changes to existing ones with the attendant requirements for

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[7] 1992 DOJ report at 2.

[8] The allegations under review are that such independents have an unfair cost advantage as producers because they have an unfair share of the higher value Class I fluid market and an unfair cost advantage as processors because they do not have to pay the pool for their greater Class I usage. The purpose of this letter is not to argue the merits of the proceeding before USDA. However, both of these arguments ignore the fundamental fact that the cost of production for these independent producer-handlers includes the full economic cost of both operations (operating capital, other non-land capital, and land). *See, e.g.*, GAO Report at 22.

[9] GAO Report at 47.

[10] 1992 DOJ Report at 2.

supporting data and analysis required under E.O. 12866, including inter-agency review to assure data quality.

Instead, the USDA conducts a hearing and USDA then makes a decision on the basis of whatever evidence is introduced. A decision approved by the Secretary of Agriculture and by a majority of the producers in the market area becomes final and takes effect. **The ability of the cooperatives who control the milk supply to block vote their members assures the outcome.** In addition, the right to judicial review at that point is limited. An adversely aggrieved party must first challenge the Department's decision through the Department's administrative law system to determine whether the Secretary of Agriculture, wearing his judicial hat, agrees with the Secretary of Agriculture, wearing his rulemaking hat. These administrative exhaustion processes typically consume a number of years and virtually eliminate the right to effective judicial review guaranteed by the APA. The statistics show that USDA almost never changes its initial decision. The second administrative hearing is based upon virtually identical information. Moreover, USDA has never permitted a party a stay of the effect of the administrative order while it challenged that decision in the "second" administrative hearing. Thus, the party challenging the USDA decision is, indeed, exhausted, financially and otherwise.

IV. Competitive Opportunities in the U.S. Dairy Market Free of FMMO Constraints Abound

The impetus for a workshop on this subject should not be negative. It should be positive. AIDA believes that there are many opportunities in the modern market for dairy entrepreneurs, which it, as an association, exemplifies. There will always be a market for high-quality commodity milk – primarily, although not exclusively, for manufacturing purposes. That market is most likely to be served by the producers with the lowest cost of production.

The opportunities for dairy farms have, however, never been greater, as consumers increasingly seek and spend purchasing dollars for differentiated milk products – milk from a single farm of the "know your farmer" model with easy traceability; milk produced through specific production practices – organic, grass-fed, kosher, local; milk that combines one of the foregoing with consumer direct delivery, glass-bottle packaging, etc. Value is added on the farm for such consumers, and can generate concomitantly greater returns for the producer who invests in the production practice of interest. The FTC has recently determined that such markets constitute definable market sectors.[11]

There is a substantial opportunity for the U.S. dairy industry in the international market which is projected to grow and in which the U.S. is well-positioned to compete, if it can move beyond the backwards-looking FMMO system.

Modernization of the FMMO system is essential to the re-invigoration of the U.S. dairy industry. AIDA believes that a forum in which DOJ is both the U.S. advocate for competition

[11] *FTC v. Whole Foods Market,* 548 F. 3d 1028, 1037-1038 (D.C. Cir., 2008).

and the protection of consumers, and is also a full-participant with USDA which is essential to fostering discussion and promoting real change.

Respectfully submitted,

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