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USDA Upset with Dairyman's Low Prices

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CONSUMER NEWS

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USDA Upset With Dairyman's Low Prices

The U.S. Department of Agriculture ("USDA") recently decided that Hein Hettinga's dairy business is competing unfairly with most of the other dairy farmers and producers in the nation.[1] It ordered Hettinga to fall in line with the industry or face substantial fines.[2] Undeterred, Hettinga pledged to continue his fight with Dean Foods and the Dairy Farmers of America ("DFA") and the showdown could unravel the mysterious world of the American dairy industry that has existed since it was regulated by New Deal legislation in the 1930s.[3]

Hettinga is a Dutch immigrant who owns and operates his own dairy farm in the American southwest.[4] Actually, he owns fifteen dairy farms that stretch from western Texas to the state of Washington, making him one of the largest dairy farmers in the country.[5] He also owns three homes, a private plane, and employs his own pilot.[6] What makes Hettinga unique – and thus troubling to the dairy industry – is that his Sarah Farms operation is vertically

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1 Joyce Lobeck, *Dairyman biding time with USDA decision*, THE SUN (Yuma, AZ), Feb. 12, 2006, page number unavailable, *available at* 2006 WLNR 2448809.

2 Lobeck, *supra* note 1.

3 Ilan Brat, *Small Dairyman Shakes Up Milk Industry*, WALL ST. J., Feb. 2, 2006, B1, *available at* 2006 WLNR 1884328.

4 Andrew Martin, *He Sells Milk for Half the Price You Pay. The Feds Want Him to Stop. Why?*, CHI. TRIB., Feb. 19, 2006, A1, *available at* 2006 WLNR 2900900.

5 *Id.*

6 *Id.*

integrated.[7] A business is vertically integrated where all of the goods and services necessary for the creation of a product are under the control of that business.[8] In other words, Hettinga not only owns the dairies, he also owns two bottling plants, a plant to make his own plastic bottles, and a fleet of trucks to ship Sarah Farms products.[9] The end result is that he can currently sell two gallons of Sarah Farms whole milk in California for $3.99.[10] By comparison, a single gallon of milk in Chicago carries a retail price of $3.99.[11] However, vertical integration is not new. The concept was most likely first implemented in the American steel industry by Andrew Carnegie and remains prevalent in the petroleum industry.[12] Despite this, the model had been unknown to the dairy industry and it has since gained some powerful enemies.

Opposing Hettinga is the DFA.[13] The DFA is the nation's largest dairy cooperative, claiming 21,946 members in 2004.[14] In addition, the DFA maintains bottling plants and manufacturing plants that create dairy products for consumers.[15] It is estimated that the DFA controls about one-third of the nation's raw milk.[16] Joining the DFA is Dean Foods, the nation's largest processor and distributor of milk and other dairy products.[17] Dean Foods bottles approximately

[7] *Id.*

[8] Mohab Tarek Khattab, *Revised Circular A-76: Embracing Flawed Methodologies*, 34 PUB. CONT. L.J. 469, 505 (Spring 2005).

[9] Martin, *supra* note 4.

[10] *Id.*

[11] *Id.*

[12] Irene Musselli, and Simonetta Zarrilli, *Oil and Gas Services: Market Liberalization and the Ongoing GATS Negotiations*, 8 J. IN'T. ECON. L. 551, 553 (June 2005).

[13] Brat, *supra* note 3.

[14] Information supplied by the Dairy Farmers of America, *available at* http://www.dfamilk.com/who_we_are/who_we_are_facts.html (last visited Feb. 28, 2006).

[15] *Id.*

[16] Andrew Martin, *System Controlled by Industry Giants*, CHI. TRIB., Feb. 19, 2006, A4, *available at* 2006 WLNR 3050546.

[17] Information supplied by Dean Foods Company, *available at* http://www.deanfoods.com/aboutus/aboutus.asp (last visited Feb. 28, 2006).

35% of the nation's milk.[18] These two organizations have pressured Congress and the USDA to close what they see as regulatory loopholes that Hettinga has exploited in building his business.

At the heart of the dispute lay the complex federal regulations controlling the price and supply of milk. Since the 1930s, the marketing of milk in the United States has been regulated by the Agricultural Marketing Agreement Act of 1937, a federal scheme designed to establish orderly dairy market conditions while maintaining constant and sustainable prices for farmers.[19] Under the Act, the Secretary of Agriculture ("Secretary") is permitted to issue "orders" regulating the dairy market.[20] The regulations are designed to correct two unique phenomena present in the dairy industry.[21] First, dairy farmers can receive higher prices if the milk they produce is ultimately used for fluid purposes than if that same milk were directed to non-fluid products like cheese and butter.[22] Second, the supply of milk is not static. Cows produce significantly more milk in the spring and summer months.[23] On the other hand, consumer demand for milk is relatively steady year-round, with demand reaching a low point in the summer months when school is out of session.[24] Accordingly, dairy farmers maintain herds that are large enough to satisfy demand through the fall and winter months when milk production levels are at their lowest.[25] As a result, dairy farmers produce too much milk in the spring and summer and this surplus milk is known as the "spring flush."[26] This surplus milk is directed to non-fluid purposes, where it can better be stored and transported.[27] Yet, as previously noted, milk that is ultimately used for fluid purposes can command a higher price. Thus, dairy farmers in an unregulated market engaged in "cutthroat" competition for the more

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[18] Martin, *supra* note 16.

[19] 7 U.S.C. §§ 601 (2006) *et seq.*

[20] 7 U.S.C. §§ 608c(5), 608c(7) (2006)

[21] Jim Chen, *Around the World in Eighty Centiliters*, 15 MINN. J. INT'L L. 1, 6-7 (Winter 2006).

[22] *Id.* at 7.

[23] *Id.*

[24] *Smyser v. Block*, 760 F.2d 514, 515-16 (3rd Cir. 1985).

[25] *Id.* at 516.

[26] *Id.*

[27] *Id.*

profitable fluid milk sales, which ultimately depressed prices, driving many out of business and destabilizing the milk market.[28]

The federal system combats these problems by distributing the economic burden for the excess milk over all producers in a regional market.[29] It accomplishes this by classifying milk according to its ultimate use – fluid (Class I) and non-fluid (Class II and Class III).[30] The Secretary then fixes a price that each handler – middlemen who process and market the milk – must pay for the milk.[31] While the handlers pay higher prices for milk destined for fluid purposes, the producers receive a single blended price for all the milk they produce, regardless of their milk's ultimate use.[32] The blended price is roughly the average price for all milk in all classes sold in the region during a specified timeframe.[33] Thus, by paying the dairy farmer based on the market's use of all the milk in his region, rather than by what specific purposes his milk was used, the incentive for farmers to sell their milk for fluid use is eliminated.[34]

Of course, there is an exception. These regulations do not apply to "producer-handlers" – dairy farmers who bottle their own milk.[35] By vertically integrating his operations, Hettinga is able to escape the federal regulations and pass some of the savings onto consumers.

The DFA and Dean Foods claim that Hettinga is exploiting a loophole that was designed to protect small, individual farmers who occasionally sold milk to their neighbors.[36] They argue that the reason Hettinga can sell his product at such discounted prices is because he does not have to pay the federally mandated price for milk.[37] Hettinga, they claim, is threatening to destroy the entire

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[28] Chen, *supra* note 21, at 7.

[29] *Id.*

[30] 7 U.S.C. § 605c(5)(A) (2006)

[31] *Id.*

[32] 7 U.S.C. § 605c(5)(B) (2006)

[33] *Smyser*, 760 F.2d at 516.

[34] *Id.*

[35] Martin, *supra* note 4.

[36] *Id.* Marvin Beshore, a lawyer for the DFA said that the producer-handler exception was designed for "mom and pop diaries that bottled the little milk they produced and sold to their neighbors."

[37] *Id.*

federal milk order system, which will result in wild price fluctuations and shut out smaller producers from the market altogether.[38]

Dean Foods and the DFA convinced the USDA with the arguments and the USDA approved changes to the regulations, which limit the producer-handler exception to dairy farmers processing less than 3 million pounds of product a month.[39] The USDA changes will become law once they are approved by the local markets affected by Hettinga, something that will almost surely happen as cooperatives like the DFA have agreements to vote as a block.[40] Once approved, Hettinga and the other small producer-handlers[41] must either join the local co-op or pay millions of dollars a year into the pool of other dairy farmers in their respective regions.[42] Along the same lines, Congressman Devin Nunes, from California's dairy-rich San Joaquin Valley, introduced a bill in Congress in October, 2005, that parallels the USDA's decision.[43]

Hettinga and others argue that the federal system is outdated and out of touch with the realities of the modern milk industry. When the regulations were enacted, half of all American dairy farmers were producer-handlers.[44] Today, only 1.5% can claim that status.[45] Transportation and refrigeration abilities are also much improved since the 1930s.[46] Furthermore, Wisconsin is no longer the main dairy production region in the nation, a fact that has contributed to

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[38] *See* Geoffrey M. Adalian, *Solving California's Milk Crisis*, 11 SAN JOAQUIN. AGRIC. L. R. 87, 102 (2001).

[39] Thomas Alex Tizon, *New Rules May Make Milk Farm Run Dry*, LOS ANGELES TIMES, July 11, 2005, page unavailable, *available at* http://www.keepmilkpriceslow.org/news/news7112005.htm.

[40] Martin, *supra* note 4.

[41] There are at least three other producer-handler dairies that would be affected by the changed regulations. They are Mallorie's Dairy in Oregon, and Smith Brothers and Edaleen Dairy, both in Washington State. The new regulations might put these diaries out of business. Martin, *supra* note 4.

[42] Lobeck, *supra* note 1.

[43] Milk Equity Act of 2005, H.R. 4015, 109th Congress (2005)

[44] Lobeck, *supra* note 1.

[45] *Id.*

[46] William Petit, *The Free Trade Area of the Americas: Is it Setting the Stage for Significant Change in U.S. Agricultural Subsidy Use?*, 37 Tex. Tech. L. Rev. 127, 138 (Winter 2004).

the stable flow of milk to a variety of markets.[47] At the same time, other oddities persist. For example, federal regulations require that milk produced at Cedar Grove Cheese in Wisconsin must be trucked 180 miles south to the Oberweis Dairy in North Aurora, Illinois, where it is pumped into a holding tank, then pumped back onto a truck, and sent back to Cedar Grove before it can be processed into cheese.[48] Additionally, studies suggest that the federal milk market acts as an artificial incentive for dairy farmers, who are in turn subsidized by US consumers to the tune of $2.7 billion a year.[49] Rather, according to Hettinga, the DFA is simply trying to push competitors out of business, all while gouging consumers.[50] He notes that were it not for him, a gallon of milk in Arizona would cost $0.50 more than the current price.[51]

Whether that savings is a result of Hettinga's vertical integration is beyond the scope of this article. What is clear is that Hettinga is forcing Dean Foods and the DFA to justify the continuation of an inefficient regulatory system which forces consumers to pay inflated prices. Perhaps the milk orders are justified and Hettinga is just a freerider undermining the integrity of the system. If so, parties as big as Dean Foods or the DFA should have little difficulty funding research to illustrate the regulations' necessity. Or perhaps, as Hettinga explains, it is an "un-American" system whereby "the consumer is getting ripped off."[52]

FCC Endorses à la Carte Menu Cable

In a report released February 9, 2006, the Federal Communications Commission ("FCC") went on record in support of so-called "à la carte" cable programming.[53] The FCC report

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[47] *Id.*

[48] Martin, *supra* note 16.

[49] Petit, *supra* note 46.

[50] Joyce Lobeck, *Public Rallies Behind Local Dairyman*, THE SUN (Yuma, AZ), Jun. 19, 2005, page unavailable, *available at* http://www.keepmilkpriceslow.org/news6192005.htm (last visited Feb. 28, 2006).

[51] Lobeck, *supra* note 50.

[52] Martin, *supra* note 4.

[53] Feb 2006 FCC report, at 47, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-263740A1.pdf (last visited Feb. 27, 2006) (hereinafter "2006 FCC report").