

State Regulation of Milk Producer Pricing and Sales in California

This article discusses state regulation of milk producers in California. The legislature recently amended the regulations governing production and sales of milk in California. This article examines these changes and their ramifications upon the current status of the milk industry.

For several decades, California has regulated the sale of milk by producers in two important aspects: setting prices paid to producers for their milk¹ and the amount of milk producers can sell at a particular price.² The goals of such regulation are first, to ensure an adequate supply of milk for the consumer and second, to ensure producers a fair return on their investment.³

From 1935 to the present, California consumers rarely have suffered from a lack of milk.⁴ Milk always has been plentiful and generally less expensive than in other parts of the country.⁵ Despite the steady supply of milk to consumers, the producers' position has been unstable. To ensure that producers received a fair return on their investment, the California legislature enacted the Young Act in 1935.⁶ Under the Young Act, minimum prices were established and milk was classified into four classes for purposes of pricing and sales.⁷ Under the classification scheme, Class 1 refers to milk which is put to the highest quality use,⁸

1. "Each stabilization and marketing plan shall contain provisions whereby the director establishes minimum prices to be paid by handlers to producers for market milk in the various classes." CAL. FOOD & AGRIC. CODE § 62062 (West Cum. Supp. 1978). The CALIFORNIA AGRICULTURAL CODE was renamed the CALIFORNIA FOOD AND AGRICULTURE CODE by 1972 Cal. Stats. 498. In the statutes and administrative rules covering the industry, milk is broken down into fat and solids-not-fat. Such distinction is not necessary for the purposes of this article. Thus, this article refers to 'milk' throughout its text.

2. CAL. FOOD & AGRIC. CODE § 62707 (West Cum. Supp. 1978).

3. *Id.* § 62701 (West 1968).

4. CALIFORNIA LEGISLATIVE ANALYST, PRODUCER MILK PRICING IN CALIFORNIA 18 (1975) [hereinafter cited as PRODUCER MILK PRICING IN CALIFORNIA].

5. *Id.* at 84.

6. 1935 Cal. Stats. 922. The current version is at CAL. FOOD & AGRIC. CODE §§ 61801-62491 (West 1968 & Cum. Supp. 1978).

7. *Id.* §§ 61931-61937.

8. Class 1 milk is primarily used for fluid consumption. *Id.* § 61932. Class 2 is used in the manufacture of cream, sour cream, cottage cheese and buttermilk. *Id.* §

while Classes 2, 3 and 4 refer to lesser qualities of usage respectively. The price for each class of milk is set and regulated by the Director of the State Department of Food and Agriculture (Director).⁹ Class 1 is the highest priced, and Classes 2, 3 and 4 are priced progressively lower.¹⁰

Although the consumer supply of milk was adequate under the Young Act, producers still suffered. In fact, from 1935 to 1967 the number of milk producers in California decreased by over 20,000.¹¹ Because producers continued to experience economic problems unique to the milk industry during this period,¹² the California legislature enacted the Gonsalves Act in 1967. The new milk regulations attempted to equalize revenue among producers and bring stability to the industry.¹³

The Gonsalves Act established a pooling system,¹⁴ while retaining the classification scheme which existed under the Young Act. The pooling system guaranteed that each milk producer could sell a minimum amount of milk each year at the highest market price.¹⁵ The guaranteed amount of milk that could be sold at the highest price was called "quota".¹⁶

When the Gonsalves Act went into effect in 1969, the Director assigned quota to California milk producers according to a formula that used the amount of each producer's Class 1 sales during a prior base period.¹⁷ Since each producer's previous Class 1 sales were different, all

61933. Class 3 is used for frozen dairy products. *Id.* § 61934. Class 4 is used for the manufacture of butter, Cheese and dried milk. *Id.* § 61935.

9. See note 6 *supra*

10. PRODUCER MILK PRICING IN CALIFORNIA, *supra* note 4, at 20.

11. E. Nickerson, writing for the Department of Agricultural Economics at the University of California, Berkeley, indicates that the number of milk producers in California declined from 17,224 in 1955 to 3,830 in 1975. E. NICKERSON, ECONOMIC REGULATION: A REEVALUATION OF THE CALIFORNIA MARKETING POLICY 17 (1975). These figures indicate that there has been a decline of over 20,000 producers in California since 1915.

12. See text accompanying notes 31-36 *infra*

13. The Gonsalves Act was enacted in 1967. 1967 Cal. Stats., ch. 927, §§ 2-3. The current version is at CAL. FOOD & AGRIC. CODE §§ 62700-62731 (West 1968 and Cum. Supp. 1978).

14. "The director is authorized to develop a pooling system . . ." *Id.* § 62704 (West 1968).

15. See text accompanying notes 37-47 *infra*

16. "The allocation to each producer within any pool of a pool quota, which shall be 110 percent of that producer's Class 1 usage." CAL. FOOD & AGRIC. CODE § 62707(d) (West Cum. Supp. 1978).

17. *Id.* § 62707(d). The producers had the option of choosing as their base period either July 1—December 31, 1966 or the calendar year of 1967. For the period chosen, the Director determined the total amount of milk that a producer had produced on a daily basis as well as each producer's average daily Class 1 sales. After determining these figures, the Director took each producer's Class 1 sales during the chosen base period and multiplied that figure by 110% or 1.1 to determine the amount of quota which that producer would be assigned. The amount of quota was then subtracted from the producer's total production. Base was the amount of production left over. A producer's total production during the base period, in other words the total of his quota and base, was designated as each producer's production base.

producers did not receive the same quantity of quota initially. The legislature, however, did not intend the amount of distributed quota to remain frozen since it realized that an unequal distribution of quota resulted in unequal incomes.¹⁸ Instead, the legislature provided that to equalize¹⁹ Class 1 revenues,²⁰ new quota would be created by the Department of Food and Agriculture.²¹ Equalization is achieved when quota comprises at least ninety-five percent of a milk producer's production.²²

In the eight years following implementation of the Gonsalves Act, new quota was not distributed in anticipated amounts, producers' revenues were frozen and, consequently, many producers went out of business. Instead of being the magic balm to cure the problems of unequalized revenue, the 1967 milk legislation created some new and unique problems of its own.²³ Because the Gonsalves Act failed to fully equalize revenue among producers within its stated time goal, the California legislature recently made major changes in the regulatory program. Thus, the latest revision of the pooling program provides that on July 1, 1978 the Director shall issue new quota sufficient to bring all producers who have been in business since 1969 up to full equalization.²⁴

This article discusses the reasons for the legislature's enactment of the most recent milk equalization legislation, the effect the new legislation will have on milk producers and whether it is sufficient to solve the problems which the legislature sought to address. The first section discusses the historical development of the governing statutes and the second section describes the relevant provisions of the new legislation. The third section focuses on some problem areas of the new legislation and analyzes its effect upon the milk industry. Finally, the article suggests some alternative solutions the legislature should consider in the future.

I. HISTORICAL BACKGROUND OF MILK REGULATION IN CALIFORNIA

A. *The Young Act*

The Young Act divided milk into four classes, each priced differ-

18. "All producers who have not reached the equalization point shall share in such allocation of (new) pool quota . . ." *Id.* § 62707(e).

19. *Id.* § 62702 (West 1968).

20. CAL. FOOD & AGRIC. CODE § 62707(e) (West Cum. Supp. 1978).

21. Hereinafter cited as the Department of Agriculture.

22. BUREAU OF MILK POOLING, CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE, HISTORY OF THE MILK POOLING PROGRAM 7 [hereinafter cited as HISTORY OF MILK POOLING].

23. See text accompanying notes 92-99 *infra*.

24. CAL. FOOD & AGRIC. CODE § 62707.1 (West Cum. Supp. 1978). This equalization will be brought about by equalizing all quota issued in 1969.

ently.²⁵ Class 1 was the highest priced while Class 4 was the lowest. Under the Young Act, milk producers sold their milk by contracting individually with distributors.²⁶ Since the various classes of milk were priced differently,²⁷ individual producers fared differently depending upon the type of contract they obtained. For example, a producer shipping to a distributor with all Class 1 usage fared well financially and was able to meet production costs easily.²⁸ Producers in the same area, selling a like quantity of milk earned considerably less, however, if their milk was sold to a distributor that marketed only Class 2, 3 or 4 products.²⁹ Since production costs are essentially the same for all producers in a given area,³⁰ a producer's financial welfare was related directly to the proportion of Class 1 milk obtained in contracts negotiated with distributors.

Fierce competition among producers for the more lucrative Class 1 contracts was the natural result under such circumstances. Such competition, in turn, led to many abuses by distributors. For example, contracts typically had thirty-day termination notice provisions that could be invoked by either party.³¹ Producers rarely used the clause³² and might have had difficulty in securing a new contract if they chose to do so. For distributors, however, such clauses were an effective way to control producers. Since competition for Class 1 contracts was so tough, distributors could acquire contracts with new producers easily.³³ Other abuses common in the industry included kickback agreements which required milk producers to return a portion of the monies paid to them by distributors.³⁴ Moreover, producers were forced to produce milk in excess of contract amounts to guarantee retention of their Class 1 contracts.³⁵ Distributors also coerced reductions in the amount of milk covered by a contract and the acceptance of excessive hauling charges.³⁶

25. See text accompanying note 7 *supra*

26. CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE, THE CALIFORNIA MILK MARKETING PROGRAM: A SPECIAL REPORT TO THE SENATE COMMITTEE ON AGRICULTURE AND WATER RESOURCES PURSUANT TO THE PROVISIONS OF SENATE RESOLUTION NO. 98 OF THE 1973-1974 REGULAR SESSION 62-63 (1974) [hereinafter cited as CALIFORNIA MILK MARKETING PROGRAM]. In this article, distributor includes processors and handlers of milk.

27. See text accompanying notes 9-10 *supra*

28. CALIFORNIA MILK MARKETING PROGRAM, *supra* note 26, at 8.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.* The purpose of forcing producers to produce excess amounts of milk was to provide the distributor with quantities of inexpensive milk which could be resold for high prices.

36. *Id.*

B. The Gonsalves Act

Because of the competitive abuses under the Young Act, the legislature enacted the Gonsalves Act. The Gonsalves Act sought to equalize the disbursement of revenue among producers by instituting a pooling system based on quota.³⁷ Under the pooling system, a three-tier priority system was created with quota comprising the highest tier. Quota is the amount of milk a producer may sell at the highest market prices.³⁸ The second tier is called base.³⁹ Base is the amount of milk not classified as quota. The lowest tier is called over-base and generally includes the increase in milk production since the quota system was implemented in 1969.⁴⁰

Under this three-tier pooling system, producers are paid on the basis of their allocated quota, base, and over-base production rather than in accordance with the class usage of their milk.⁴¹ For example, if distributor D purchases overbase milk from producer P, D will pay P whatever price is set for over-base at that time. If D then sells such milk for drink-

37. See text accompanying notes 14-22 *supra*.

38. See text accompanying note 16 *supra*.

39. CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE, PROPOSED POOLING PLAN FOR FLUID MILK AND FLUID CREAM § 116 (Sept. 1968) [hereinafter cited as PROPOSED POOLING PLAN].

40. *Id.* § 117.

41. This graph indicates how class usage is translated into quota values:

Lb.	Class 1		Class 2	Class 3	Class 4
\$	(x ¹)		(x ²)	(x ³)	
Lb.	Quota			Base	Over-Base
\$					

from HISTORY OF MILK POOLING, *supra* note 22, at 4. It can be seen that the amount of quota, base, and over-base in a particular marketing area is matched up against the amount of usage (sales) in the different classes. In this example, the value of a pound of quota would be equal to the values of Class 1 (x¹), Class 2 (x²) and the portion of Class 3 (x³), which is also matched up, divided by the total number of pounds of milk in these three categories. For example, using the graph above, if:

Class 1 = \$5/lb. with usage of 70 lbs.

Class 2 = \$4/lb. with usage of 20 lbs.

Class 3 = \$3/lb. with usage of 30 lbs.

120 lbs.

If the quota allocation for this particular market is 100 lbs.—the match-up would look like this:

All 70 lbs. of Class 1 would be quota

All 20 lbs. of Class 2 would be quota

Only 10 lbs. of Class 3 would be quota

The value per lb. of quota would then be as follows:

$$\frac{x^1 (70 \times \$5) + x^2 (20 \times \$4) + x^3 (10 \times \$3)}{100 \text{ lbs. (total quota)}} = \frac{\$460}{100} = \$4.60/\text{lb.}$$

ing purposes, a Class 1 use,⁴² D will have purchased milk at essentially Class 3 or 4 prices and sold it for a Class 1 use.⁴³ To prevent the resulting profit that D would enjoy, the Gonsalves Act provided that D must pay such profit into a "pool" maintained by the Director. The Director is authorized to use the "pooled" money to offset deficits incurred by other distributors. For example, if a distributor purchased quota milk at quota prices and then used it in the production of Class 4 products, the distributor will have suffered a loss. Such a distributor can recover the loss from revenue in the "pool." This system ensures that producers receive the price to which they are entitled based on their holdings of quota, base and over-base. Also, it guarantees that distributors will not be hurt financially by having to pay producers quota prices when the distributor is manufacturing a product which does not require quota class of milk. The system is designed so that neither distributor nor producer suffer or benefit from the other's financial position.

When quota allocation originally was granted, the legislature did not provide that all producers would receive the same amount of quota at first. Quota initially was allocated by the Director according to a formula based on each producer's amount of Class 1 sales during a prior period.⁴⁴ Since each producer had a different amount of prior Class 1 sales, producers shared disproportionately in the allocation of quota. Such an allocation essentially guaranteed that producers who had pre-Gonsalves Act contracts containing high proportions of Class 1 milk received the most quota allocation. The Gonsalves Act, however, did not freeze the amount of quota that was available. Instead, the Act provided that Class 1 revenues slowly would be equalized among all producers.⁴⁵ The Act's goal was for all producers to sell a similar percentage of their milk production as quota milk.⁴⁶ Thus, the Act provided that the Department of Agriculture create new quota as Class 1 sales expanded.⁴⁷ The Director was authorized to allocate new quota among producers with low quota and new producers.

42. See note 8 *supra*

43. It should be noted that today in California almost 95% of all milk produced is of drinking milk quality. The distinctions therefore among classes are merely a pricing mechanism today.

44. See note 17 *supra*

45. "All producers who have not reached the equalization point shall share in such allocation of (new) pool quota . . . No allocation shall be made to any producer for any new quota in excess of the equalization point." 1967 Cal. Stats. c. 937, § 3. This has been recently changed. See text accompanying notes 81-85 *infra*

46. See text accompanying notes 17-22 *supra*

47. "It is intended that (increase in quota) shall generally reflect the increased class 1 usage which developed during the preceding year . . ." CAL. FOOD & AGRIC. CODE § 62707(e) (West Cum. Supp. 1978).

C. *The Gonsalves Act's Failure to Achieve Full Equalization*

The Department of Agriculture indicated that equalization, the situation where each producer's quota comprises ninety-five percent of production,⁴⁸ was expected to take about seven years.⁴⁹ Thus, producers originally allocated quota in 1969 should have been fully equalized by 1976. Full equalization of producers, however, did not occur. When the Gonsalves Act was implemented, there were approximately 2,882 milk producers in California.⁵⁰ In 1977, the legislature determined that of the 2,882 milk producers allocated quota in 1969, approximately 1,732 were still in business. Thus, since the enactment of the Gonsalves Act almost 1,150 producers, or approximately forty percent, left the milk industry. The decline in the number of original producers is offset, in part, by an influx of new producers. Since 1969, approximately 612 new producers have entered the milk industry.⁵¹ Today California has approximately 2,344 milk producers,⁵² which is an overall decline of 538 producers since the implementation of the Gonsalves Act.

Out of the 1,732 producers still in business in 1977, approximately 500 had not reached full equalization.⁵³ These 500 unequalized original producers represent almost thirty percent of the producers who have remained in business since 1969. Although the decline in original producers probably is not based exclusively on the Gonsalves Act,⁵⁴ the combination of 500 unequalized producers and 1,150 producers who have left the industry indicates that the Gonsalves Pooling Plan has not been effective in dealing with the milk producer's problems in California.

48. See note 22 *supra*.

49. PRODUCER MILK PRICING IN CALIFORNIA, *supra* note 4, at 63. At the end of 1973, after four years under the Gonsalves Act, only 35.46% of all milk producers had reached equalization. CALIFORNIA MILK MARKETING PROGRAM, *supra* note 26, at 66.

50. CAL. CROP & LIVESTOCK REPORTING SERVICE, DAIRY INFORMATION BULLETIN 7 (March 1978) [hereinafter cited as DAIRY INFORMATION BULLETIN].

51. Interview with Eugene A. Carpenter, Staff Supervisor, Bureau of Milk Pooling, in Sacramento, Cal. (Feb. 27, 1978). New Producer Entry Into the Pooling System Since 1969, calculated as of 1/1 of each year:

Year	New Producers
1973	232
1974	102
1976	103
1977	80
1978	95
Total	612

52. DAIRY INFORMATION BULLETIN, *supra* note 50, at 7.

53. Eugene A. Carpenter, *supra* note 51.

54. Some portion of the producers may have gone out of business for other reasons including retirement and death. It is difficult, however, to visualize 1,150 producers leaving the milk industry exclusively for non-economic reasons.

Equalization is critically important because the producer's amount of quota determines whether that producer can survive economically, since only the price of quota milk takes the cost of production into consideration.⁵⁵ The difference between the price producers receive for milk sold as quota and that sold as base or over-base is fairly substantial.⁵⁶ For example, the difference between quota and base ranged from \$.93 to \$1.67 per hundredweight from November 1976 through October 1977.⁵⁷ Since the cost of producing milk which is sold as quota or nonquota is the same,⁵⁸ the difference in prices for base and over-base milk may cause producers to lose money on their base and over-base sales. Such loss can drive producers out of business.⁵⁹

Thus, producers who have reached equalization and whose total production is comprised almost exclusively of quota are in a relatively good economic position under the Gonsalves pricing system. The price they receive is based, at least in part, on production costs with an allowance for profit.⁶⁰ Essentially, such producers are guaranteed a certain rate of return. Low quota producers who are not equalized, however, have economic problems. The average cost of production per hundredweight of

55. CALIFORNIA MILK MARKETING PROGRAM, *supra* note 26, at 24-30; PRODUCER MILK PRICING IN CALIFORNIA, *supra* note 4, at 20-31. These sources describe the methods of pricing the different classes of milk. They indicate that only Class 1 pricing takes cost of production into consideration. Referring back to the description of how quota prices are established, note 41 *supra*, it can be seen that quota is the only classification of milk which incorporates Class 1 into its price.

56. HISTORY OF MILK POOLING, *supra* note 22, at Appendix A.

Month	Quota	Base	Difference in Price
Nov. '76	\$ 9.79	\$8.60	\$1.19
Dec.	9.94	8.40	1.54
Jan. '77	9.94	8.33	1.61
Feb.	9.94	8.27	1.67 (high)
March	9.97	8.34	1.63
April	9.97	8.92	1.05
May	10.13	9.20	.93 (low)
June	10.48	9.03	1.37
July	10.48	8.90	1.55
Aug.	10.52	9.04	1.48
Sept.	10.59	9.15	1.44
Oct.	10.56	9.13	1.43

Average difference = \$1.41/cwt.

57. *Id.*

58. Milk is only separated into quota and non-quota after it is produced. CALIFORNIA MILK MARKETING PROGRAM, *supra* note 26, at 54-57. Since quota and non-quota is all produced out of the same herd, costs should be the same whether the milk is ultimately sold as quota or non-quota milk.

59. An example of such a producer is Val Tarabini who was forced out of business because his allocation of 43% quota did not give him enough return to cover losses he was experiencing on his other 57% of production which was not quota. *Hearing of the Assembly Select Committee on Agriculture, Producer Perspective on Milk Prices and Milk Pricing* 93 (May 10, 1974) [hereinafter cited as *Producer Perspective on Milk*].

60. See note 55 *supra*

milk in California was \$10.02 for the last two months in 1977.⁶¹ For the preceding year, the price of base never exceeded \$9.20 per hundred-weight,⁶² while the price of quota has been higher than \$10.02 since May 1977.⁶³ Therefore, although low quota producers receive a profit on their quota milk, they may lose money on their non-quota milk. Thus equalization is critically important in solving the problems of the low quota producer.

D. Problems in the Transfer or Sale of Quota

Another major problem area in the pooling system arises in the transfer or sale of quota among producers.⁶⁴ The Gonsalves Act provided that the Director administer the quota plan so as "to avoid the development of excessive values for such bases and quota."⁶⁵ Although the Act provides no definition of "excessive," the sale of quota has become a prosperous business and several factors indicate that it may have excessive value.

For example, governmental studies show that: 1) by January 1975, quota had developed an aggregate market value of \$499 million;⁶⁶ 2) the average asset value of quota owned by a milk producer in 1975 was \$210,000;⁶⁷ and 3) the cost of quota for an average cow's production was \$938 in October 1974.⁶⁸ When starting a new dairy, quota is more expensive than the cows⁶⁹ and has been estimated as comprising between twenty-five and forty percent of the entire cost of a new dairy.⁷⁰ Thus, if a dairy costs \$176,000,⁷¹ quota costs the dairy farmer an additional

61. BUREAU OF MILK STABILIZATION, DEPARTMENT OF FOOD AND AGRICULTURE, STANDARD MILK PRODUCTION COST INDEX (average of all production areas) (Nov.—Dec. 1977).

62. See note 56 *supra*.

63. See note 56 *supra*.

64. CAL. FOOD & AGRIC. CODE § 62707.5 (West Cum. Supp. 1978).

65. *Id.* § 62707(g).

66. OFFICE OF THE AUDITOR GENERAL, REPORT ON THE CALIFORNIA MILK MARKETING PROGRAM AS ADMINISTERED BY THE DEPARTMENT OF FOOD AND AGRICULTURE 26 (1975) [hereinafter cited as AUDITOR GENERAL'S REPORT].

67. ROBERT E. JACOBSON, CURRENT MILK QUOTA VALUATION IN CALIFORNIA 6 (1975).

68. AUDITOR GENERAL'S REPORT, *supra* note 66, at 26.

69. *Hearing of the Senate Committee on Agriculture and Water Resources, Partial Transcript on SR 98 (Way) Relating to Marketing of Milk* 111 (May 7-8, 1974) (statement of Roy Alper) [hereinafter cited as *Senate Committee on Milk*].

70. *Id.*

71. This hypothetical figure was determined by adding the cost of land to the cost of cows. A survey of advertisements in *Dairyman*, an industry publication, over the first three months of 1978 indicates that the price of dairy land ranges from about \$1,000/acre to approximately \$2,600/acre. The size of the dairy lands varied from 80 to 740 acres. DAIRYMAN, Jan.-March 1978. Assuming a small dairy of a minimal size of 100 acres, if it were sold at the minimum price listed in *Dairyman*, those hundred acres would be worth \$100,000. The price of cows in California varies from region to region. The top price for replacement cows in California in February 1978 was in Southern California at

\$44,000 to \$70,000. To finance the purchase of quota, a potential producer must obtain an equivalent percentage of extra credit. It should be remembered that prior to 1969 and the enactment of the Gonsalves Act, the price of a dairy did not include such costs.⁷² Any increase in price to the new producer due to quota is the direct result of the Gonsalves Act. Although the Director has not determined that current prices for quota are excessive, a recent Auditor General's Report indicates that the current price of quota very well may be deemed excessive.⁷³ Thus, despite clear legislative intent that quota should not develop a high value in and of itself,⁷⁴ the above figures indicate that quota in fact may have an excessively high value.⁷⁵

The failure to achieve anticipated goals in equalizing producer revenues and the creation of possibly excessive values for quota represent two breakdowns in the administration of the Gonsalves Act. In 1977, realizing the inadequacies of the Gonsalves Act,⁷⁶ the legislature passed several amendments to the milk pooling program. The remainder of this article discusses the changes that such amendments will bring to the

\$900-1,000 for top Holstein cows. The lowest price in California was in the San Joaquin Valley at \$600-850 for medium Holstein heifers. The average number of cows per dairy also varies from place to place in the state. The lowest average number of cows per dairy is 127 in the Del Norte-Humboldt area. The highest average number of cows per dairy is 513. BUREAU OF MILK STABILIZATION, DEPARTMENT OF FOOD AND AGRICULTURE, STANDARD MILK PRODUCTION COST INDEX 1, 9. Taking the smallest average and multiplying it by the lowest price per cow (\$600), the average price for cows for a smaller dairy is \$76,200. Combining this with the cost of land totals \$176,200. It must be remembered that this is a minimal price. All factors in determining the price were the minimum available. This hypothetical also fails to take into account the cost of buildings, machinery and other necessities for running a dairy. As a comparison, a 511 acre dairy in Oregon which included 125 cows was on the market for \$975,000. DAIRYMAN, Jan. 1978 at 63.

72. Prior to the Gonsalves Act there was no quota, therefore it was not a factor in the costs of purchasing dairies.

73. AUDITOR GENERAL'S REPORT, *supra* note 66, at 27. This report concluded that the current price for quota might be determined to be excessive under § 62707.

74. See text accompanying note 65 *supra*.

75. The problems with the legislation which is designed to regulate the producer have ramifications which reach to the consumer level. The Department of Agriculture has reported that the average producer receipts for 1972 varied from 23.2 cents (low quota producer) to 31.1 cents (high quota producer) per one-half-gallon of milk. PRODUCER MILK PRICING IN CALIFORNIA, *supra* note 4, at 81. Stated from the consumer's point of view, the Gonsalves pooling system requires the distributor, and consequently the consumer, to pay one producer 31.1 cents per half gallon when other producers were willing to supply the same quality for up to eight cents less per half gallon. *Id.*

76. See text accompanying notes 25-75 *supra*.

It is recognized by the Legislature that the provisions for equalization of usages among producers and entry of new producers contained in the Gonsalves Act, as originally enacted, and the pooling plan adopted thereunder, tended to achieve the purposes of that act; however, the provisions for more rapid equalization and additional new entry would more rapidly and effectively achieve the purpose of this chapter.

CAL. FOOD & AGRIC. CODE § 62702.1 (West Cum. Supp. 1978).

milk industry and analyzes whether these changes will be sufficient to solve the problems plaguing that industry.

II. LEGISLATIVE CHANGES IN THE MILK POOLING PLAN

In the most recent changes to the statutory scheme regulating milk, the legislature focused on two major problems: 1) the failure of the Gonsalves Pooling Plan to equalize quota among producers in an equitable fashion⁷⁷ and 2) the abuses which have occurred in the transfer of quota among producers.⁷⁸

Realizing that the Gonsalves Act's gradual plan of equalization had not achieved anticipated goals,⁷⁹ the legislature revised the pooling program to provide that on July 1, 1978, the Director would issue new quota sufficient to equalize all producers who have been in business since 1969.⁸⁰ The new legislation also provides for a different method of allocation of new quota after July 1, 1978. The Director will distribute quota annually as follows: 1) forty percent of all new quota will be assigned to producers who are below equalization;⁸¹ 2) forty percent will be assigned to those producers who are at or above equalization;⁸² and 3) the remaining twenty percent will be assigned to new producers.⁸³ This contrasts to the old scheme of distribution which allocated eighty percent to producers below equalization and twenty percent to new producers.⁸⁴ Moreover, in providing for quota distribution to existing producers, the legislature recognized that many producers have been equalized for several years with no real growth in their incomes.⁸⁵ Thus, the new system of distribution provided for growth by all producers, not just those below equalization.

To prevent abuses connected with the transfer of quota, the legislature limited the means of obtaining quota. Under the old scheme, producers obtained quota by purchasing it from other producers except when quota was distributed by the Director. The latest revisions charge the Director with formulating a pooling plan that facilitates the transfer

77. See text accompanying notes 48-54 *supra*

78. See text accompanying notes 64-76 *supra*

79. See text accompanying notes 48-54 *supra*

80. CAL. FOOD & AGRIC. CODE § 62707.1(a) (West Cum. Supp. 1978). Such equalization is being accomplished by equalizing all quota issued in 1969. Although enacted in 1967, the Gonsalves Act was not implemented until 1969. Producers who have been in business since 1969, therefore, are those who have been involved in the Pooling Plan from the outset.

81. *Id.* § 62707.1(b)(1)

82. *Id.* § 62707.1(b)(2).

83. *Id.* § 62707.1(b)(3).

84. HISTORY OF MILK POOLING, *supra* note 22, at 7.

85. "It is also recognized . . . that equalized producers have for a number of years not shared in any benefits of new quota . . ." CAL. FOOD & AGRIC. CODE § 62707.1 (West Cum. Supp. 1978).

of quota from one producer to another but also prevents abuses in such transfers and avoids the development of excessive value for quota.⁸⁶ To accomplish such goals, the Director placed restrictions on the transfer of quota.⁸⁷ The most recent legislation requires that new producers who obtain quota from the state will not be eligible to transfer any quota for a period of five years.⁸⁸ On-going producers who obtain new quota from the Director may not transfer any of that quota for the same period.⁸⁹ Moreover, producers who acquire quota from other producers after January 1, 1977 shall not be eligible to transfer their quota during a twenty-four month period immediately following such acquisition.⁹⁰ Producers who transfer their quota after January 1, 1977 are not eligible to acquire additional quota for a twenty-four month period immediately following such transfer.⁹¹ The purpose of such restrictions is to prevent persons from speculating in the quota "market".

III. POSSIBLE PROBLEMS RESULTING FROM THE NEW LEGISLATION

In evaluating the recent changes in the pooling program there are three potential problem areas: 1) the legislature's method of dealing with producers who have been in business since 1969 may be inequitable to other producers; 2) the new plan may hinder rather than facilitate the equalization of unequalized producers; and 3) the legislation may not have a major effect in stabilizing the price of quota.

A. Inequities in the Equalization of Original Quota

The first difficulty in the new legislation arises from the legislative decision to equalize quota distributed at the implementation of the pooling system in 1969. The legislature's intent seems to be to aid those producers who have been participating in the pooling system since its initial implementation in 1969. The legislature specifically stated as one of its reasons for amending the Gonsalves Act "that some holders of pool quota and production base initially issued under the Gonsalves

86. "The transfer of production bases and pool quotas from one fluid milk producer to another under conditions so designed as to prevent abuses in such transfers and to avoid the development of excessive values for such bases and quotas." *Id.* § 62707(g).

87. BUREAU OF MILK POOLING, CALIFORNIA DEPARTMENT OF FOOD & AGRIC., POOLING PLAN FOR MARKET MILK AS AMENDED § 500(o) (January 1, 1978) [hereinafter cited as AMENDED POOLING PLAN].

88. *Id.* This restriction does not apply to that quota equalized on July 1, 1978. Nor is this restriction an absolute prohibition on the transfer of quota since it does allow for producers leaving business or going bankrupt to transfer their quota.

89. *Id.*

90. *Id.* § 500(i)(2).

91. *Id.* § 500(1)(2).

Milk Pooling Act have waited several years for equalization."⁹² The legislature mandated that the Director equalize 1969 quota irrespective of such quota's present owner. The quota issued in 1969 is not necessarily held by those producers to whom it was originally allocated though. Since 1969, approximately 1,150 of the original producers have left the industry. As producers left the industry, they sold their quota to other producers. Thus, the original 1969 quota is held not only by original 1969 producers, but also by producers who have come into the industry since 1969. Some producers who now hold 1969 quota already were equalized when they bought it, but purchased it to cover their base or overbase production. Other producers bought the 1969 quota when they entered the industry to ensure a good return on their investment. Some producers hold enough 1969 quota to become fully equalized when the July 1, 1978 allocation of quota takes place. Other producers have very little or no 1969 quota and the July 1 allocation will be of little or no benefit to them. Thus, the plan focuses on present holders of quota issued in 1969 regardless of whether they were the original grantees of the quota.

The recent legislative changes should accomplish the goal of equalizing the 500 unequalized producers from 1969.⁹³ However, they may have inequitable effects, perhaps not intended by the legislature. Since approximately 1,150 of the original 1969 producers have gone out of business,⁹⁴ their quota is distributed now among the producers who are in business today. When the 1969 quota is equalized, benefit will inure to everyone who has purchased some of it.⁹⁵ For example, a producer

92. CAL. FOOD & AGRIC. CODE § 62702.1 (West Cum. Supp. 1978).

93. See text accompanying note 53 *supra*

94. See text accompanying notes 50 & 53 *supra*

95. The ways in which quota can be transferred from producer to producer and the way in which the July 1st equalization will affect the different transfers is very complex and can best be explained through the use of examples.

1) Assuming in 1969 that producer A was assigned 200 lbs. of production base and 100 lbs. of quota. At this time A would have quota equal to 50% of his production base. If A has not sold any of his quota, then on July 1, 1978, he will be equalized to 95% of his production base or 190 lbs. of quota. This will mean that A will have 190 lbs. of quota out of 200 lbs. of production base. Even if he has increased his production over the past eight years so that A is actually producing 300 lbs. of milk, he still will only be equalized as to his 200 lbs. of production base.

2) If A has gone out of business and sold his entire quota to B, B will have received all of A's quota plus production base. B therefore will be equalized to the same extent that A would have been, had A stayed in business.

3) If A has gone out of business, and instead of selling all of his quota to B, A sells half to B and the other half to C, then B and C will each receive 50 lbs. of quota plus a proportionate share of A's production base. Therefore, on July 1, 1978, when both are equalized, each will be equalized to 95% of 100 lbs. or 95 lbs. of quota.

4) If instead of selling half of his quota to B and half to C, B has instead sold half to B and kept the other half, the result is entirely different. In this case, B will get 50 lbs. of quota and only an equal, equivalent amount of production base. B will in this instance receive 50 lbs. of quota and 50 lbs. of production base. A will retain 50 lbs. of quota and

who purchased quota in 1977 from a 1969 producer that went out of business will benefit from the new equalization plan to the same extent as a producer who has been in business since 1969. Moreover, a producer who purchased quota in 1977 from a producer that received quota in 1969 will benefit more than a producer who entered the business in 1971, but never purchased any quota. Thus, the 1969 quota will be equalized for the 1977 producer, but the 1971 producer will not have any quota eligible for such equalization.

The fact that post-1969 producers share in the benefits of equalization is not expressly contrary to legislative intent. Such sharing, however, is arguably inequitable to 1969 producers and possibly contrary to an implied legislative intent.⁹⁶ Such sharing may be inequitable because the implied rationale for equalizing unequalized 1969 producers is that they have been in business the longest and are the group which has benefited least from the system.⁹⁷

Yet by focusing upon the quota distributed in 1969 and not on individual producers, the equalization plan also overlooks a class of producers who are economically indistinguishable from unequalized original grantees. Producers who entered the milk industry in 1970 or the years immediately thereafter were unable to obtain any quota,⁹⁸ much less full equalization, when they entered the industry. As a result, many of these producers remain unequalized though they have been in the industry for a substantial period of time,⁹⁹ some just a year less than the original grantees. Under the new equalization plan, such producers will

100 lbs. of production base. The other 50 lbs. of production base will be lost and no one will get it. Therefore, when quota is equalized July 1st, B will receive no quota for the quota received from A because the amount of quota already equals the amount of production base. CAL. FOOD & AGRIC. CODE § 62707.5 (West Cum. Supp. 1978).

96. "It is also recognized that some holders of pool quota initially issued under the Gonsalves Milk Pooling Act have waited several years for equalization . . ." *Id.* § 62707.5.

97. The Gonsalves Act was implemented in 1969 to help bring about an equalization in the revenues of producers and to curb distributor abuse of the system. Any producer who has been in the industry since 1969 and has not been equalized, has not received all of the benefits the program was supposed to provide. The Gonsalves pooling plan has been limiting the unequalized producers ability to sell their milk, without the corollary guaranteed return that this program was designed to produce.

98. "There was insufficient growth in Class I sales to warrant new allocation for the corresponding periods ending in 1970 and 1971. There was growth, however, for the 1972 and 1973 periods, and new quota was allocated accordingly effective November 1, 1972, and January 1, 1974." CALIFORNIA MILK MARKETING PROGRAM, *supra* note 21, at 65. The end of 1972 was the first chance new producers entering between 1970 and 1972 had to obtain quota. If, however, any of these producers purchased quota from 1969 producers, they will be benefitted by the July 1, 1978 equalization.

99. The amount of quota individual producers ultimately receive when new quota is distributed is relatively small. Therefore, any producer who does not have a fairly large amount of quota to begin with cannot expect to be equalized very rapidly. The fact that many producers did begin with very little quota is one of the reasons that there are 500 producers from 1969 who are not equalized.

benefit only if they purchased quota from one of the original producers who went out of business. There is no reason, however, to distinguish between producers who were in the industry in 1969 and those who entered in 1970 and 1971. Yet the legislature makes such a distinction. By equalizing 1969 quota, all the original producers who are still in business automatically will benefit, but only producers from 1970 or 1971 who purchased some of the original quota will receive any benefit from equalization. Thus, the legislature draws a distinction that works to the disadvantage of producers who entered immediately following 1969.

If a line needs to be drawn between those benefitted by instant equalization and those who will not benefit, a fairer demarcation seems to be 1974—the year when the system began to function as anticipated.¹⁰⁰ Since 1973 was the first year producers who entered the industry between 1969 and 1973 could obtain quota from the state, any producer who entered during this time suffered through some very difficult financial times. Since 1973, quota has been allocated to some extent almost every year, helping new producers who have entered the industry since 1973. Thus, rather than distinguish between original grantees of quota and those producers who entered in 1970 or 1971, post-1973 producers should be distinguished from their pre-1973 counterparts because they were allocated some new quota every year and their length of time in the industry is less.

B. Equalization May be Hindered Rather Than Facilitated

The second problem area in the new legislation is that it may hinder rather than facilitate equalization of producers. Many producers who have not reached equalization failed to do so because the Director, pursuant to the Gonsalves Plan, originally issued them insufficient amounts of quota. In issuing new quota under the Gonsalves Plan, the Director distributed eighty percent of the new quota to unequalized producers¹⁰¹ and twenty percent of the new quota to new producers.¹⁰² Under the new distribution scheme, the Director will distribute only forty percent to unequalized producers.¹⁰³ Twenty percent still will go to new producers and the other forty percent will be distributed to producers who are

100. PROPOSED POOLING PLAN, *supra* note 39, at § 301(d)(1).

The new producer's production base shall be his daily production marketed during the twelve-month period immediately preceding his application or 90 percent of the average production base of all other producers having production base, whichever is the lesser, and his pool quota shall be an amount computed by using the percentage ration of pool quota to production base represented by the lowest relative quota of all producers in the pool or 20 percent of his production whichever is the lesser.

101. *See* text accompanying note 84 *supra*.

102. *Id.*

103. *See* text accompanying note 81 *supra*.

already equalized.¹⁰⁴ Therefore, although the equalized producers finally have an opportunity to increase their income, the unequalized producers actually receive less new quota than under the Gonsalves Plan.¹⁰⁵ The unequalized producer's chances of reaching equalization thus are made even more remote.

C. Quota May Still Have Excessive Value

Another potential problem area is the failure of the legislature to deal with the possibly excessive price of quota. By placing limits on the transferability of quota,¹⁰⁶ the legislature inadvertently may cause prices for quota to rise. The limitations on the transfer of quota may tend to tighten the market, lessen the amount of quota capable of being traded and thus increase the demand for available quota. Producers who cannot expect to reach equalization through the Director's distribution of new quota¹⁰⁷ must purchase quota from other producers. If the legislative changes actually do tighten the market for quota, then the situation for such producers buying quota is worsened. The new legislation fails to place any restrictions or controls on the price of quota itself. As a result, quota still may have an excessive value, which forces burdensome financial investment on unequalized producers¹⁰⁸ contrary

104. See text accompanying notes 82-83 *supra*.

105. The fact that there are fewer producers competing for this 40% of new quota may tend to lessen any detrimental effect the reduction in quota for unequalized producers might have. However, the reduction in the number of producers will not be by half, therefore statistically there will be slightly more producers as compared to the quota available. Considering the failure of the equalization plan to begin with, this reduction in the amount of quota available for unequalized producers can only hinder those waiting to be equalized.

106. See text accompanying notes 86-91 *supra*.

107. Any producer who was in business in 1969 can expect to be equalized to the extent of his original production base on July 1, 1978. All other producers can only expect to be equalized to the extent they purchased quota from an original 1969 producer. Any producer who has not purchased any of the original 1969 quota cannot expect any benefit from the July 1st equalization of original quota. Any producer entering the industry since 1969 must have purchased quota from an original producer to receive any direct benefit from the July 1st distribution.

108. The problem of high priced quota has been further complicated by the announcement that all original quota will be equalized. When producers realized the passage of the new legislation was imminent at the end of 1977, the price of quota rose significantly. Average Price of Quota in Dollars for 1977:

January	293	July	305
February	332	August	299
March	299	September	306
April	286	October	304
May	306	November	339
June	293	December	416

BUREAU OF MILK POOLING, DEPARTMENT OF FOOD AND AGRICULTURE, SUMMARY OF TRANSFERS (1977). This increase in price occurred because producers realized quota would be more valuable on July 1, 1978 when it is equalized. Of course, the prices will undoubtedly continue to rise until July 1st, at which time they will probably fall.

to the original intent of the Gonsalves Act.¹⁰⁹

IV. POSSIBLE ALTERNATIVE SOLUTIONS

For the reasons discussed above, the solutions provided by the new legislation may not be capable of totally solving the problems of the milk industry. This section, therefore, explores some possible alternative solutions. While not a comprehensive discussion of all possible solutions, this section briefly discusses the more common solutions which have been proposed.

A. Eliminate All Regulation

One extremely clear-cut solution to the problems caused by regulation of producers is to eliminate such regulation altogether. Such a solution is unlikely to be accepted since the memory of the intense competition of the pre-Gonsalves and pre-Young periods¹¹⁰ is not far from current consciousness. Even if the problems that plagued the industry before 1935 would not occur now with all regulation eliminated, other problems demand that similar control exist.

Absent regulation, the primary problem well might be that of oligopoly. With fewer large dairies exercising a great degree of control in the milk industry, the possibility of creating oligopoly is high in the absence of governmental regulation. This alone is another strong reason for continuing regulation of the milk industry.

B. Reduce the Price Gap Between Class 1 and Other Milk

The legislature could make a rather simple change that probably would eliminate a large number of the present problems in the current system. The legislature could decrease the gap between minimum prices for Class 2, 3 and 4 milk and Class 1 milk. Such a change would decrease the inherent value of quota, as well as its market price, since producers would receive more money for their non-quota milk. Quota would not be as crucial a factor, therefore, in a producer's economic viability.

A major side effect with such a change in the pricing system, however, is that consumer prices would rise. The price paid by the consumer for dairy products in the store is related directly to the underlying class

Despite all of these problems there is one group who will probably not be bothered by the legislation. That group is the consumers. This legislation should have a *de minimis* impact on consumer prices. The distributor is already required to pay for his milk according to the use to which it is to be put. Unless this legislation results in an increase in Class 1 consumption, it is doubtful that it will have much impact on the average consumer.

109. CAL. FOOD & AGRIC. CODE § 62707(g) (West Cum. Supp. 1978).

110. See text accompanying notes 25-62 *supra*

price of the milk used to manufacture that product. If underlying class prices rise, so will the price of the product. Class 1 prices probably would not be brought down to conform more closely with Class 2, 3 and 4 prices since costs of production are closer to Class 1 prices. Thus, any price change would be a price increase and such an increase eventually would be reflected in higher consumer prices.

C. Strict Controls on the Transfer of Quota

One way to solve the producers' problems with quota is to prohibit all transfer of quota among producers.¹¹¹ The immediate effect of freezing the redistribution of quota would be to eliminate the economic value of quota in the market. Although quota would retain its inherent value because it still would be valuable to dairy producers in guaranteeing them a particular income, it would not have any market value. Since quota could not be sold when producers left the business, their quota would revert to the Department of Agriculture instead of being sold at inflated prices to other producers. The Department then could reassign it to new or below equalization producers. The advantage in such a plan is that unused quota could be redistributed easily to bring additional producers up to equalization.

Alternatively, the Department of Agriculture could reclaim quota not being utilized fully. For example, if a producer is allocated a hundred pounds of quota but is only producing seventy pounds of milk, thirty pounds of quota is not being utilized. Even though some producers currently are not utilizing their full quota,¹¹² it is to their advantage to keep it because of its market value if they ever decide to leave the industry. The legislature could authorize the Director to remedy this situation by reclaiming the unused quota and reassigning it to a producer who has not achieved equalization.

Reclamation should be neither automatic nor arbitrary. Quota should not be reclaimed simply because a producer failed to produce up to quota level for just one year. Instead, quota, for example, should be reclaimed only when there has been a lack of production over two, three or four years. Further, if a producer had a legitimate reason for the lack

111. There is a potential due process problem in the possible reclamation of quota by the state. The analysis will turn on whether quota is characterized as a property interest or as a state regulatory device. If characterized as a property interest there are clear due process problems. It seems likelier, however, that quota would be defined as a state regulatory system since the legislature designed the Gonsalves Act to benefit all citizens of the state by regulating milk sales. Considering this regulatory aspect, the question is the reasonableness and rationality of the state regulation.

112. The primary reason a producer may not fully utilize quota is that the producer's milk, for some reason, has not met the health standards regulating the quality of milk, and for that reason cannot be sold for one day or several days. Another reason could be that the producer is holding onto the quota as an investment.

of production, such as a drought or fire, no quota should be reclaimed. If no mitigating circumstances exist, however, the Department of Agriculture should act to alleviate the problems caused by unused quota by reclaiming such quota.

A less harsh method of reclamation would be for the Department of Agriculture to take a certain percentage of any quota transferred¹¹³ and to reallocate that quota to low quota and new producers. This solution would allow producers to recover some of the return they expected on the quota they held, while allowing the Department of Agriculture to redistribute quota to unequalized producers who cannot afford to buy it.

D. Regulate the Price of Quota

A possibly preferable solution is regulation of the price of quota by the Director. Recognizing the possible problems which result from "excessive" prices in the buying and selling of quota, the legislature specifically gave the Director the power to regulate the price of quota.¹¹⁴ This power, however, has not yet been exercised by the Director,¹¹⁵ partly because "excessive" has never been defined and partly because the Department of Agriculture posits that the price of quota already reflects its true economic worth since it is traded in a free marketplace.¹¹⁶ If the Department's theory is correct and quota prices actually reflect the true economic worth of quota, then quota prices are not excessive. The theory, however, seems unrealistic since quota has not been traded in an uncontrolled marketplace. Supply always has been *de minimis* in comparison to the demand for quota.¹¹⁷ Also, perhaps the excessiveness of the price of quota should be determined in terms of whether those who have the most need for it can purchase it, rather than whether it reflects its true market value.

The legislature should mandate that the Director use the delegated power and regulate the price of quota. By exercising this power, the Director could prevent excessive prices as condemned in the legislation¹¹⁸ by requiring producers to offer their quota to the Department of Agriculture before selling it to another producer. When offered quota, the Department could buy it or approve a sale between producers if the buyer is below equalization. The regulation of quota prices seems to provide a more equitable solution to the problems caused by the exces-

113. See text accompanying notes 64 & 86-91 *supra*.

114. CAL. FOOD & AGRIC. CODE § 62707(g) (West Cum. Supp. 1978).

115. None of the pooling plans make any provision for dealing with the price of quota.

116. Interview with Eugene Carpenter, Staff Supervisor, Bureau of Milk Pooling, in Sacramento, Cal. (Feb. 27, 1978).

117. One reason to equalize all quota originally allocated in 1969 is to put more quota on the market.

118. See text accompanying note 65 *supra*.

sive price of quota than other possible solutions. It allows the Director to control the redistribution of quota so that unused or unwanted quota will be allocated where it is most needed. Moreover, the quota will be purchased and not reclaimed. Thus, producers giving up quota will realize a portion of the revenues they expected from a sale of their quota rather than incur substantial losses.

V. CONCLUSION

Ultimately the success of any milk regulation scheme depends upon a fair allocation of quota to ensure producers the best possible return for their product, while ensuring the consumer an adequate supply of milk at reasonable prices. Historically, a need for regulation at the producer end of the industry has existed because the producer has been plagued by economic problems since the 1930s. The pooling plan devised under the Gonsalves Act and recently amended by the legislature has great potential for dealing with the producers' economic problems. The only way to ensure the long term success of the program, however, is to establish a system where the quota already allocated in California can be transferred to those who need it rather than to those who can afford it.

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