BEFORE THE
DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C.

PROPOSED MARKETING ORDER No. 991, HOPS PRODUCED IN WASHINGTON, OREGON, IDAHO, AND CALIFORNIA	**Docket No.: AO-F&V-991-A3; FV03-991-01**

UNITED STATES DEPARTMENT OF JUSTICE
<u>POST-HEARING MEMORANDUM</u>

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INTRODUCTION

On July 28, 2003, the Department of Agriculture issued a notice of public hearing to consider a proposed federal marketing agreement and order under the Agricultural Marketing Agreement Act of 1937 to cover hops grown in Washington, Oregon, Idaho, and California. 68 Fed. Reg. 44244 (July 28, 2003). The hearing was devoted almost exclusively to consideration of volume-control regulations (producer allotments) that would authorize a Hop Administrative Committee to control the quantity of hops that producers may market. After the close of the hearing, the Administrative Law Judge set February 18, 2004, as the final date for filing written arguments and briefs based on the evidence received at the hearing.[1]

POSITION OF THE DEPARTMENT OF JUSTICE

The Department of Justice opposes the proposal to allow a Hop Administrative Committee artificially to restrict the hop supply. The costs of the proposal clearly exceed its benefits. The proposed restrictions on output would lead to non-competitive pricing effects and resource misallocations by shifting agricultural resources away from the production of hops into products that consumers do not value as highly as hops. There is no reason to impose these costs on consumers and the public, especially because most producers would not even benefit from the order, and some would be harmed. A prerequisite for regulation is that there be some form of market failure, but as discussed below, there is none here.

The record shows the hop industry to be a well-performing, competitive market with many producers and dealers who have ready access to high-quality market information and ample opportunities to enter into long-term contracts as they see fit to hedge against price fluctuations. In short, there exists no problem that the proposed marketing order would solve, and implementation

[1] Administrative Law Judge Jill S. Clifton conducted the hearing over an eight-day period in October of last year at two sessions in Portland, Oregon and Yakima, Washington. Approximately 40 witnesses testified, including 28 hop producers, 2 dealers, 2 brewers, 3 economists, the General Counsel of The Beer Institute, and a consultant for the proponent committee who is a manager of the spearmint marketing order. The record consists of 2461 pages of hearing transcript and 59 exhibits.

of the order would itself harm the public.

I. Background

A. The Hop Industry

Approximately 60 producers grow and harvest hops in the United States for sale to dealers who then resell the hops to domestic and foreign breweries. Ex. 26 at 1; Roy tr. 1632; Smith tr. 249, 392. United States producers are among the world's leaders, accounting for more than a quarter of world output. Jekanowski tr. 1024. In 2002, they produced 58 million pounds of hops, which they sold at an average price of $1.94 per pound, resulting in total sales revenue of $113 million. Ex. 5 at 2. United States breweries consumed approximately 14 million pounds of the domestic aroma hops crop (along with about 9 million pounds of foreign aroma hops) and another 52 million pounds (mostly alpha hops) are exported, primarily to Canada, Mexico, Europe, South America, and Asia. *See* ex. 5 at 2; ex. 30 at 34; ex. 37.

Producers in the United States grow numerous varieties of alpha and aroma hops. Ex. 5 at 10; ex. 37. Alpha hops yield relatively large quantities of alpha acid, which imparts the characteristic bitter flavor to beer. Aroma hops contain alpha acid but in much smaller quantities, and so they are grown mainly for their mild, distinctive flavors. Ex. 31 at 2; Kenneth Dessaurault tr. 454-55. Producers sell fresh hops loose, packaged, or baled, and they also extract alpha acid from hops, selling the extract in pellets and in other forms. Gasseling tr. 613-15.

Anheuser-Busch and at least some domestic micro breweries use primarily aroma hops. *See* Kloth tr. 676; Smith tr. 319. Other domestic brewers and many foreign brewers use mainly alpha hops. In 2002, approximately 65% of the domestic crop consisted of alpha hops. *See* ex. 37.

Most or all of the domestic aroma hops crop is consumed in the United States. Ex. 30 at 34. Aroma hops are also imported, though many of the imported aromas have different characteristics than aroma hops grown in the United States. Most of the U.S. alpha hops crop is exported, and there are few, if any, imports of alpha hops by U.S. breweries. Ex. 38 at 18; Tweeten tr. 1211. The U.S. world market share in alpha hops is about 30 percent. Ex. 37.

B. The Proposed Marketing Order

The proposed marketing order would establish a Hop Administrative Committee ("HAC") to regulate the domestic hop industry, subject to approval by the Secretary. The order's principal regulatory provisions, and its most anticompetitive part, are its volume-limitation provisions. Ex. 1 at §§ 991.15, 991.50-58. These provisions authorize producer allotments.

Under the proposed marketing order, HAC, composed of eight otherwise competing producers from the states of Washington, Oregon, Idaho, and California, would consult and then establish allotment bases for all competitors who produced hops in the 2001 or 2002 crop year in amounts proportional to their individual hop production (expressed in pounds of alpha acid) in the highest year during the base years 1997-2002. Ex. 1 at §§ 991.15, 991.53.

The proposed marketing order's allotment provisions would authorize HAC to regulate the total amount of hops that producers may sell in any given marketing year. Each year prior to November 15, HAC would review various types of market information. *Id.* at § 991.51. If HAC wanted to limit the quantity of hops to be brought to market in the coming marketing year, it would recommend a salable quantity and allotment percentage to the Secretary of Agriculture, who may or may not approve the recommendation. *Id.* at §§ 991.51-52.

The salable quantity is the total quantity of hops that HAC recommends, and the Secretary approves, that producers may sell in the coming marketing year. The allotment percentage equals the salable quantity divided by the total of all producers' allotment bases. *Id*. at § 991.52(a). For example, if the initial allotment base is 9.2 million pounds, and HAC recommends and the Secretary approves an allotment percentage of 55%, then producers in the aggregate would be permitted to market 5.1

million pounds of alpha acid (the salable quantity) during the 2003-04 marketing year. Jekanowski tr. 1029-36. A producer's annual allotment of salable quantity is the product of the allotment percentage and that producer's allotment base. *See* ex. 1 at § 991.52(a).

II. The Applicable Standard

The Secretary's determination whether the order would effectuate the purposes of the Agricultural Marketing Adjustment Act of 1937, as amended, 7 U.S.C. §§ 601-74 (the "Act"), should include an evaluation of its potential economic impact on consumers, producers, and society as a whole. Although the general purposes section of the Act, 7 U.S.C. § 602, indicates that a principal purpose of the Act is to benefit producers, it also refers to the interests of consumers and the public at large. In subsections (2) and (4), Congress declared its policy to be:

* * * *

> (2) *To protect the interest of the consumer* by (a) approaching the level of prices which it is declared to be the policy of Congress to establish in subsection (1) of this section by gradual correction of the current level at as rapid a rate as the *Secretary of Agriculture deems to be in the public interest* and feasible in view of the current consumptive demand in domestic and foreign markets, and (b) authorizing no action under this chapter which has for its purpose the maintenance of prices to farmers above the level which it is declared to be the policy of Congress to establish in subsection (1) of this section.

* * * *

> (4) [T]o establish and maintain such orderly marketing conditions as will provide, *in the interests of producers and consumers,* an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and demands.

7 U.S.C. § 602 (2), (4) (emphasis added).

The general policies section thus clarifies that the Act is designed to benefit producers *and* to balance their interests with those of consumers and the public. It follows that the Secretary should carefully consider all of the costs and benefits associated with the proposed agricultural programs, adopting only those programs that prove beneficial to society as a whole.

Competitive considerations and antitrust policy are generally subsumed in the "public interest standard" that qualifies many federal regulatory programs.[2] Efficient allocation of resources is a central goal of antitrust policy. Indeed, the Secretary, in a recent policy report, reiterated the Department of Agriculture's strongly held view "that agriculture policy must recognize that the marketplace is the best guide for allocating resources and provides for the most objective reward for efficiency and good management." U.S. Dep't of Agric., *Food and*

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[2] *See, e.g.*, *United States v. FCC*, 652 F.2d 72, 88 (D.C. Cir. 1980) (en banc) (noting that agencies need to "consider antitrust policy as an important part of their public interest calculus" and that agencies are "entrusted with the responsibility to determine when and to what extent the public interest would be served by competition in the industry."); *Sabin v. Butz*, 515 F.2d 1061, 1069 (10th Cir. 1975) ("Where the governing statute charges the agency with considering the public interest in its decisions, in appropriate cases it must weigh traditional antitrust concepts and related anti-competitive factors."); *N. Natural Gas Co. v. Fed. Power Comm.*, 399 F.2d 953, 959-61 (D.C. Cir. 1968).

Agricultural Policy: Taking Stock for the New Century at 51 (2001); *see also, e.g.*, U.S. Dep't of Agric., *Guidelines For Fruit, Vegetable, and Specialty Crop Marketing Orders* at 2 (1982) (stating that the Department's involvement in marketing orders "will be consistent with the efficient use of the nation's resources in the interest of producers and the general public").

This concern for efficient markets also is consistent with Exec. Order No. 12866, 58 Fed. Reg. 51,735 (Sept. 30, 1993), *as amended by* Exec. Order No. 13258, 67 Fed. Reg. 93,385 (Feb. 26, 2002), 5 U.S.C. § 601. The preamble of the Executive Order provides that,

> The American people deserve a regulatory system that works for them, not against them: a regulatory system that protects and improves their health, safety, environment, and well-being and improves the performance of the economy without imposing unacceptable or unreasonable costs on society; regulatory policies that recognize that the private sector and private markets are the best engine for economic growth; regulatory approaches that respect the role of State, local and tribal governments; and regulations that are effective, consistent, sensible, and understandable.

Section 1(a) of the Executive Order provides that,

> In deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating.... Further, in choosing among alternative regulatory approaches, agencies should select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity), unless a statute requires another regulatory approach.

Although these executive orders are not binding on the Secretary in this proceeding, *see* exhibit 1 at 44,244, the rationale for them is sound and should be applied here, *i.e.*, federal agencies should seek to achieve their goals in ways that depart least from a free market system.

ANALYSIS

III. The Proposed Marketing Order Would Harm The Public Interest

The allotment provisions contained in the proposed marketing order would impose clear costs on consumers and society without providing offsetting long-term benefits to producers. Moreover, the allotment provisions are unnecessary because there is no problem that they would solve.

A. The Proposed Marketing Order Would Harm Competition and Consumers

The producer allotment system would, in effect, be a government sanctioned and enforced cartel of United States producers, where the central producer committee (HAC) could absolutely control the quantity of domestic hops marketed.[3] HAC certainly would seek to hold this quantity below that which would

[3] Any producer who exceeded the allotment fixed for him by these provisions would have to forfeit his illicit gains to the government. *See* 7 U.S.C. § 608a(5). We also note that, outside the regulatory context, an agreement among competitors to establish a mechanism to restrict supply, as the hops producers are seeking to accomplish through the proposed marketing order, would be a *per se* violation of the antitrust laws. *See, e.g.*, *United States v. Socony-Vacuum Oil Co*., 310 U.S. 150, 210-226 (1940). Certain types of conduct (including agreements to fix prices or restrict output) are deemed to be *per se* illegal because the courts are confident that conduct of that kind has such a tendency to be socially inefficient that it can be condemned without inquiry into its actual effects. *See id*. at 224 n.59.

be supplied in a free market.

Artificially restricting the domestic supply of alpha acid may cause both alpha and aroma prices to deviate from the true costs to society of those products, and unless expansion of foreign supply fully fills the void caused by a restriction of United States output, there will be at least some increase in price to United States consumers. Indeed, many proponents of the proposed marketing order undoubtedly expect to achieve exactly this result. *See, e.g.*, Folwell tr. 851 (anticipating that the proposed marketing order's allotment provisions would increase United States hops prices in the long-run).

Beyond the price effects, the economy also would be harmed by the distortion in market incentives and the resulting inefficient adjustments made by producers. Dr. Jekanowski explained that, because the marketing order is based on alpha acid content, this creates an incentive for consumers and growers to switch to varieties of lower alpha acid content.[4] *See* Jekanowski tr. 1410-11. Moreover, domestic hops producers will divert their land and energies to producing fewer hops and more of other crops, which, according to the marketplace, consumers value less highly or producers cannot bring to market as efficiently, or both. *See* Jekanowski 1064; Tweeten tr. 1205.

B. The Proposed Marketing Order

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[4] Aroma hops, in particular, have a lower alpha acid content than do alpha hops. Therefore, in addition to leading growers to produce hops containing less alpha acid in total, the marketing order will tend to induce inefficient substitution by growers from alpha hops towards aroma hops.

Would Harm Some Producers

To the extent that the HAC can restrict the total quantity of hops below the quantity that would be marketed in an unregulated economy, prices to consumers can rise and producers' profit margins consequently can increase above competitive levels. But producers' higher returns would last only as long as HAC could hold the hops supply below that produced in an unregulated market. These potentially higher prices might induce an additional supply of hops available for United States consumers, most notably from United States producers who would otherwise export their hops. In addition, higher domestic prices could well lead foreign producers, who would not be subject to the proposed marketing order, to start selling hops in the United States *See, e.g.*, Desmarais tr. 2383-84; Aaron Gamache tr. 2320-21; Jekanowski tr. 1026-27, 1069-70; Kloth tr. 653; Riel tr. 2341-43; Smith tr. 246-47, 309, 369-70; Ungewitter tr. 1798-99. To maintain high prices in the face of this increased supply, HAC would have to restrict the hop supply even more.

The proposed marketing order would tend to harm those who most efficiently produce the quantity of hops eliminated by the marketing order, including those who enter the hop industry after 2002 and those who expand their crop beyond their initial allotment base. *See* Jekanowski tr. 1037-40, 1045, 1059. These producers could enter or expand only if they purchase or lease base from another producer. Ex. 1 at §§ 991.52(b)(1) and 991.58. Further, to the extent that industry participants incur costs in adjusting to the development of a market for buying and selling base, additional and needless inefficiencies will result.[5]

Ordinarily, the market rewards the most efficient producers; a regulated market would penalize them. The lower a producer's costs, the greater the difference between its costs and the competitive price and the more profits ("economic rents") it earns. If that producer can efficiently produce a greater quantity, he or she will do so and continue to expand production until the cost of the last marginal pound of hops equals the competitive price, thus making further expansion unprofitable.

In a regulated hop market, efficient producers could expand only if they buy or lease additional base. These efficient producers must buy or lease base from other producers and will pay up to the amount of their economic rents. Hence the order effectively will require the most efficient producers to transfer much of their profits to other producers who are less efficient.[6]

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[5] There currently is no developed market for trading base, and two witnesses testified at the hearing about the costs associated with creation and operation of such market. *See* Gasseling tr. 2053-56; Jekanowski tr. 1057-58.

[6] *See* Jekanowski tr. 1028, 1045, 1058-60 (noting that the proposed order's allotment base provides the mechanism for transferring wealth from efficient producers to those who are unable or unwilling to compete in the market); Carpenter tr. 109 (acknowledging that transfers between producers will occur); Kloth tr. 662 (declining producers will have excess allotment to sell to expanding producers), 664; Obendorf tr. 496 (noting that the proposed marketing order would subsidize producers from Washington at the expense of producers from Idaho); Tweeten tr. 1134, 1236 (the transfer of benefits likely would be from low to high-cost producers).

This inequity may explain the sharp divide among the producers who testified at the hearing for and against the proposed marketing order.[7] Rather than benefit all producers, the order would tend to benefit only some, while harming others.

C. The Hop Industry is a Well-Performing Competitive Marketplace That Does Not Require Regulation

The only legitimate reason for government interference with the free market is to correct a clear market failure. But the record clearly shows that there is no market failure in the hop industry.

The hop industry is competitively structured. Approximately sixty producers grow almost all of the domestic hops supply on 29,000 acres in Washington, Oregon, Idaho, and California, the four states that the proposed marketing order would cover. Ex. 1 at § 991.05. Not one of these producers accounts for a significant share of total supply. There is no evidence that entry into hops production is particularly difficult. In addition, information about current market conditions is readily available and rapidly disseminated to producers. *See, e.g.*, ex. 37; ex. 38; Kloth tr. 658.

Taken together, these facts are strong indicia of a

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[7] Of the 28 producers who testified at the hearing, 15 favor the proposed marketing order and 13 oppose it. It is noteworthy that the Secretary terminated the prior marketing order for hops after 44% of producers participating in a special referendum voted against continuance of that order. Termination Order, Hops of Domestic Production, 51 Fed. Reg. 32779 (Sept. 16, 1986). It was the Secretary's strongly held view that marketing orders tend to be less effective absent substantial industry support. *Id.*

competitive marketplace: many producers each accounting for a small proportion of industry output, ease of entry, and readily available information enabling individual producers to respond to market signals.[8] This is not a market in need of government regulation.

In spite of the clear evidence that the hop industry functions competitively, proponents complain that the industry "is suffering from a chronic oversupply situation that is depressing prices to below economically viable levels." Ex. 1 at 44244; *see also, e.g.,* ex. 7; Carpenter tr. 57. However, Mr. Smith testified that this "chronic" oversupply only started in 2000. He said, "[i]n 2000 was really the beginning ... of the oversupply situation that we've been suffering under the last few years." Smith tr. 208-9. Mr. Smith went on to say that he

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[8] While proponents acknowledge that producers are highly competitive, *see, e.g.*, Dale Gamache tr. 2234-35, Professor Folwell asserts that they have no choice but to sell their hops to four dealers who can exercise market power against them, and that the situation is even worse with respect to high alpha and Willamette hops, for which there are, respectively, two buyers and one buyer. *See* Folwell tr. 849-51, 878-89, 919, 1148-49. There is, however, no persuasive evidence in the record to even suggest that buyers of hops have market power; *i.e.*, the power to depress the price they pay for hops to a level that is below the competitive price. Indeed, on cross-examination, Professor Folwell admitted that the number of buyers of hops is some number greater than six. Tr. at 1155. The only other relevant record evidence on this point demonstrates that buyers of hops do not exercise market power against the producers. Tweeten tr. at 1144 (the hop industry, with 45 to 70 producers and four to six buyers is a competitive market). As to the buyers of high alphas and Willamettes, producers could defeat any efforts by these buyers to depress prices below competitive levels in these varieties simply by switching their production to any of the other numerous varieties of hops. *See* Tweeten tr. 1144-45. Moreover, even if there were buyers with market power that were using it to restrict output, regulations enabling producers to restrict output further would hardly be an economically appropriate solution.

“think[s] the industry has operated the last 3 or 4 years under a significant over supply of alpha acids." Tr. 291. Mr. Carpenter agreed, saying that what he meant by "chronic oversupply" was only "this inventory that's kind of hung over our heads." Carpenter tr. 62.[9]

The evidence in the record demonstrates not a chronic oversupply, but rather an industry benefitting from technological progress. High yielding super-high alphas were introduced in the mid-1990s, which drove down the cost of producing alpha acid and led to lower alpha prices. *See* Dale Gamache tr. 2231; Jekanowski tr. 1348-49; Serres tr. 2008-10. Greater supply and lower prices led, predictably, to producers making adjustments. This is how unregulated markets efficiently respond to changing conditions.

Producers also benefitted from the German crop failure in 2003, which presented them with more sales that helped to deplete their surpluses. As proponents themselves acknowledge, the market now has corrected itself and producers have adjusted to the technological advances that have increased the efficiency of producing hops. Carpenter tr. 121-22. Mr. Smith agreed that

[9] There is also evidence that temporary overpricing by producers cooperative Yakima Chief may have contributed to the industry’s difficulties by needlessly creating an inventory surplus. Instead of pricing their hops at whatever the market would bear, "[w]e made the mistake of trying to price at the cost of production, plus a reasonable profit." Smith tr. 253-54. In 2002, Yakima Chief changed their way of marketing hops, establishing a new consignment pool that will sell to world brewers at market prices. Smith tr. 273-75. With that change, Smith said, "we felt that there was a reasonable expectation ... that those hops would be sold, and so we made the decision to grow hops for that additional pool." Smith tr. 274.

market forces have operated to correct the "oversupply" situation. Smith tr. 291. Indeed, Mr. Smith plans to expand in 2004. Tr. 298.

Proponents also complain about fluctuations in hop prices, as if to suggest that such fluctuations are inherently harmful to producers and consumers. *See, e.g.*, Smith tr. 324. Proponents make no attempt to explain how and why they are harmed. Fluctuating prices provide valuable signals to producers and consumers by reflecting changes in market conditions over time. *See* Tweeten tr. 1182 (noting that some price variation is desirable because it “send[s] out changing signals to get resources to move in the right directions or products to move in the right direction”); Jekanowski tr. 1402-5 (discussing prices as signals). Market signals, rather than mandatory output decisions by industry committee, are best able here to ensure a fair and efficiently performing marketplace.

Proponents also ignore the numerous mechanisms that the market already provides and producers already use to hedge against price fluctuations. Producers may substantially reduce the risks they face from fluctuating prices by entering into forward contracts with buyers, pursuant to which price is set one, two, or even three years in advance of harvest. Producers testified that forward contracts are available for both alpha and aroma hops, that their 2003 crop was grown under forward contracts, and that much of their 2004 crop was already under contract. *See, e.g.*, Reggie Brulotte tr. 2205; Desmarais tr. 2382, 2415-16; Aaron Gamache tr. 2315-16; Gasseling tr. 2040; Obendorf tr. 497-98; Riel tr. 2337; Weilmunster tr. 506-7. In this way, producers effectively may transfer risk of low prices to their buyers at harvest time. Tweeten tr. 1226-27. Such contracts offer producers and buyers the price stability necessary for them to plan as necessary for their businesses.[10] *See, e.g.,* Kloth tr. 666 (noting that forward contracts bring stability); Smith tr. 257.

Producers also reduce their risks by storing low-priced hops for future sale when prices are higher. *See, e.g.,* Carpenter tr. 76-77; Roy tr. 1709-11. Because hops may be packaged, baled, or pelletized, they are far more readily storable than many other crops. Folwell tr. 937-39; Roy tr. 1651.

Finally, producers can and do reduce risk by diversifying into other crops, including apples, cherries, wine grapes, pears, apricots, sweet corn, beans, and alfalfa. Carpenter tr. 110; Desmarais tr. 2381; Aaron Gamache tr. 2307; Dale Gamache tr. 2216; Gasseling tr. 2041; Hogue tr. 2360; Kerr tr. 783; Morford tr. 1933; Roy tr. 1469, 1635-36; Serres tr. 2008-9; Smith tr.

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[10] Some producers did complain at the hearing that contracts are not available, but, as we note in the text, their complaints do not square with the evidence. We also note that Anheuser-Busch indicated that it is awaiting the outcome of this proceeding before renewing its contracts. Kloth tr. 657. Producers also point to low spot market prices as a problem. However, producers are not forced to consider only the spot market in their long-term planning decisions. Jekanowski tr. 1405.

333; Tobin tr. 2251. Indeed, it is unusual to find a grower whose only crop is hops, and those who choose not to diversify may be comfortable with the risk they face. Moreover, the ability of hop growers to shift in and out of these other crops benefits even those growers who do not choose to diversify, because it has a stabilizing effect on production and prices for the industry as a whole. *See* Roy tr. 1635.

Each of the foregoing market mechanisms permit producers to choose the level of risk that they prefer. These mechanisms are far superior to government regulation for reducing risk because they are less costly, more flexible, and help producers deal with variation in prices without artificially increasing prices. Tweeten tr. 1182. This is significant because price changes provide valuable market signals that induce producers to shift resources to their most valued use in response to changes in underlying market conditions. *Id.* The proposed marketing order, by tampering with these signals, would interfere with the efficient allocation of resources. *See* Jekanowski tr. 1286.

D. Proponents Have Not Demonstrated That The Proposed Marketing Order Likely Would Stabilize Hop Prices or Supply

Proponents argue that the proposed marketing order would be beneficial because HAC could use its allotment provisions to "stabilize" or reduce the fluctuations in hop prices. *See*, *e.g.*, Roy tr. 1522-25. Even putting aside the issue of whether additional stability beyond what the market would provide is desirable, proponents' proof on this point fails.

Proponents offered testimony by numerous producers and a university professor to try to show that the proposed order would stabilize hop prices. While many of the producers said, in substance, that they *expect* the proposed order would stabilize the hop industry, their subjective expectations are not a substitute for objective evidence that prices are likely to vary less under the proposed order. None offered any plausible explanation as to *how* the proponents could use the proposed order to achieve greater price stability.[11] Indeed, a number of other producers at the hearing testified that they did not expect the proposed order to stabilize hop markets. *See, e.g.*, Annen tr.

[11] Proponents' producer testimony was consistently conclusory and speculative: Carpenter tr. 114 (hopes committee can balance supply and demand); Dale Gamache tr. 2215 (believes that "an HMO board will collectively read and understand the market better than each of us individually"); Darren Gamache tr. 2452 ("An active hop marketing order gives the hop industry a tool to keep supply in balance with demand."); Hogue tr. 2236 (the marketing order is "about balancing supply and demand" and "stable prices"); Newhouse tr. 2446 ("the order will manage any over or undersupply"); Roy tr. 1525 ("I think it creates stability"); Serres tr. 2012 (intent of order is "to bring production and consumption in closer balance"); Tobin tr. 2245 ("proposals will put stability and profitability back in our marketing equation.").

742; Gooding tr. 471-72; Kerr tr. 785-86.

Proponents may place special reliance on the testimony of Michael Smith, a Washington producer who is one of the few witnesses who tried to explain why he thought the proposed marketing order might stabilize hop prices. To study hop price variability, Mr. Smith compared hop prices in 1966-1982 with hop prices in 1950-1966 and 1982-2000. Smith tr. 222-24, 282-84, 288-89, 324, 328-32 361; ex. 8 at 25. He claims to have observed that price variability decreased after 1966 and increased after 1982 and therefore concludes that the prior marketing order for hops stabilized prices. *See* tr. 224.

But even a quick look at Mr. Smith's United States Season Average Price chart, exhibit 8 at 25, suggests it is unsound, for it depicts the prior order as having terminated in 1982, when, in fact, that order terminated in 1986. *See* Termination Order, Hops of Domestic Production, 51 Fed. Reg. 32779 (September 16, 1986). Mr. Smith's cutoff date is significant because hop prices soared during the period 1980-86. Any meaningful study of hop price variability should not ignore 1980s hop price data, which documents the most unstable hop prices in years.[12]

Even if Mr. Smith had shown that hop prices were more stable under the prior marketing order, he also would have had to show

[12] Mr. Smith recognizes that the prior order did not prevent hop prices soaring from fifty cents to five dollars per pound in the early 1980s. Smith tr. 223, 282-84, 361.

that the stabilization followed from the order itself and not other events. To do this, Mr. Smith would have had to control for other events that affect price variability. For example, foreign crop failures and production shortfalls dramatically affect price variability.[13] But Mr. Smith failed to control for these events. His failure made it impossible for him to determine whether it was the prior marketing order or other events that caused the stability he believes he observed.

Proponents may also rely on the testimony of Professor Raymond Folwell, Professor of Agricultural Economics at Washington State University, and the public representative on the HAC that administered the prior hop marketing order. In support of his conclusions on stability, Professor Folwell relies, for the most part, on his observations of hop prices during the years 1965-2002. Tr. 859, 929-30, 1009; ex. 26 at Appendix Table A1; ex. 27. Professor Folwell, just like Mr. Smith, did not make the necessary cause and effect connection. He claims to have observed price stability and presumed it was caused by the prior marketing order. But like Mr. Smith, Professor Folwell did not control for foreign crop failures and other causes of hop price movements.

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[13] Domestic hop prices increased sharply five times in the past twenty-five years, in 1980 (when the prior marketing order was in effect), 1990, 1992, 1994, and 2003, each time in response to German crop failures or production shortfalls. *See* Gooding tr. 470; Smith tr. 203-4, 206, 222, 265, 395-96.

CONCLUSION

For the reasons set forth above, the Secretary should reject the proposed order. The proposed regulation would permit producers to restrict the hop supply and raise prices above competitive levels, thereby misallocating the economy's resources and harming consumers and society as a whole. At the same time, the proposed order would harm efficient producers, and in the long-run, benefit few.

The record in this proceeding demonstrates that the proposed marketing order is inconsistent with sound economic policy and the policies of the Agricultural Marketing Agreement Act. In the absence of any demonstrated need for intervention, where the potential benefits are so speculative, and the harm to consumers and society is so clear, the Secretary should refuse to issue proponents' proposed marketing order.

Respectfully submitted,

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