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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

STRAUS FAMILY CREAMERY, INC. and HORIZON ORGANIC HOLDING CORPORATION. Plaintiffs. vs. WILLIAM B. LYONS, JR., Secretary, California Department of Food and Agriculture, Defendant.	Case No.: C 02 1996 BZ MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO MOTION FOR JUDGMENT ON THE PLEADINGS Date: January 22, 2003 Time: 10:00 a.m. Department: G Judge: Magistrate Judge Bernard Zimmerman

TABLE OF CONTENTS

TABLE OF AUTHORITIES

STATUTES

I. INTRODUCTION

In this action, Plaintiffs Straus Family Creamery, Inc. ("Straus") and Horizon Organic Holding Corporation ("Horizon"), challenge the constitutionality of California's milk stabilization and pooling laws as implemented by defendant. Defendant requires plaintiffs, who process organic dairy products, to pay money into a pool that is designed to provide a sustainable pay price to conventional (but not organic) dairy farmers, from whom plaintiffs cannot, by law, purchase milk.

Prior to bringing this action, plaintiffs unsuccessfully petitioned the defendant to amend the pooling regulations on the ground that they were contrary to the requirements of the authorizing statutes. Defendant concluded that he could not amend the current regulations, regardless of their validity, without the assent of dairy farmers state-wide. The vast majority of those farmers produce conventional milk, and would clearly refuse to assent to an amendment that would reduce plaintiffs' participation in the pool from which they benefit. The Third Claim in plaintiffs' complaint alleges that the referendum statute, California Food & Agriculture Code § 62717,[1] as applied by defendant, violates plaintiffs' right to procedural due process.

Defendant seeks judgment on plaintiffs' procedural due process claim, arguing that the referendum provision in Section 62717 is *per se* constitutional. The Court should deny the motion. Although the government may provide that a law which it could validly enact will only become effective upon a referendum vote, it may not perpetuate an invalid regulation on the ground that interested, biased and adverse private parties would not assent to an amendment.

[1] Statutory sections referred to herein are references to the California Food & Agriculture Code unless noted otherwise.

II. STATEMENT OF ISSUES

Is the referendum requirement set forth in Section 62717, as applied to plaintiffs in this case, constitutional as a matter of law, even though: (1) the requirement delegates to private parties the power to preclude the defendant from amending unconstitutional regulations that do not conform to the requirements set forth in the enabling statutes; (2) the requirement delegates to farmers of one commodity, who have a direct adverse, personal, pecuniary interest in their decision, the power to veto regulations applicable to processors of a different, competitive commodity; and (3) all of the other facts alleged in plaintiffs' Complaint for Declaratory and Injunctive Relief, and all inferences reasonably drawn from those facts, are assumed to be true.

III. BACKGROUND

A. LEGAL BACKGROUND

1. The California Milk Pooling Statutes

Since the 1930's, through the Milk Stabilization Act, the state of California has attempted to stabilize the supply and price of milk by establishing minimum prices that dairy processors (also called "handlers") must pay to dairy farmers (also called "producers"). Under the system in place prior to 1967, the state, through the defendant and his predecessors, established different minimum prices to which dairy farmers would be entitled that depended upon the value of the end-product for which a processor ultimately used the producer's milk. The end-products are divided into 5 different "classes."

In 1967, in response to the competition among producers to obtain contracts to sell their milk for the highest valued uses, and the adverse market conditions associated with that competition, the legislature enacted the Gonsalves Milk Pooling Act ("the Pooling Act"). Cal. Food & Agr. Code §§ 62701, *et seq.* The Pooling Act authorizes the defendant to create one or more marketing areas and to set uniform minimum prices that all processors must pay to all producers within each marketing area. In order to equalize the obligations and benefits of the uniform pricing scheme to processors, the Pooling Act

and implementing regulations require processors who process milk into products having a value above the minimum price to pay money into a pool, which defendant then disburses to processors who process products that have a value below the minimum price. Essentially, the processors of higher class products pay into the pool the difference between the minimum price and the class price of their products, and processors of lower class products receive out of the pool the difference between the minimum price and the class price of their products. However, the pool obligations of processors of higher class products are based on the value of conventional dairy products and conventional milk prices, and do not reflect the higher cost of producing organic milk.

The legislature has authorized the defendant to "formulate stabilization and marketing plans, subject to the limitations prescribed" by the legislature. Section 61805(c). The legislature has prescribed that the minimum prices that defendant sets must be "at fair and reasonable levels so as to generate reasonable producer incomes," (§ 61802(h)), taking into consideration the "varying costs of production, health regulations, and other factors of costs of production" resulting from "varying conditions of production," (§ 61807), "varying costs of production, health regulations, transportation, and other factors" (§ 61805(b)), including "any relevant economic factors," (§ 62062(b)), such as "the cost of producing and marketing market milk for all purposes," as well as the "purposes, policies, and standards" set forth by the legislature. (§ 62062(a), (c)). The legislature has also mandated that, in administering the Plan, the defendant "endeavor under like conditions to achieve uniformity of costs to handlers" (§ 61805), including by providing for different sets of regulations and pricing schemes where "he finds the conditions affecting the production, handling, and sale of market milk, are reasonably uniform." Section 61962. The enabling statutes further provide that "[n]o pooling plan . . . shall result in unequal raw product cost between distributors [*i.e.*, processors] in the same marketing area." Section 62720.

A petition to amend the regulations is the only administrative avenue for a processor to challenge the legality of defendant's implementing regulations. Following the hearing on such a petition, the defendant may make substantive amendments to the pooling plan upon the assent of "producers concerned." Section 62717.

2. The Federal Pooling Statutes[2]

While the California dairy industry is subject only to the state milk stabilization and pooling laws, the dairy industry in the majority of other states is subject, instead, to federal stabilization and pooling laws. Unlike California's statutes, the federal statutes authorize the Secretary to conduct a quasi-judicial hearing on claims that the regulations are "contrary to law" and to modify the regulations after such a hearing without producer referendum or approval. 7 U.S.C. § 608c(15)(A) and 7 U.S.C. § 608c(15)(A)(i), (19). Where a referendum is allowed or required, only those producers of the commodity at issue, in the market at issue, are entitled to vote. 7 U.S.C. § 608c(8)(A), (B).

B. FACTUAL BACKGROUND

Plaintiffs are licensed processors of organic dairy products, who are subject to the state Stabilization and Pooling laws, as well as the state and federal organic foods laws,[3] which were not enacted until after the Stabilization and Pooling laws were in effect. Complaint, ¶¶ 6-7, 9. To comply with the organic foods laws, plaintiffs may purchase raw milk only from certified organic dairy farmers. Id., ¶¶ 13, 19. As a direct result of the requirements of the organic foods laws, the cost of producing, and of purchasing, raw organic milk is substantially higher than the cost of producing, and of purchasing, raw conventional milk. Id., ¶¶ 13-15. However, neither the Stabilization Plan, nor the Pooling Plan account for the increased expenses incurred by plaintiffs and by the organic dairy farmers from whom plaintiffs must purchase their raw milk. Rather, defendant

[2] While the federal statutes are not at issue in this case, the defendant's authorities in support of his motion are based exclusively on federal statutes. Thus, some background on the relevant distinctions between California law and federal law is in order.

[3] The California Organic Foods Act of 1990, California Health & Saf. Code §§ 110810 *et seq.* and California Food & Agr. Code §§ 46000 *et seq.*, the Federal Organic Food Production Act of 1990, 7 U.S.C. §§ 6501 *et seq.*, and the National Organic Program, 7 U.S.C. § 6517.

establishes minimum producer pay prices each month based on the value of conventional dairy products, and calculates the plaintiffs' pool obligation each month based on those conventional values. Id., ¶¶ 10, 13, 16-17.

As a result of the failure to account for the costs unique to organic production, the Stabilization and Pooling Plans do not create a sustainable minimum price for organic producers. Nevertheless, defendant calculates plaintiffs' pool obligation each month based on the fiction that the minimum price would be a sustainable price for organic milk producers and thus that plaintiffs may purchase raw milk at the minimum price established by defendant each month. Further, plaintiffs are required to pay into a pool that only supports the conventional dairy industry, from which plaintiffs cannot purchase milk. Virtually all recipients of payments from the pool are members of the conventional dairy industry. Thus, the Stabilization and Pooling Plans, as applied to plaintiffs' operations, subsidizes the conventional dairy industry at plaintiffs' expense. Id. ¶¶ 18, 19, 24.

On October 23, 2000, plaintiffs submitted a petition to defendant. In the petition, plaintiffs asserted that the current regulations were contrary to the enabling statutes in that they failed to account for the additional costs of production that organic producers incur and the resulting higher price that organic processors must pay to organic producers, and proposed a modification to the regulations to account for such costs. Id., ¶ 20. Defendant denied the relief requested in plaintiffs' petition based, in part, on the conclusion that, because the amendment would "significantly reduce the obligation of organic processors to the pool," he "would not make such a change effective without first issuing the proposed change to referendum vote of market milk producers. Given testimony presented at the hearing, the proposed change would be defeated overwhelmingly by producers in a statewide referendum." Id., ¶ 22, quoting, Notice of Decision, dated May 21, 2001, p.2. Dairy producers would defeat the proposal because the vast majority of them produce conventional milk, and they economically benefit by maximizing the plaintiffs' contributions to the pool. Complaint, ¶ 22.

In this action, plaintiffs allege that defendant's decision to perpetuate the current regulations notwithstanding their failure to conform to the requirements of the implementing statutes, on the ground that an amendment to account for organic costs would require, and would not receive, approval of all market milk producers in the state, violates plaintiffs' right to procedural due process. The producers state-wide would not approve this amendment because they are overwhelmingly members of the conventional dairy industry who have a financial interest in requiring organic producers to contribute to the pool. Complaint, ¶¶ 36-39. Defendant seeks judgment on the Third Claim of the Complaint on the ground that there can be no constitutional impediment to requiring that approval.

IV. ARGUMENT

A. STANDARD FOR DECIDING A MOTION FOR JUDGMENT ON THE PLEADINGS

"The standard applied on Rule 12(c) motions is essentially the same as applied on Rule 12(b)(6) motions: Judgment on the pleadings is appropriate when, assuming all material facts in the pleading under attack are true, the moving party is entitled to judgment as a matter of law. In deciding whether to grant a motion for judgment on the pleadings, not only are the material facts alleged in the complaint assumed to be true, but all inferences reasonably drawn from the facts must be construed, and all doubts resolved, in favor of the nonmoving party." Patel v, United States, 823 F.Supp. 696, 697 (N.D.Cal. 1993) (citations omitted).

Where legislative action is challenged, and the rational basis for the action is predicated on economic facts particular to an industry, those facts are properly subject to evidence and findings, and the court should not dismiss the claim on the face of the complaint. Borden's Farm Products Co., Inc. v. Baldwin, 293 U.S. 194, 204, 210-212, 55 S.Ct. 187 (1934) (holding that lower court should not have dismissed constitutional challenge to milk regulations where propriety of the regulations was dependent upon economic facts of industry).

B. DEFENDANT'S APPLICATION OF THE REFERENDUM REQUIREMENT VIOLATES PLAINTIFFS' RIGHT TO PROCEDURAL DUE PROCESS

Defendant's motion for judgment on the pleadings is premised exclusively upon the purported "long line of authority that confirms that referendum provisions in agricultural regulations are constitutional." Def. Br., p.5:20-21. There is no such *per se* rule. Whether a law unconstitutionally delegates legislative authority, or is unconstitutional as applied, depends entirely upon the particular law at issue and the facts of the case. See e.g. Carter v. Carter Coal Co., 298 U.S. 233, 311, 56 S.Ct. 855 (1936); Young v. City of Simi Valley, 216 F.3d 807, 817, 820 (9th Cir. 2000) (the same law may be found constitutional in one case and unconstitutional in another depending on its particular effect). The referendum provision in question, as applied in this case, is unconstitutional in a number of respects.

1. Defendant May Not Use The Referendum To Perpetuate Improper Regulations

Defendant's application of the referendum requirement in this case violates plaintiffs' right to due process because defendant has used that requirement to justify perpetuating invalid regulations, rather than merely as a condition for a proper regulation to take effect.

As a matter of well-established law, the government may not allow private parties to determine regulations applicable to other private parties. Carter, supra. In Carter, the Court held that a law that allowed two-thirds of coal producers in a particular district to establish minimum wages for all coal producers in that district, by their agreement as to what the minimum wage should be, was an unconstitutional delegation that violated the due process clause. The Court stated that "one person may not be entrusted with the power to regulate the business of another, and especially that of a competitor. And a statute which attempts to confer such power undertakes an intolerable and unconstitutional interference with personal liberty and private property. The delegation is so clearly a denial of rights safeguarded by the due process clause . . ." Id., at 311.

The prohibition expressed in Carter is not limited to laws that allow private parties to create the regulation in the first instance. Rather, laws that, by their application, allow private parties to validate improper or unconstitutional regulations, or to effectively veto constitutional regulations, are equivalent to allowing private parties to create the law and are improper. International Assoc. of Plumbing & Mechanical Officials v. California Building Standards Commission, 55 Cal.App.4th 245, 254 (1997) (prohibition against allowing private parties to make the law "applies equally to any legislation that would abrogate the state's police power by giving a private party or parties a veto over the regulatory function."). The government may not use a private voting scheme to avoid the requirements of the law; it may not accomplish through private parties what it is forbidden to do itself. Washington ex rel. Seattle Title Trust Co. v. Roberge, 278 U.S. 116, 121-122, 49 S.Ct. 50 (1928); Edwards v. United States, 91 F.2d 767, 788 (9th Cir. 1928) (only "if the findings satisfy the statutory requirements for the regulations," will a provision conditioning the effectiveness of the regulations upon approval by producers comport with the due process clause.); Young, 216 F.3d at 819 (holding that ordinance that comported with constitutional requirements but that allowed private parties to do what the city could not, itself do, was an unconstitutional delegation that violated plaintiff's right to due process).[4]

In both Young and Roberge the courts distinguished between laws that allowed private parties, by their vote, to affect the property rights of other parties in a manner that the government could constitutionally impose itself, and laws that allowed private parties to impose conditions upon the property rights of others in a manner that the government itself, could not. See Roberge, 278 U.S. at 120-123 (law that allowed property owners to

[4] See also Fry v. City of Hayward, 701 F.Supp. 179, 182 (N.D.Cal. 1988) ("It is plain that the electorate as a whole, whether by referendum or otherwise, could not order city action violative of the Equal Protection Clause, and the City may not avoid the strictures of that Clause by deferring to the wishes or objections of some fraction of the body politic."); and Jones v. Bergland, 440 F.Supp. 485, 489 (E.D.Pa. 1977) (recognizing that "the referendum may not validate an otherwise invalid [milk marketing] order.")

prohibit billboards was not an unconstitutional delegation because prohibition against billboards would be properly within police power, while law that allowed property owners to prohibit old age home violated the due process clause because there was no showing that such a prohibition would be a proper exercise of the police power.) Here, not only has defendant failed to show that the regulations are valid, but, because the plaintiffs' allegations are assumed to be true for the purposes of this motion, defendant cannot make such a showing.

In United States v. Rock Royal Co-Operative, Inc., 307 U.S. 533, 59 S.Ct. 993 (1939), upon which defendant relies, unlike the present case, there was no question of the invalidity of the action that was subject to producer approval. The Court described the issue as follows: "The objection is made that this is an unlawful delegation to producers of the legislative power to put an order into effect in a market." The Court then stated that, in considering the question, it would assume that Congress had the power to put the order into effect "without the approval of anyone." Based on that assumption, the Court explained that the referendum requirement in that case was permissible "inasmuch as Congress could place the Order in effect without any vote." Id., at 577-578. Here, of course, because of the rules governing 12(c) motions, the contrary assumption must be made.

None of the cases upon which defendant relies support the use of a referendum to perpetuate an improper and unconstitutional law. All of defendant's cases merely held that Congress could condition the application of an otherwise valid law upon the consent of certain affected parties. Currin v. Wallace, 306 U.S. 1, 15, 59 S.Ct. 379 (1939); Rock Royal, 307 U.S. at 577-578; United States v. Frame, 885 F.2d 1119, 1127-1128 (3d Cir. 1989); Sequoia Orange Co. v. Yeutter, 973 F.2d 752, 759 (9th Cir. 1992); Brock v. Superior Court, 9 Cal.2d 291 (1937). Further, each of the cited cases involved a challenge to the constitutionality of the referendum requirement on its face, rather than

"as applied" in response to a substantive challenge to the propriety of regulations. See Currin, at 15-16; Rock Royal, at 574[5]; Sequoia Orange Co., at 759.

The referendum requirement challenged in this case is different from the referendum requirements described in Rock Royal and Edwards, supra and, instead, is more akin to Carter, Roberge, and Young. In Roberge, the Court explained that, because the private parties "are not bound by any official duty, but are free to withhold consent for selfish reasons or arbitrarily . . . The delegation of power so attempted is repugnant to the due process clause of the Fourteenth Amendment." Roberge, 278 U.S. at 122. In this case, as in Roberge, the conditions upon which the current regulations are based are not those prescribed by the statute, and the Secretary's findings do not satisfy the statutory requirements for the regulation. The defendant has rendered the regulations and plaintiffs' property rights "subservient to selfish or arbitrary motivations" of conventional dairy producers, conferring upon those producers the power to perpetuate improper regulations. As in Carter and Roberge, the delegation at issue in this case violates plaintiffs' right to due process. See also Young, 216 F.3d at 820 (administrative decision making may not be rendered "subservient to selfish or arbitrary motivations" of private parties).

In Currin, which was the lynchpin upon which defendant's other authorities turned, the Court specifically distinguished Carter and Roberge, on the ground that Currin did not present a case where private parties, at their discretion, could impose unconstitutional conditions upon other parties. Currin, at 15-16. However, in the case at bar, plaintiffs allege that private parties have been given the power to veto amendments to unconstitutional regulations that do not conform to the requirements of the enabling statutes, thus effectively imposing unconstitutional conditions on the plaintiffs.

[5] Significantly, in Rock Royal, the Court held that the pooling scheme at issue, and the delegation of authority to the Secretary, was constitutional because it required and contained differentials to cover variations in costs, unlike the unconstitutional pooling scheme in Railroad Retirement Board v. Alton, 295 U.S. 330, 55 S.Ct. 758 (1935), (also unlike the case at bar) wherein all carriers were treated alike, regardless of variations in businesses, and thus the burdens were not equalized with the benefits. See Rock Royal, 307 U.S. at 573, 576.

The administrative agency bears the ultimate responsibility to assure that the regulations conform to the law. It cannot abdicate that responsibility to private parties. The amendment of regulations that are unconstitutional and contrary to the enabling statutes is not properly contingent upon producer assent. See, e.g., Zuber v. Freeman, 402 F.2d 660, 674-675 & fn. 41 (D.C.App. 1968) (holding that where provision in milk marketing plan was unauthorized and thus invalid, amendment of plan to conform to statutory requirements did not require remand to Secretary or producer referendum).

2. The Referendum Requirement, As Applied, Improperly Delegates Decision Making Authority Affecting Plaintiffs To Members Of A Distinct Industry Who Have A Direct Pecuniary Interest In Their Decision

Defendant's application of the referendum requirement violates plaintiffs' right to due process because defendant has interpreted Section 62717 to require the approval of producers of conventional milk, from whom plaintiffs do not, and cannot, purchase milk. These producers have a direct pecuniary interest in their decision that is antagonistic to the interest of plaintiffs. See e.g. Carter, 298 U.S. at 311; and Bayside Timber Co., Inc. v. Board of Supervisors, 20 Cal.App.3d 1, 14 (1971). The defendant's attempt to subject the property rights of processors of one commodity, to the desires of producers of a separate, competing, commodity, appears to be unprecedented. It is certainly unlawful.

As a matter of well-established law, subjecting a party's property rights to the decision of others who have an adverse, personal, pecuniary interest violates the right to due process. Gibson v. Berryhill, 411 U.S. 564, 578-579, 93 S.Ct. 1689 (1973); Tumey v. Ohio, 273 U.S. 510, 522-524, 47 S.Ct. 437 (1927); Ward v. Village of Monroeville, 409 U.S. 57, 59, 93 S.Ct. 80 (1972); Bayside Timber Co., Inc., 20 Cal.App.3d 1 at 14. In Bayside Timber Co., the Court struck down a law that precluded the State Board of Forestry from implementing regulations necessary to protect the environment, without the approval of members of the timber industry, as an unconstitutional delegation that violated the due process rights of the public, which had an interest adverse to the timber industry. Id., at 10, 12-14. In doing so, the Court held that authorities prohibiting self-

interested parties from serving in a quasi-judicial capacity[6] applied equally to the quasi-legislative function. Id., at 14. The Court's ruling relied upon Johnson v. Michigan Milk Marketing Board, 295 Mich. 644, 295 N.W. 346 (1940), in which the court held that allowing industry members to determine the regulations that affected the plaintiff distributor differently than they affected other distributors, deprived that plaintiff of the right to due process. Id, at 659-660.

Plaintiffs have alleged that conventional dairy producers, from whom plaintiffs cannot even purchase milk, have a personal financial interest in maximizing plaintiffs' pool obligations. See Complaint ¶¶ 18, 22, 25, 32 and 38. The defendant denied plaintiffs' petition to amend the pooling regulations based in part on his determination that conventional producers have the power to, and would, preclude such an amendment. There is no authority to support the propriety of such a delegation. None of defendant's authorities remotely addressed whether the government could condition the application of a law to an industry upon the vote of members of a different, competitive industry. Defendant's cases all merely held that the government could condition the effectiveness of certain laws or regulations on a vote of producers who produced the same commodity in the same market.[7] See e.g. Rock Royal, 307 U.S. at 577-578; Sequoia, supra. This is consistent with the federal statutes, which only allow producers who produce the same commodity and sell that commodity to handlers in the same market, to vote on the regulations that affect those handlers. See 7 U.S.C. § 608c(8), (19); H.P. Hood & Sons, Inc. v. United States, 307 U.S. 588, 598, 59 S.Ct. 1019 (1939) (holding that Secretary properly limited the producers entitled to vote in the referendum to those farmers who sold milk to processors within the affected market area.) Conventional producers do not sell milk to organic processors such as plaintiffs. Complaint, ¶ 19.

[6] See, e.g., American Motors Sales Corp. v. New Motor Vehicle Board, 69 Cal.App.3d 983, 992 (1977).

[7] If defendant should argue that organic milk is the same commodity as conventional milk, that would raise issues of fact that would preclude a judgment on the pleadings. Borden's Farm Products Co., Inc., 293 U.S. at 204, 210-212.

The referendum provision, as applied in this case, violates plaintiffs' right to procedural due process.

C. AT MINIMUM, IF THE MOTION IS GRANTED THE COURT SHOULD GRANT PLAINTIFFS LEAVE TO AMEND THE COMPLAINT

The court has broad discretion to permit a party to amend its pleading. "In exercising its discretion 'a court must be guided by the underlying purpose of Rule 15 -- to facilitate decision on the merits rather than on the pleadings or technicalities.'" DCD Programs, Ltd. v. Leighton, 833 F.2d 183, 186 (9th Cir. 1987) (citation omitted). The Ninth Circuit has noted on several occasions that the "Supreme Court has instructed the lower federal courts to heed carefully the command of Rule 15(a), F[ed].R.Civ.P., by freely granting leave to amend when justice so requires. Thus 'rule 15's policy of favoring amendments to pleadings should be applied with 'extreme liberality.'" Id. (citations omitted). The court should grant leave to amend where there is no bad faith, undue delay, or prejudice to the opposing party.

If this Court concludes that plaintiffs' Third Claim fails to state a procedural due process violation, plaintiffs respectfully request that the Court permit them to amend that claim. There is no evidence of bad faith or undue delay. Since discovery is still open, there could be no prejudice to the defendant.

V. CONCLUSION

For the foregoing reasons, plaintiffs respectfully request that the Court deny defendant's Motion for Judgment on the Pleadings. If the Court grants the motion, plaintiffs request leave to amend their Third Claim.

Dated: December 31, 2002

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