R. Charles Martin

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BEFORE THE
UNITED STATES DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C.

ORANGES AND GRAPEFRUIT GROWN IN THE LOWER RIO GRANDE VALLEY; PROPOSED HIGHER QUALITY AND REDUCED SIZE REQUIREMENTS FOR TEXAS GRAPEFRUIT	)	Docket No. FV94-906-3-PR

COMMENTS OF THE DEPARTMENT OF JUSTICE

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September 16, 1994

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COMMENTS OF THE DEPARTMENT OF JUSTICE

By notice dated September 1, 1994, the United States Department of Agriculture ("USDA") requested comments on a proposed rule to increase the minimum grade requirements for Texas grapefruit sold in the fresh market.[1] The Texas Valley Citrus Committee ("the Committee"), a group consisting of competing growers and handlers, has proposed this rule which would prohibit Texas growers from continuing to ship U.S. No. 2 grade grapefruit to the fresh market. The proposed rule would also relax the minimum size requirements for Texas grapefruit shipped during the 1994-95 season.

POSITION OF THE DEPARTMENT OF JUSTICE

The Department of Justice opposes the increased minimum grade standard proposed by the Committee.[2] Raising the mandatory grade

[1] 59 Fed. Reg. 45,241.

[2] The Department of Justice does not oppose the provisions in the proposed rule that would relax the minimum size requirements for Texas grapefruit shipped during the 1994-95 season. As the

requirements for fresh Texas grapefruit shipments is inconsistent with Executive Order 12,866 and the applicable public interest standard of the Agriculture Marketing Agreement Act of 1937. Contrary to the assertions of the Committee, the proposed restriction on grapefruit shipments offers no long term benefits to consumers or producers. Instead, these higher minimum grade requirements would artificially restrict the supply of fresh grapefruit, causing consumer prices to rise and promoting wasteful misallocation of society's resources. Therefore, the Secretary should reject this proposed restriction on the supply of grapefruit made available to the fresh market.

DISCUSSION

I. SUMMARY OF MINIMUM GRADE STANDARD PROPOSALS CURRENTLY BEFORE USDA

The proposed rule is based upon a recommendation made by the Committee on July 30, 1993 to prohibit Texas growers from shipping a particular grade of grapefruit, the U.S. No. 2, to the fresh market. The U.S. No. 2 is one of seven grades of grapefruit Texas growers are allowed to ship to the fresh market under the Order. If the Committee recommendation is adopted by USDA, the new minimum grade of marketable fresh grapefruit would be Texas Choice. The only difference between the Texas Choice

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Committee found, some consumers prefer smaller grapefruit. These consumers and Texas growers would benefit from allowing smaller grapefruit to be shipped from Texas to the fresh market. Texas Valley Citrus Committee, Justification of Committee Recommendation, Section 906.365(a)(4), adopted June 30, 1994.

and U.S. No. 2 grades is the allowance for surface discoloration. Such discoloration may appear on no more than two-thirds of the surface of a U.S. No. 2 grapefruit, while for Texas Choice grapefruit, the allowance is reduced to no more than 60 percent affected by discoloration.

USDA is also considering a similar regulatory change for fresh grapefruit from other major growing regions. The Florida Citrus Administrative Committee, the Florida equivalent of the Texas Committee, has recommended that USDA prohibit Florida growers, as well as foreign suppliers, from shipping U.S. No. 2 grapefruit to the fresh market. USDA, by notice dated September 8, 1994, has published the Florida recommendation as a proposed rule and requested comments.[3] Florida and Texas supply over 80 percent of U.S grapefruit production.[4]

II. THE STATUTORY BASIS FOR REGULATION AND THE PROPOSED RULE

USDA has proposed this rule pursuant to Marketing Order 906, as amended, 7 C.F.R. § 906 ("the Order"),[5] which authorizes the

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[3] 59 Fed. Reg. 46,361.

[4] United States Department of Agriculture, Fruit and Tree Nuts Situation and Outlook Yearbook, July, 1993, Table C-3.

[5] The Secretary of Agriculture is empowered by the Agricultural Marketing Agreement Act of 1937, as amended, 7 U.S.C. §§ 601 *et. seq.* ("AMAA" or "the Act"), to regulate the handling of a broad range of agricultural commodities. Under the Act, "marketing agreements" and "marketing orders" are the basic mechanisms through which the Department of Agriculture promotes the Act's policies. The Act authorizes handlers, with the consent of the Secretary of Agriculture, to enter into marketing agreements that are exempt from the antitrust laws and cover many significant aspects of the handlers' business. The Secretary of Agriculture is also authorized to issue marketing orders, which are regulations

regulation of the handling of oranges and grapefruit grown in the Lower Rio Grande Valley in Texas. Rules issued pursuant to the Order bind all handlers, including any handlers who oppose the rules. Thus, the proposed rule would impose mandatory restraints on the grades of fresh Texas grapefruit that may be lawfully marketed by all grapefruit growers in the Lower Rio Grande Valley of Texas.

In order to implement the proposed rule, the Secretary is required to make a determination that such action is likely to promote the Act's policies. 7 U.S.C. §§ 608(c)(4), 608c(16)(A). The policy of particular relevance to the proposed rule is found in Section 602 (3) of the Act, which states:

> It is declared to be the policy of Congress --
>
> Through the exercise of the powers conferred upon the Secretary of Agriculture under this title, to establish and maintain . . . such minimum standards of quality and maturity and such grading and inspection requirements [for the particular product] as will effectuate such orderly marketing of such agricultural commodities as will be in the public interest.

Thus, the language of the statute expressly directs the Secretary to act in pursuit of the public interest. The public interest includes the interests of consumers, which must be considered along with the interests of farmers.[6] Competitive

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that govern the activities of all specified handlers of a particular product.

[6] The Secretary of Agriculture, in determining "crucial facts and conclusions . . . cannot be guided solely by deference to industry desires." Walter Holm & Co. v. Hardin, 449 F.2d 1009, 1016 (D.C. Cir. 1971); Fairmont Foods Co. v. Hardin, 442 F.2d 762, 766 (D.C. Cir. 1971).

considerations, including the efficient allocation of resources, are important elements of the "public interest" standard, which applies not only to this program, but to many other types of federal economic regulatory programs.[7] Indeed, the Secretary has announced his goals in administering fruit and vegetable marketing orders must "be consistent with the efficient use of the nation's resources in the interests of producers and the general public."[8] In particular, the Secretary has announced concern that quality control provisions of marketing orders not be used as a form of anticompetitive supply control.[9]

The Secretary's prior announcements are consistent with President Clinton's Executive Order 12,866[10], which directs how federal agencies are to review their regulatory programs. USDA has stated that this regulatory change is being reviewed in accordance with the President's Order.[11] Section 1(a) of the Executive Order provides:

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[7] Paragon Cable Television, Inc. v. FCC, 822 F.2d 152, 154 (D.C. Cir. 1987); Sabin v. Butz, 515 F.2d 1061, 1069 (10th Cir. 1975); Democratic National Committee of D.C. v. Metropolitan Area Transit Commission, 485 F.2d 886, 906 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974); Woods Exploration and Production Co. v. Aluminum Co. of America, 438 F.2d 1286, 1302 (5th Cir. 1971), *cert. denied*, 404 U.S. 1047; Cities of Stateville v. Atomic Energy Commission, 441 F.2d 962, 987 (D.C. Cir. 1969).

[8] U.S. Department of Agriculture, Guidelines for Fruit, Vegetable and Specialty Crop Marketing Orders at 2 (1982).

[9] *Id.* at 5.

[10] 3 C.F.R. 636 (1993), 5 U.S.C. § 601 (1993).

[11] 59 Fed. Reg. 45,241.

> Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people. 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.

As these Comments will demonstrate, the proposed increase in minimum grade standards for Texas grapefruit will not address any compelling public need and will not promote the objectives of the Act. Principles of sound economic theory, validated by past experience, strongly suggest that such regulation will serve only to restrict supply and raise prices of fresh grapefruit, and thus defeat the goals set forth by the President, the Secretary and the Act itself.

III. THE PROPOSED CHANGE IN MINIMUM QUALITY STANDARDS IS NOT IN THE PUBLIC INTEREST

The Committee claims that the major benefits from higher minimum grade requirements would be (1) greater consumer demand for fresh grapefruit due to the increased confidence in grapefruit quality and less consumer confusion over the number of grades of grapefruit; (2) higher grower returns; and (3) continued sales of fresh Texas grapefruit that the Committee claims would be lost if similar minimum grade standards are

adopted for Florida growers.[12] These asserted benefits do not withstand analysis.

A. Higher Mandatory Grade Standards Will Not Offer Any Benefits to Consumers and Will Not Promote Consumer Demand

U.S. No. 2 grapefruit already meet the highest USDA standards for internal quality and differ from higher-grade grapefruit only in the amount of discoloration on the fruit's surface. Surface coloration is an external characteristic that consumers can easily observe before making their purchases. Thus, consumers already can select higher quality (i.e. more attractive) grapefruit if they choose. For this reason, the proposed increase in the minimum grade standard for fresh Texas grapefruit offers consumers no new benefits -- it merely removes one of their currently available choices.

Furthermore, grocers have the ability to order higher quality grapefruit on their own. If consumers demand only higher-grade grapefruit or are confused by the number of grades of grapefruit, then grocers would have the same interest as growers in not offering U.S. No. 2 grapefruit to consumers.

Grocers can also separate U.S. No. 2 grapefruit from other grapefruit on their shelves and price them differently. Then consumers who are willing to pay for more attractive grapefruit could find the grapefruit they demand, and consumers who prefer to pay less for less attractive (but equally safe and nutritious) grapefruit can find those grapefruit as well. If the price

[12] *Id.* at 45,242.

consumers are willing to pay for higher grade grapefruit is sufficiently high, producers will incur the additional costs that are necessary to produce such grapefruit. In this way, the market will increase the quality of fresh grapefruit, without regulatory intervention, if it is in the mutual interest of growers and consumers to do so.

Thus, this proposed regulatory change is likely to decrease, not increase, the volume of fresh Texas grapefruit demanded by consumers. Undoubtably, some consumers who would be willing to buy U.S. No. 2 fresh grapefruit will choose to forego buying any grapefruit rather than buying a more expensive grade of grapefruit. These consumers would suffer because the regulation prevents them from buying grapefruit at a price at which producers would otherwise be willing to sell. Other consumers who prefer U.S. No. 2 grapefruit will choose to buy higher-grade grapefruit instead, but will be made worse off by having to pay higher prices.

The evidence shows that some consumers would prefer to buy U.S. No. 2 grapefruit as long as this grade is available in fresh markets. Both the Texas Valley Citrus Committee and the Florida Citrus Administrative Committee report that growers from the two states successfully sell U.S. No. 2 grapefruit on the fresh market. Indeed, Florida sales of U.S. No. 2 fresh grapefruit

have been substantial in recent years.[13] If the Secretary implements the recommendations of the Florida and Texas committees, those consumers will be foreclosed from buying this grade of grapefruit from the two states accounting for the vast majority of domestic grapefruit production, as well as from foreign sources.

The Texas Committee appears to be aware of the ability of consumers to make knowledgeable decisions about the grapefruit they buy. The Committee justified its recommendation to allow shipments of smaller grapefruit to the fresh markets by claiming that there are "many citrus buyers who prefer small sizes . . . therefore Texas growers [in previous year] lost out on that segment of the trade."[14] This reasoning applies equally well to consumers who prefer to buy fresh U.S. No. 2 grapefruit.

The critical difference that explains the Committee's apparently inconsistent justification of both relaxed size standards and stricter grade standards appears to be the availability of grapefruit from other states. Consumers who prefer smaller sizes can buy such grapefruit from other states, especially Florida. But if USDA adopts the proposed higher mandatory grade requirements for Texas, Florida and imported grapefruit, consumers would not be able to buy U.S. No. 2

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[13] Texas Valley Citrus Committee, Shipments by Variety and Grade between 09/01/1993 and 05/20/1994, May 27, 1994; Citrus Administrative Committee, Statistical Bulletin No. 36, June 14, 1994, p. 9.

[14] Texas Valley Citrus Committee, Justification of Committee Report, Section 906.365(a)(4), adopted June 30, 1994.

grapefruit from the vast majority of current supply sources.

B. Any Short Term Profit Benefits to Producers Would Be Outweighed by the Short and Long Term Harm to Consumers and the General Public

The only asserted benefit that may actually be achieved by any segment of the public from higher minimum grade standards is higher grower returns. This benefit, however, would not be achieved by protecting consumers from misinformed purchases of low quality fresh grapefruit, but from the use of a cartel-like restriction on the supply of fresh grapefruit. Such supply restrictions would not provide any benefits to the public as a whole. Instead, the proposed USDA rule would do no more than transfer money from consumers to producers in the form of higher fresh grapefruit prices, while creating some losses to both consumers and producers as some buyers of U.S. No. 2 grapefruit choose not to pay the higher prices.

Furthermore, these increased grower profits would not be sustainable in the long run, because any artificially raised returns to producers will provide incentives for inefficient new grapefruit production. The new inefficient production will drive up producer costs and erode grower profits until producer returns fall back to the point where producers earn only a normal return on their investment.

While in the long run, no benefits to producers from restricting the supply of fresh grapefruit will be sustained, prohibiting shipments of fresh U.S. No. 2 grapefruit will impose both intermediate and continuing costs on consumers. Prices will

rise and remain above what they would be without this rule as the costs of wasteful additional production of grapefruit are necessarily passed on to consumers.[15] The effects of inefficient grapefruit overproduction will be felt in other markets as well, as growers divert land and resources from their highest value uses to inefficient grapefruit production.

C. Consumers Demand for Texas Grapefruit Would Increase if Minimum Grade Standards Are Imposed On Florida Growers

Contrary to the Committee's claim, Texas growers would likely be helped (at least in the short run), compared to the status quo, if Florida growers must comply with higher minimum grade standards while they do not. Thus, the proposed rule cannot be justified as a defensive measure to maintain market share against Florida grapefruit. If USDA adopts the higher minimum grade standards for Florida and foreign suppliers, a large share of the consumers who would prefer to buy U.S. No. 2 grapefruit would turn to Texas suppliers. At the same time, Texas growers and grapefruit retailers could continue to sell Texas Choice grapefruit to consumers who prefer more expensive higher-grade grapefruit.

Thus, the importance of Texas-supplied U.S. No. 2 grapefruit to the domestic fresh market may be far greater than is suggested

[15] The magnitude of the waste caused by marketing orders can be quite substantial. For example, the Department of Justice has calculated that the waste caused by the prorate provisions in the California-Arizona navel orange marketing order had been as high as $40 million per year. Comments of the Department of Justice, Dkt. No. FV-91-408PR, (Navel oranges) October 20, 1991.

by the current quantity of U.S. No. 2 fresh grapefruit sales. Although the Committee claims that Texas supplies relatively few U.S. No. 2 grapefruit to the fresh market, growers in Texas may have a strong incentive to ship far more grapefruit of this grade if Florida and foreign suppliers are prohibited from doing so. In that case, Texas growers would become the most important source of this grade of grapefruit to many consumers who prefer this grade, and Texas growers would have the incentive to sell more U.S. No. 2 grapefruit in the fresh market rather than in the processed market.

Texas growers currently ship a large share of their grapefruit crop to processors.[16] Many of these processed grapefruit may qualify as U.S. No. 2 grade if growers are encouraged by higher prices to offer them to the fresh market. Therefore, USDA cannot assume, as the Committee claims, that this regulatory change will have little effect on the supply of fresh grapefruit from Texas.

D. The Costs of Higher Minimum Quality Standards Outweigh the Benefits

Evaluating the overall effect of the proposed rule requires a balancing of the benefits of higher minimum grade standards against the costs imposed by the supply restrictions. Here the evidence strongly suggests that consumers would be significantly harmed by loss of choice and higher prices, and receive no

[16] United States Deprtment of Agriculture, Fruit and Tree Nuts Situation and Outlook Yearbook, July, 1993, Table C-3.

benefits from higher mandatory grade requirements. The only benefits to growers would be higher short term profits that would erode as wasteful overproduction occurred. In contrast, consumers and the public at large will suffer long term harm from this unnecessary regulation and the resulting misallocation of productive resources.

CONCLUSION

For the reasons stated above, raising the minimum grade standard for shipments of Texas grapefruit to the fresh market would be contrary to Executive Order 12,866 and would not address any compelling public need or effectuate the purposes of the Agriculture Marketing Agreement Act. The Secretary should therefore reject the increased mandatory grade provisions of the proposed rule.

Respectfully submitted,

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