September 28, 2006

Nina Mitchell Wells
Secretary of State
Office of the Secretary
PO Box 300
Trenton, NJ 08625-0300

Re: Findings of Fact and Conclusions from the
Dairy Hearing Held August 29 and 31, 2006

Dear Secretary of State:

Please accept this document as my findings of fact and conclusions as to whether to set the price of milk in New Jersey in accordance with N.J.S.A. 4:12A-23. Pursuant to that section, any order issued as a result of a hearing held to set the price of milk must be filed in your office. N.J.S.A. 4:12A-23. Such a hearing was held on August 29, 2006 and concluded on August 31, 2006.

For the reasons set forth below, please be advised that I have determined that the best way to assist New Jersey's dairy industry is through a multi-faceted approach implementing both short-term and long-term industry reforms. Long-term, the Department intends to explore the possibility of establishing an anti-price gouging regulation, and the establishment of minimum prices for raw milk and milk sold at wholesale and retail in the New Jersey milk marketing system. In addition, the Department intends to explore whether it is necessary or appropriate to regulate premium payments to producers. Full consideration of these options and their appropriateness to New Jersey's milk industry will require additional information. These future programmatic changes will most likely be considered at future hearings in accordance with N.J.S.A. 4:12A-23.

In the short-term, revisions to the reporting requirements will be made for agricultural cooperatives, and all licensees licensed under both N.J.S.A. 4:12-1 et seq. and 4:12A-1 et seq. Also, industry meetings bringing together various members of the dairy industry will be coordinated to enlist assistance other members of the dairy industry may be willing to offer. The Department will also explore whether regular industry meetings could be established to ensure that in the future, all sectors of the industry are meeting and communicating about issues of concern on a routine basis. Finally, to assist the producers in the short term, a fuel adjuster as described in the record, and an rBST-free premium will be established to offset the extremely high costs currently plaguing the dairy producer. Going forward, the Department will also explore funding sources to ensure that the various producer improvement programs are properly financed to allow producer participation. Once a permanent funding source is established, the fuel adjuster

and rBST-free premium payments will be conditioned upon producer participation in the Milk Quality Program and the Ag Re-engineering Program.

I. STATUTORY AUTHORITY

Pursuant to N.J.S.A. 4:12A-19, the Director of Dairy Control is empowered to conduct investigations into "all matters pertaining to the production, distribution, importation, storage, disposal, classification, sale or resale, conditions and terms of sale or resale, [and] costs of production, distribution, sale and resale, processing, [and] sale for manufacture, of milk." The Director is also empowered to promulgate rules, regulations and orders that are necessary to carry out the provisions of the Title 4, Chapter 12A of the New Jersey Statutes. N.J.S.A. 4:12A-20.

Among the many powers of the Director pursuant to Chapter 12A, the Director has the authority to fix the price at which milk is to be purchased or sold in New Jersey. N.J.S.A. 4:12A-22. Prior to fixing such a price, however, the Director is obligated to conduct a hearing in accordance with N.J.S.A. 4:12A-23. Such price-fixing authority includes the authority to set minimum prices charged to consumers for milk in accordance with the requirements of N.J.S.A. 4:12A-22.1. The authority of the Director does not end at fixing prices; rather, the Director is permitted to "regulate the conditions and terms of sale [of milk], establish and require observance of fair trade practices; supervise, regulate and control the entire milk industry of the State of New Jersey, including the production, importation, classification, processing, transportation, disposal, sale or resale, storage or distribution of milk." N.J.S.A. 4:12A-21. Finally, the Director is authorized to control the conditions of sale, and the terms and credit regulations governing sales of milk between processors, dealers and stores. N.J.S.A. 4:12A-26.

On July 6, 7, and 11, 2006, I received four letters from Gloucester County Board of Agriculture, Salem County Board of Agriculture, Sussex County Co-operative Milk Producers Association, and Sussex County Board of Agriculture requesting that a hearing be held to consider imposition of an over-order premium to address the rising production costs and falling milk prices debilitating the New Jersey producer. (AP-193 to AP-196). A hearing was subsequently held on July 24, 2006 wherein testimony and evidence was presented by various members of the dairy industry. (T1 and AP-190). Thereafter I issued findings of fact indicating that insufficient evidence was presented at the first hearing on which to base my decision and a subsequent hearing was scheduled for August 29, 2006.

Therefore in accordance with my authority in N.J.S.A. 4:12A-22, I held a hearing pursuant to N.J.S.A. 4:12A-23. Public notice was provided in accordance with N.J.S.A. 4:12A-23 and testimony was taken addressing both short-term and long-term measures that could be implemented to stabilize and revitalize the New Jersey milk marketing system.

II. FINDINGS AND CONCLUSIONS

A. LONG-TERM ACTION ITEMS:

1. Price Gouging:

As set forth in N.J.S.A. 4:12A-21, the Director has the authority to "regulate conditions and terms of sale; [and] establish and require observance of fair trade practices." Past precedent has found anti-gouging regulations to be within the scope of the statutory authority granted to the Director. See Port Murray Dairy Company, 6 N.J. Super 285, (App. Div. 1949) (upholding regulation 15, an anti-price gouging regulation). In addition, Abbotts Dairies v. Armstrong, 14 N.J. 319, 329 (1954) construed the Director's authority under N.J.S.A. 4:12A-1 et seq. to include the setting of both a maximum and a minimum milk price.

At both the July and August hearings, very few retailers, wholesalers and milk dealers were willing to disclose sufficient financial information to permit a reasonable analysis as to whether price gouging was occurring in the New Jersey milk marketing system.[1] As was explained by one witness, "Cost margin and profit information of individual plants is closely guarded and considered very confidential by dairy processors." (T2, 202:25-203:2). Another witness opined that the only way to get reliable data is to collect it ourselves. (T2, 195:4-8). Since the exercise of the Director's authority in setting milk prices is both administrative and quasi-judicial, sufficient facts must be set forth on the record to permit judicial review of the Director's decision. National Dairy Products Co. v. Milk Control Bd. of N. J., 8 Abbotts 491, 495 (1945) (emphasis added). Absent sufficient evidence on the record, I am without authority to act on this issue at this time.

However, there was sufficient evidence to conclude that this issue needs to be explored more fully. As one economic expert opined, there is an 80-percent correlation between the price of the finished product and the price of the raw material, and that correlation has a direct impact on retail profitability. (T2, 161:11-20). Moreover, it was admitted that although in the 1970s and 1980s milk was considered a loss leader[2], today supermarkets can and do make a profit on the sale of milk. (T2, 255:19-256:15). This is not to say that the simple fact that some entities are making money in the milk marketing chain automatically leads to the conclusion of price gouging. Nevertheless, given the extremely high correlation between raw milk price and retail profitability and the current extreme difference between the raw milk and retail price (T1, 13:8-14:10), the possibility of price gouging cannot be ruled out at this time.

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[1] While there was insufficient information regarding wholesaler and retailer costs and sale price information, there was however, sufficient information presented regarding costs to producers as relates to fuel and transportation costs and the additional costs incurred in producing rBST-free milk versus commodity milk.

[2] A "loss leader" is a product sold below cost, at a loss, to get customers in the door to buy more profitable products. Blacks Law Dictionary 965 (8th ed. 2004).

During the hearing, evidence was presented as to how other states have addressed or attempted to address the price-gouging problem. (AP-851 to AP-901). For example, in New York State, a price gouging law was developed that prohibits the sale of milk at retail at prices greater than 200 percent above the raw milk price. (T2, 208:12-16 and AP-854 to AP-893). There was testimony presented at the hearing, however, regarding the difficulties that existed in the implementation of that program. For example, one problem that was identified with the New York model was that when raw milk prices are low and processing costs are high, the processors and retailers are squeezed financially. (T2, 208:14-209:1). "There is no room in New York's formula for such high costs since retail stores are presumed to be in violation if they exceed 200 percent limit." (T2, 208:23-209:1). In addition, this system has led to too much instability in milk prices since the maximum retail price changes monthly with the price of raw milk. ((T2, 258:5-11 and T2, 278:12-21). Probably the most unfortunate consequence of New York's system on price gouging is the fact that it actually results in increased retail prices because New York posts the maximum retail price at which milk can be sold. (T2, 246:9-247:2). Posting maximum retail prices encourages retailers to compete to sell the highest priced milk rather than competing to sell the lowest priced milk. (T2, 247:19-248:3).

Similarly, the Connecticut legislature attempted to address anti-gouging through a "price collar" approach. (AP-897). Under this approach, a processor could not charge a retailer more than 140 percent of the raw milk price and the retailer could not charge a consumer more than 130 or 140 percent of wholesale milk price. (AP-852, AP-901 and AP-918). The OLR Research Report explained that at least one dairy cooperative was concerned that the price collar approach would give out-of-state processors a competitive advantage over in-state processors or in the alternative, would violate the commerce clause. (AP-919). Later in the report, however, a Connecticut research analyst dismissed the commerce clause issue, suggesting that the legislation should be able to withstand a commerce clause challenge. (AP-920). Regardless, these issues were never resolved, as this legislation was never enacted into law. (AP-853).

While those testifying at the hearing argued that New Jersey should not consider an anti-gouging measure based on the New York and Connecticut experience, I find that simply because the New York and Connecticut models appear to have been unsuccessful, it does not mean that anti-price gouging regulations are not warranted in New Jersey. Rather, a good anti-price gouging system should find a way to overcome the difficulties experienced by these programs, while still protecting the consumer. Therefore, additional research, analysis and information gathering will be undertaken to determine whether anti-gouging regulations would be beneficial in New Jersey, and if so, how to appropriately implement them.

2. Minimum Price to Farmer, Processor and Retailer

a. Should Minimum Prices be Set?

Obviously the most expeditious way to improve a producer's bottom line is to ensure that the producer receives a milk price that covers all costs to the producer. Setting a minimum price for milk has been found to be an appropriate exercise of state power.

United Dairy Farmers Coop. Assoc. v. Milk Control Comm. of the Commonwealth of PA, 335 F.Supp. 1008 (D.Pa. 1971), aff'd. 404 U.S. 930 (1971). The Director of Milk Control is empowered under N.J.S.A. 4:12A-22 to set a minimum price for milk in New Jersey. National Dairy Products Co. v. Milk Control Board of NJ, 8 Abbotts, 491, 133 N.J.L 491 (1945).

Testimony presented at the July 24, 2006 and August 29, 2006 hearings overwhelmingly indicated that producers in New Jersey are currently experiencing significant losses in their dairy operations. Some producers reported losses in revenue between the first six months of 2005 to the first six months of 2006 ranged from $13,547.49 (T1, 26:13-16) to $23,500 (T1, 47:17-48:1). One producer, in particular indicated that she was losing a thousand dollars a day. (T2, 92:17-19). Another witness indicated that the average New Jersey producer was losing $45,000 annually. (T1, 97:3-7).[3] These losses were attributable to a combination of low milk prices and high production costs. Dairy producers in New Jersey have reported that their milk production costs have increased as much as $1.50 per hundredweight (T2, 26:15-16 and T2, 91:9-15) while the price of milk has fallen more than $2 per hundredweight since the beginning of 2006 (T2, 26:9-11).

Cost of production and processing is more expensive in New Jersey than elsewhere in the Northeast. (T2, 108:10-20 and T2, 129:20-21). Specifically, the average cost of production in the Northeast is $14.76 while the average cost in New Jersey is $15.05 per hundredweight. (T2, 326:1-6). Other producers reported that the total production costs were $15.70 per hundredweight (T2, 91:17-19), and $15.00 per hundredweight (T1, 24:7-8). One farmer estimated that he was receiving $3.00 to $4.00 per hundredweight below cost for his milk. (T1, 52:9-11). By contrast, in May 2006, New Jersey dairy producers were only receiving between $12.26 and $12.46 per hundredweight for their milk (T2, 131:21-132:11), and New Jersey's raw milk prices for June 2006 equaled $1.07 a gallon, a 25-year low. (T1, 13:23-25).

Many of the inputs[4] required for the production of milk have increased significantly since last year. Costs of feed increased 23 percent (T2, 85:24-86:2), costs of fertilizer and chemicals increased 10 percent (T2, 85:17-21) and costs of medicine has risen 29 percent (T2, 86:9-11). Producers reported increased fuel costs of approximately $2,700 annually (T1, 26:18-21), approximately $2,300 semi-annually (T1, 48:2-3), and $4,000 monthly (T1, 37:1-2 and AP-208).[5] Likewise, feed and fertilizer costs rose dramatically from 2005 to 2006. Fertilizer costs for one producer in 2005 increased approximately

[3] The difference in loss estimations and increased cost information is due to the varying sizes of the dairy farms. For example, the producer who reported a loss of $13,547.49 has a herd size of 86 cows. (T1, 26:9-16). Another producer who had reported a loss of $23,500 had a herd size of 120 cows. (T1, 47:24-48:1 and T1, 49:16). Finally the producer who reported losses of $1,000 per day has a herd size of 300 cows. (T2, 82:4-9 and T2, 92:17-19).

[4] An example of the inputs or expenses required in the production of milk can be found at AP-627.

[5] As indicated in footnote 3 above, the variation in cost figures is due to the variation in dairy operation size.

$3,300 just in the first six months of 2006. (T1, 26:22-25 and AP-202). Another producer indicated that his feed costs jumped 20 percent in the last year. (T1, 48:1-12). NASS, the National Agricultural Statistical Service, estimates that fertilizer prices have risen 8.7 percent, agricultural chemical prices have increased 9.9 percent, farm machinery costs have increased 7 percent and fuel prices have risen drastically by 22 percent. (T1, 66:16-20 and AP-238). If those increases were not enough, labor costs are also going to increase as of October 1, 2006 due to a higher minimum wage. (T2, 162:14-20). Many of the losses reported did not even take into consideration other expenses such as personal living expenses, and loan payments. (T2, 91:21-23).

Despite the significant losses experienced by New Jersey producers, one expert opined that over-order premiums and other pricing systems should not focus on cost of production because producers should change their inputs based on changes in market conditions. (T2, 127:11-128:13). "When milk prices are low, dairy farmers can and do adjust the quality of the feed or the ratio of feed in order to control costs." (T2, 128:17-22). Likewise, the expert opined that the producer could increase the number of milkings per day to increase production. (T2, 142:16-23). However, when asked, "how low do you think a producer can get in their cost of production on a hundredweight basis?" the expert replied, "I don't know." (T2, 141:17-24). Moreover, the expert could not indicate how much impact increased fuel costs would have on production costs. (T2, 143:3-18). When asked whether a producer could withstand times of low milk prices coupled with high production costs, she replied "There's an old adage of 'make hay when the sun shine' and 'Saving for a rainy day.' And successful dairy producers are those that really made hay when the sun shined with record high prices in 2004 and 2005, and that is what's helping them weather through these times." (T2, 145:18-146:6). One major flaw of the expert's testimony rests in an exhibit she herself introduced, which indicates,

> It is generally understood that as long as the variable costs of production are exceeded by milk price, rational producers choose to remain in business for a period of time even if total costs are not met. ***In the long-run, this is <u>not</u> a sustainable decision*** and questions often arise as to why the published total cost of production exceed milk price in every year. The answer to this conundrum lies in the estimation of the fixed or overhead expenses that are added to the variable or operating expenses to determine total cost. Items included in the overhead expense category typically include: depreciation, unpaid family labor, operator labor, operator management, and a return to equity. These items are real, but non-cash costs of doing business.

(AP-152 to AP-153) (emphasis added).

As the above quote points out, while producers are occasionally willing to operate their businesses at a loss, they cannot continue to do so over an extended period of time. Logically, when there are high fixed and variable costs and low milk prices, even if a producer is able to reduce some input expenses, so long as he or she is unable to break

even and operates at a loss, it will not be long before the producer will be forced to close the business. Furthermore, the economic expert's testimony focused on reducing variable costs and did not include a discussion on the impact of the rising costs of fixed expenses that are beyond the producer's control, such as taxes, land and utilities. (T1, 61:3-8). While cost of production information should not drive pricing decisions (T2, 210:15-17), it is an "important factor" that must be considered. (T2, 214:10-11 and T2, 214:23-24).

Moreover, even if the producers "made hay" and "saved for a rainy day," the savings acquired will only last so long before they are exhausted as well. As was indicated by one producer, saving money is extremely difficult even in high milk price times, because producers are obligated to pay back the bills and other debt accumulated during the previous low milk price period or make capital purchases (T2 332:12-333:3). First Pioneer Farm Credit concurred with this testimony. (AP-598 to AP-599). While adjustments should be made to input costs in times of low milk prices, when low milk price is coupled with high milk production costs, it is extremely difficult for producers to make sufficient adjustments to remain viable. (AP-236 to AP-237). This is the same situation seen in 1997, which was the last time New Jersey producers sought assistance from the Department. (AP-236). Clearly, the expert's economic theory is less applicable in times such as these.

b. Concerns as to Implementation

"In fixing milk prices, the Director must be concerned with three principal elements: whether to fix prices at all; if so, on what basis and to what extent; and what precise figures should be prescribed." Garden State Farms, Inc. v. Mathis, 61 N.J. 406, 428 (1972). Since it appears there is sufficient justification in which to establish a minimum price or an over-order premium to assist the producers in this period of low milk prices, the next question is how best to accomplish this task. Many witnesses expressed concern regarding the establishment of such minimums. Concerns were raised by several individuals that such a pricing system would discourage processors from purchasing New Jersey milk. (T1, 37:18-23; T1, 89:8-17; T2, 30:15-21 and T2, 50:11-18). Because demand in wholesale and retail markets needs to provide appropriate price signals to encourage the purchase of additional milk, (T2, 35:8-17), it was suggested that a parallel minimum pricing program be adopted through the whole milk marketing system. (T2, 271:15-18).

When setting a minimum price for the sale of milk, there must be sufficient evidence in the record to support the Director's decision; otherwise, the director's decision will be set aside. Garden State Farms v. Hoffman, 46 N.J. 595 (1966). As was stated by the Supreme Court in Lampert Dairy Farm, Inc. v. Hoffman, 37 N.J. 598, 605 (1962), "there must be evidence to support the conclusion that the minimums realistically reflect cost factors . . ." I find that insufficient evidence was presented to establish wholesale and retail prices for milk. Absent this critical information, minimum prices cannot be established for milk sold by processors and retailers at this time. Since this second prong of the minimum pricing cannot be established at this time, it is prudent for the Department to defer setting minimum prices payable to New Jersey producers until such

time as a holistic system can be developed to ensure that no sector of the milk marketing system is overly burdened.

Although several other concerns were raised about establishment of market-wide minimum pricing, such as resulting higher prices in the marketplace (T2, 138:16-19; T2, 188:20-25; T2, 189:17-190:1 and T2, 192:5-16), compact clause concerns (T2, 98:25-99:10 and AP-137 to AP-141), and commerce clause concerns (T2, 101:4-18; T2, 104:13-17 and T2, 113:5-23), many of these concerns may be elevated in the way that such a pricing system is structured. Absent sufficient financial information upon which to act, these issues cannot be adequately addressed at this time.

3. Regulate how premiums are paid to producer:

Among the many other powers vested in the Director, N.J.S.A. 4:12A-21 authorizes the Director to regulate the conditions and terms of the sale of milk so as to "prevent unfair, unjust, destructive or demoralizing practice which are likely to result in the demoralization of agricultural interest in this State engaged in the production of milk or interfere with the maintenance of a fresh, wholesome supply of sanitary milk for the consumers of this State . . ." Allegations were made that processors are paying premiums to producers over the federal minimum but producers are not receiving these payments. (T2, 131:12-14 and T2, 171:17-25). For example, in May 2006, the blended price for milk was $12.46 for New Jersey producers and the co-op over-order premium equaled $1.10, but the mailbox price paid to farmers was approximately $12.26 per hundredweight. (T2, 131:21-133:12). However, the mailbox price was not an actual New Jersey price, as it was arrived at through the averaging of other states' mailbox prices. One producer explained that the premiums she received from the co-ops have been cut in half over the past five years (T2, 87:5-8), and the only justification for the reduction in these premiums was that there was too much milk supply in the market place. (T2, 93:23-94:6).

It does appear that there are a number of premium programs processors make available to the producers and include premiums for quality, quantity, proximity to the plant, and loyalty. (T2, 235:15-17). Premium payments vary by milk procurement operation and range from a flat fee premium that averages about one dollar per hundredweight to quality premiums that range from zero to 60 cents per hundredweight. (T2, 297:4-12). In addition, volume premiums are paid in the amount of zero to 30 cents per hundredweight. T2, 297:13-17). For example, Land O'Lakes pays a quality premium up to 60 cents per hundredweight and a volume premium based on average daily pick-up. (T2, 62:9-15). Land O'Lakes also pays a flat premium per hundredweight to all producers. (T2, 62:15-18). Each producer has equal opportunity to collect these premiums, but premiums vary by producer based on quality, size and ability to hold two days' milk production. (T2, 62:19-24). Likewise, Dairylea also has a quality premium, a volume premium and a "market adjustment," with its volume premium ranging from 5 cents to 50 cents for volumes between 100,000 pounds to over one million pounds. (AP-211 and AP-213).

The average premium paid to producers in South Jersey is 90 cents (T2, 54:9-11), with an additional handling premium that averages 30 cents per hundredweight. (T2, 54:8-10). North Jersey producers receive an average premium of about $1.15 (T2, 54:14-16), with an average handling premium of 40 cents. (T2, 54:11-15). Because these amounts are additive, the producer should be receiving a $1.20 premium in South Jersey (T2, 77:12-16 and T2, 79:19-23) and $1.40 in North Jersey.

How much of the premiums paid by processors are being passed back to the producer is unclear from the record, although at least one cooperative representative suggested that the cooperatives were paying the full $1.20 and $1.40 premium payments back to the producer. (T2, 77:5-11). It was also alleged that many producers might not be aware of what premiums processors are paying co-ops (T2, 171:25-172:2). Assuming arguendo that the cooperatives merely act as a pass-through entity transmitting all premiums received back to their producer members, the difference in premium amounts allegedly paid by processors and premium amounts allegedly received by producers raise questions about cooperatives' practices and whether all cooperatives pass the entire premium payment back to the producer.

At least one answer to these questions may lie in the fact that it appears that certain deductions are taken out of the producers' checks. For example, one cooperative admitted that hauling costs were deducted from the producers' checks.[6] (T2, 80:13-16). Allegations were also made that large regional cooperatives are imposing costs of production and marketing on New Jersey producers that may not be attributable to New Jersey. (T2, 106:7-13). Costs incurred by co-ops include un-reimbursed hauling costs, costs of balancing daily and seasonal fluctuations in milk, overall operating costs, field inspections, milk testing, routing, accounting and check-writing. (T2, 37:10-18). However, when asked how much these services cost, a co-op representative could not provide cost of production figures incurred by his cooperative. (T2, 44:12-17).

While this information raises concerns, overall there was insufficient evidence on the record to support any action at this time. N.J.S.A. 4:13-34.1 requires agricultural cooperatives to file an annual report with the Secretary of Agriculture, containing various financial information "as shall be prescribed on a form provided by the secretary." This form will be updated to ensure that the Department has sufficient information through the annual cooperative filing to determine whether regulation of premium payments is necessary. Should it be determined that regulation is necessary, such rules will be carefully crafted to comply with any limitation that may be set forth in N.J.S.A. 4:12A-31. (T2, 63:8-10; T2, 70:13-72:1).

B. SHORT TERM ACTION ITEMS

[6] At least one witness presented evidence showing that this hauling deduction appears to be routinely deducted as part of the producer's milk check. (AP-216). Hauling costs, paid by the producer to either a processor or an independent hauler are a portion of the producer's overall fuel costs.

Although most of the action items listed above would result in benefits to the New Jersey producer, those actions are unable to be implemented at this time. Immediate action is needed, however, to assist producers who are on the brink of financial ruin. Milk price volatility is inherent in the milk marketing system. (T2, 28:12-16 and T2, 29:5-11). As is evident from the exhibits presented, milk prices rarely have been consistent from year to year and can fluctuate dramatically from month to month. (AP-263, AP-322 and AP-530 to AP-533). Fluctuations in milk prices have also been recognized by the courts. See Garden State Farms, Inc. v. Mathis, 61 N.J. 406, 415-416 (1972) (attributing fluctuating milk prices to seasonal changes in milk supply); Lampert Dairy Farm, Inc. v. Hoffman, 37 N.J. 598, 599-600 (1962) (indicating minimum milk prices set by the director varied with the monthly fluctuations in raw milk price); and Ideal Dairy Farms, Inc. v. Farmland Dairy Farms, Inc., 282 N.J.Super. 140, 169-170 (App. Div. 1995) (recognizing periodic fluctuations in the price of milk).

Producers reported lost revenue in the amount of $13,547.49 (T1, 26:13-16) and $23,500 (T1, 47:17-48:1) in just the first six months of 2006. One witness testified that the average New Jersey producer would lose $45,000 annually if action were not taken soon. (T1, 97:3-7). The financial losses for one producer will be even higher as she is losing $1,000 per day. (T2, 92:17-19).[7] This is consistent with other exhibits introduced at trial indicating that the average monthly loss to a producer equaled $4,260 or $451,120 annually. (AP-252). These losses were due to a combination of low milk prices and high production costs. Dairy producers in New Jersey have reported that their milk production costs have increased as much as $1.50 per hundredweight (T2, 26:15-16 and T2, 91:9-15), while the price of milk has fallen more than $2 per hundredweight since the beginning of 2006 (T2, 26:9-11).

Cost of production and processing is more expensive in New Jersey than elsewhere in the Northeast. (T2, 108:10-20 and T2, 129:20-21). Specifically, the average cost of production in the Northeast is $14.76 while the average cost in New Jersey is $15.05 per hundredweight.[8] (T2, 326:1-6). Other producers reported that the total production costs were $15.70 per hundredweight (T2, 91:17-19), and $15.00 per hundredweight (T1, 24:7-8). Likewise, the Sussex County Cooperative Milk Producers submitted evidence indicating that the cost of milk production in New Jersey averaged between $14.50 and $16.50 per hundredweight. (AP-252). One farmer estimated that he was receiving $3.00 to $4.00 per hundredweight below cost for his milk. (T1, 52:9-11). By contrast, in May 2006, New Jersey dairy producers were only receiving between $12.26 and $12.46 per

[7] See discussion in footnote 3.

[8] The cost of producing milk in the Northeast in 2005 based on accrual basis as reported in the Northeast Dairy Farm Summary for 2005 was $15.08 per cwt. (AP-595). This figure was derived from the average of 539 farms with average of 232 cows. (AP-587). The average New Jersey farm has 100 cows; thus, $15.08 may be a lower cost than what is attributable to a New Jersey farm if you take in the account of efficiency of size and scale. The $15.08 cost figure does not include living costs, depreciation or return on equity. (AP-595).

hundredweight for their milk (T2, 131:21-132:11), and New Jersey's raw milk prices for June 2006 equaled $1.07 a gallon, a 25-year low. (T1, 13:23-25).

Many of the inputs required for the production of milk have increased significantly since last year. Costs of feed increased 23 percent (T1, 48:1-12 and T2, 85:24-86:2), costs of fertilizer and chemicals increased 10 percent (T2, 85:17-21 and T1, 26:22-25 and AP-202) and costs of medicine has risen 29 percent (T2, 86:9-11). Producers reported increased fuel costs of approximately $2,700 annually (T1, 26:18-21), approximately $2,300 semi-annually (T1, 48:2-3), and $4,000 monthly (T1, 37:1-2 and AP-208). NASS, the National Agricultural Statistical Service, estimates that fertilizer prices have risen 8.7 percent, agricultural chemical prices have increased 9.9 percent, farm machinery costs have increased 7 percent and fuel prices have risen drastically by 22 percent. (T1, 66:16-20 and AP-238). If those increases were not enough, labor costs are also going to increase as of October 1, 2006 due to a higher minimum wage. (T2, 162:14-20). Many of the losses reported did not even take into consideration other expenses such as personal living expenses, and loan payments. (T2, 91:21-23).

As was explained in the exhibit submitted by the Animal Science Extension Specialist at Rutgers University, in situations where low milk prices meet high feed costs, dairy producer find it difficult to remain profitable. (AP-236). In the past, low milk prices have been offset by low feed costs, and high feed costs have been offset by high milk prices. (AP-236 and AP-237). In fact, the last occurrence of low milk prices combined with high feed costs was in 1997, which not so coincidently happens to be the last time producers petitioned the Department for assistance. (AP-236). See also 30 N.J.R. 238(a).

Producers expressed a need for immediate action, stating, "The hearings (sic) got to stop. Now you got to go to the action." (T2, 285:14-17). Many producers testified to the effect of failure to act quickly, stating "I've been in the dairy business for 50 years myself. The farm has been there since 1870. We've milked cows that whole time. It may not be there much longer if we don't get a little bit of relief in the form of prices or something." (T2, 326:11-15). One indicated, "You can't stay in business if you can't pay your bills." (T1, 152:25-153:1). This sentiment was confirmed by others who testified, "We have a lot of young farmers in North Jersey and would like to continue farming in New Jersey, but we need to have the proper income to stay viable" (T1, 25:8-11), and "if he [the dairy farmer] can't operate in a more profitable way, he'll go out of business." (T1, 136:23-24). Likewise, another testified that, "the State wants to have preserve (sic) farms and wants open space, but they don't want to - - I don't see how we can do it if we can't pay the bills and the taxes." (T1, 51:19-22). Still others testified that, "We would like to still keep farming and so would our children would (sic) like to farm like us, but doesn't look good at this time" (T1, 27:8-10), and "everybody ask me (sic) why I'm still milk (sic) cows, it's only because I love them and I love the business. But you have to show a black line. If it's red it's not worth it." (T1, 82:2-5). Even one young future farmer explained, "well, I'm going to Cornell this fall and majoring [in] dairy science. So I hope to return home to the family farm. But there's just the issue of

is there going to be a family farm when I come back." (T1, 139:10-13). Thus, if action is not taken immediately to stop the financial bleeding, New Jersey could see its remaining 115 producers dwindle down to zero.

1. Revise reporting requirements for everyone in the chain

As is evident from the discussion of the long-term action items above, additional financial information is required in order for the Department to take certain actions to assist New Jersey's dairy industry. In order to appropriately develop cost and prices, data from a representative cross-section must be obtained. (T2, 205:3-15 and T2, 210:11-17). Likewise, in-store handling cost information is necessary in order to develop proper retail pricing, and again it must come from a representative cross-section including all types of retailers, from supermarkets to convenience stores to mom and pop operations. (T2, 210:22-211:6). Processors of packaged milk distributed in New Jersey should report their distribution cost and volume information to the Department. (T2, 59:16-22).

The record makes clear that, "The only real source of regional retail milk price data is the Agricultural Marketing Service unless you go out and collect your own." (T2, 195:4-8). However, the Agricultural Marketing Service data is not entirely accurate because it reports shelf prices and does not take into consideration what consumers actually pay. (T2, 195:8-21). Moreover, there appears to be a general consensus that any data collection done needs to protect cost and profit information of individual dairy operations. (T2, 202:25-203:2 and T2, 203:11-14). The Department's existing regulations, however, protect confidentiality of records. (T2, 212:9-11). N.J.A.C. 2:52-7.1 and 2:53-7.1 both set forth that records and reports submitted to the Department will be held confidential.

Increased reporting can be easily accomplished through a rule change. N.J.S.A. 4:12A-38 permits the director to require licensees to file a verified report containing any information as may be relevant to the enforcement of Title 12A. At minimum, the Director can mandate via regulation that the report include any information contained in any record required to be kept by a licensee. N.J.S.A. 4:12A-37 sets forth the records that licensees may be required to keep. Certainly, financial records regarding milk prices paid, cost of production information, milk prices charged and volume of milk bought and sold would be information that may be required to be kept pursuant to that statutory provision. In fact, N.J.A.C 2:52- 1.4 sets forth the exact books and records required to be kept by a licensed dealer and N.J.A.C 2:53-5.1 sets forth the exact books and records required to be kept by stores.

Currently, N.J.A.C. 2:52-1.6 and 2:52-5.2 set forth the reporting requirements of dealers and stores respectively. These rules shall be amended on an emergency basis to be effective upon filing, in accordance with the New Jersey Administrative Procedures Act, N.J.S.A. 52:14B-1 et seq. and N.J.A.C. 1:30. The forms for reporting under N.J.A.C. 2:52-1.6 and 2:52-5.2 will also be amended to include the required information to be reported. Such additional information as will be required to be reported to the Department will include, but need not be limited to, cost data for processors, dealers and

stores, data on profit margins and actual profits collected, prices charged for the sale of milk and milk products, prices paid for the purchase of milk and milk products and volume information. A majority of this information will be collected on an annual basis and will include provisions for periodic supplemental updates to variable cost data. It is anticipated that this reporting should not be overly burdensome as most of the information that will be required to be reported should be included on the records that are already required to be kept pursuant to Department regulations.

Not only will increased reporting assist in developing cost analysis figures needed for the long-term action items, such information will assist the Department in the enforcement of its existing regulations. For example, N.J.A.C. 2:52-7.1 and 2:53-6.1 prohibit sales below variable costs by dealers and stores respectively. By increasing the reporting requirements, the Department will be better able to determine when a dealer or store may be violating these regulations and to take appropriate enforcement action.

2. Fuel Adjustment Add-on:

Many producers who testified at the initial hearing in July indicated that their fuel costs have risen significantly in the year. (T1, 24:9-17; T1, 26:18-21; T1, 37:1-2; T1, 48:2-6 andT1, 95:17-24). The National Agricultural Statistics Service, NASS, statistics on fuel prices also support these allegations, reporting that the cost of fuel has increased 22% from last June's prices. (T1, 66:16-20 and T2, 52: 10-14). Given the current high fuel cost situation, it was stated that a fuel adjustment add-on be assessed to offset high costs of production during time of high costs and low revenue. (T2, 53:15-19). Such a suggestion is similar to the actions taken by other industries that add a fuel charges to the price of their products, such as feed suppliers and the milk haulers. (T2, 80:12-16 and T2, 85: 24-25). A fuel surcharge or add-on is necessary because New Jersey milk producers are currently unable to negotiate a sufficient milk price to cover their costs due to a recent surge in milk production from neighboring states (T2, 154:4-10) and lack of competition to shop around for other buyers. (T2, 32:25-33:4). This lack of market power was also recognized by the United States General Accounting Office. (AP-795).

In determining the fuel adjustment price, it was stated that the base figure for the fuel adjustment add-on begin at $1.40 for diesel fuel, which is equal to the region's average diesel price in 2002, and is the current base used by dairy haulers in charging their hauling fees. (T2, 52:1-9). Adjustments should be made to the fuel adjustment add-on to correlate with the fluctuations in the price of diesel fuel. (T2, 57:14-19). Fuel price information on which fluctuation adjustments could be based is available on the Energy Information Administration's website. (T2, 65:16-66:6 and AP-120).

In application, the fuel adjustment should increase or decrease by 3 cents per hundredweight for each 10-cent change in fuel price. (T2, 52:19-22). Of those three cents, one cent would cover hauling costs incurred by the producer and two cents would cover fuel-driven farm costs, such as fuel needed to operate farm machinery. (T2, 52:22-53:3). It was stated that this fuel adjustment be assessed on all Class 1 milk transactions

between New Jersey producer and New Jersey processor. (T2, 55:12-17). Because Class 1 utilization in New Jersey averages 75.9% (AP-189), if the actual fuel adjustment add-on was 45 cents, the fuel adjustment add-on amount payable to the producer would be approximately 30 to 35 cents per hundredweight. (T2, 56:11-17). In order to ensure proper disposition of the fuel adjustment add-on, it should be pooled and distributed to each producer on an equal basis. (T2, 58:11-15).

I find that a similar program should be established in New Jersey for the benefit of the New Jersey dairy producers, who currently have no mechanism to recovery their increased fuel costs. This fuel adjustment should be established for the short term and its effectiveness and impact should be reassessed in six months from its effective date.

To establish the formula for determining the fuel adjustment add-on, I find that it is reasonable to utilize a formula currently being utilized by other members of the dairy industry.[9] (T2, 52:1-9 and T2, 32 18-25 and AP-121 to AP-130). By using the 2002 price of diesel fuel of $1.40 as posted by the "Energy Information Administration – EIA of the US Department of Energy, Central-Atlantic price" (T2, 52 3-5)[10], the calculated premium will move at the rate of 3 cents up or down with each 10 cents change up or down from the $1.40 base Central-Atlantic diesel fuel price. The adjustment will be calculated using the monthly diesel prices for the Central-Atlantic region for the preceding month, as reported monthly by the Energy Information Administration. Since this fuel adjustment add-on should be assessed only on Class I milk, the add-on shall be adjusted to reflect the percent Class I utilization of the State. Currently, Class I utilization is approximately 76%. T2, 88:24-89:2 and AP-52). Therefore, if the fuel adjuster were calculated for September, the producer would receive a mandated $0.39 fuel adjustment. That figure would be based on August's diesel price and the formula would be calculated as follows:

$3.097August Diesel – 1.40 Base Diesel = $1.697
$1.697 / 10 cent intervals = 16.9 intervals (rounded to 17)
17 x $.03 per interval = $0.51
$0.51 x 0.76 = $0.3876 (rounded to $0.39)

This premium will be payable directly to the producer rather than being pooled, in order to avoid the administrative cost of collecting and then distributing this fuel adjustment add-on.

To effectuate the fuel adjustment add-on, the Department will promulgate an emergency rule, effective upon filing in the Office of Administrative Law, that will

[9] Currently this formula is used by dairy haulers who contract with Dairy Marketing Services and Land O'Lakes, as well as by Pennsylvania Milk Marketing Board in establishing fuel adjustments. (T2, 52:1-9 and T2, 32 18-25 and AP-121 to AP-130).
[10] The Central Atlantic area figures are used since the Energy Information Administration has designated New Jersey as part of the Central Atlantic Subdistrict of the Petroleum Administration for Defense Districts (PADD 1B). See http://www.eia.doe.gov/glossary/glossary_p.htm

require anyone subject to the licensing provisions of N.J.S.A. 4:12-2 and N.J.S.A. 4:12A-28 who purchases milk from a New Jersey producer, as defined in N.J.S.A. 4:12-1 and N.J.S.A. 4:12A-1, to pay the producer a premium calculated in a manner similar to that above for all New Jersey produced milk regardless of the class utilization. This premium will be in addition to and should not replace any existing premiums currently paid to the producer. (T2, 32: 21-25).

There was also testimony indicating that programs developed to assist producers be conditioned on producer participating in a milk improvement program (T2, 147:1-6). However, because the Milk Quality Program and the Agricultural Re-Engineering Program are currently not properly funded, as indicated below, it would be inappropriate to mandate payment of the premium on mandatory participation in those programs at this time. Should a permanent funding source be identified for those programs, the rules will be adjusted to condition payment of the premium on participation and continued compliance with the program rules of the Milk Quality Program and Agricultural Re-Engineering Program.

3. Impose rBST-free premium:

Several producers requested at the hearing that the processors be required to pay a premium on rBST-free produced milk. (T2, 43:25-44:3; T2, 88:1-90:8; T2, 290:1-292:8). PROSILAC is an FDA approved dairy supplement manufactured by Monsanto that is used by dairy producers to stimulate milk volume in their herd. (AP-47 to AP-51) Use of PROSILAC increases milk production by 10 pounds per cow. (T2, 87:18-21 and AP-51). Producers who decide to use FDA approved PROSILAC to increase feed efficiency, increase milk production by 10 pounds per cow per day. (T2 87: 18-21 and AP-51).

Recently, however, more processing plants across the country are requesting rBST-free milk from producers. (AP- 69). For example, Dean Foods has requested a full rBST-free supply for its Florence, New Jersey plant, which processes approximately 45 million pounds per month. (AP-182). Beginning June 10, 2006, DMS intends to provide a full supply of rBST-free milk to Dean Foods' Florence Plant. (AP 182). Likewise, many stores are soliciting rBST-free milk in response to short supplies of organic milk. (T2, 87:22-25 and AP-70). Interest among retailers, food service providers and consumers for rBST-free milk is expected to continue well into the future. (AP-232).

Much like organic milk, which currently receives a price of $30 per hundredweight (T2 179:22-24), rBST-free milk is a value-added product that should demand higher prices in the marketplace. (AP-69). As explained by the cooperatives, "Customers [(processors)] continue to suggest that they need rBST-free milk in order to maintain their market share." (AP-232). "In order to sustain these markets, we must meet our customers' (processing plants) needs <u>even</u> if we don't agree with the terms of their request." (AP-79). The value-added benefit of rBST-free milk is also recognized by many New Jersey processors, such as Farmland Dairies (AP-187), despite the fact that a premium is not being assessed or passed back to the producer. Moreover, at least one

processor recognizes the need to pay producers a premium for rBST-free milk and is currently calculating the exact premium that should be paid. (AP-70). Although a few processors balked at the idea of providing an rBST-free premium (T2, 176:23-177:3), it was later admitted that Farmland does pay a premium. (T2, 294:24-295:11). "The key word there, though, is there ***should*** be any additional premium. We do pay a premium." (T2, 295:10-11) (emphasis added). The record shows that some producers are not currently receiving an rBST-free premium. (T2, 89:6-10).

The value-added nature of rBST-free milk is not the only reason a premium should be paid. Part of the reason rBST-free milk is more valuable is that it is costly and cumbersome to produce and distribute. Producers need to be able to cover the additional costs associated with producing rBST-free milk. (AP-232). Due to the necessity to keep rBST-free loads segregated from conventional milk, producing, coordinating and distributing loads of rBST-free milk is cumbersome and costly. (AP-69 and AP-52). On the producer side, because the use of PROSILAC increases milk production by 10 pounds per cow per day, the premium needed to cover costs of rBST-free milk is $0.76 per hundredweight. (T2, 88:24-89:2 and AP-52).

Testimony of an expert economist at the hearing emphasized the importance of producers cutting their costs in times of low milk prices. (T2, 128:7-22; T2, 141:25-143:2; and T2, 143:24-144:8). Given the market demand for rBST-free milk from processors and stores, which appears to necessitate additional cost expenditures, and the producers' inability to recoup that loss through milk pricing, it appears that producers are caught between a rock and a hard place. Since it is admittedly difficult for producers to use negotiation alone to achieve higher milk prices or premiums (T1, 32:25-33:4; T2, 87:12-15, T2, 154:4-10), I find that it is appropriate, that should a processor demand rBST-free milk, it should be obligated at least to cover the costs of production.

To effectuate an rBST-free premium, the Department will promulgate an emergency rule, effective upon filing in the Office of Administrative Law, directing that anyone required to be licensed according to N.J.S.A. 4:12-2 who purchases rBST-free milk from a New Jersey producer, as defined in N.J.S.A. 4:12-1, will be required to pay the producer a premium in the amount of $0.76 per hundredweight to cover the cost of producing such milk. This premium will be in addition to and shall not replace any existing premiums currently paid to the producer. However, if the processor is already paying an rBST-free premium, and the premium is labeled as such as of the date of this order, the processor will not be required to pay $0.76 for an rBST-free premium in addition to the existing rBST-free premium so long as the total rBST-free premium being paid is equal to or greater than $0.76 cents. The impact of this rBST-free premium will be reassessed in six months from its effective date.

Since the Milk Quality Program and the Agricultural Re-Engineering Program are currently not properly funded, as indicated below, it would be inappropriate to mandate payment of the premium on mandatory participation in those programs at this time. However, should a permanent funding source be identified for those programs, the rules will be adjusted to condition payment of the premium on participation and continued

compliance with the program rules of the Milk Quality Program and Agricultural Re-Engineering Program.

4. Fully Fund Milk Quality and Financial Management Programs for Producers:

Many witnesses testified as to the importance of ensuring that New Jersey producers improve the quality of their product and the efficiency of their operations, and achieve a better understanding of financial management. As one witness testified, before resorting to premiums, the State needs to address productivity and efficiency in New Jersey producers. (T2, 219:10-14). Long-term education and management programs are critical to the continued viability of New Jersey producers. (AP-239). It was suggested that producers take advantage of existing programs such as those offered by Garden State Dairy Alliance and Rutgers to assist in improving milk quality and farm management. (T2, 140:1-9).

The Dairy Alliance, which is a coalition involving the Department of Agriculture, New Jersey Farm Bureau and Rutgers Cooperative Extension, offers several programs that can assist farmers in increasing production and productivity and decreasing costs. (T1, 16:2-5). Business management planning is available to producers that provides planning and advice in five critical areas: production, marketing, finance, legal and environmental, and human resource issues. (T1, 16:6-10 and T1, 78:12-16). A milk quality program also exists, which assists producers in improving herd health and milk quality in their productions. (AP-246). Increased milk quality typically translates into increased milk prices to the producer. (T1, 78:2-8). Additionally, an agricultural reengineering program is available through the Dairy Alliance and Rutgers Cooperative Extension that provides farmers with financial management tools, such as FINPACK to help increase productivity and decrease costs. (T1, 76:23-77:7 and T1, 77:21-78:1 and AP-247 to AP-248). FINPACK is farm management software that provides producers with tools to create balance sheets, cash flow management plans, and long-range plans to ensure financial viability. (T1, 77:22-25). Management teams are also utilized to coordinate management changes on farms. (AP-246).

New Jersey producers currently lack productivity and competitiveness with other states. Milk production in New Jersey was on the decline while milk production in other parts of the Northeast rose. (T2, 130:10-14). Likewise, New Jersey's milk per cow ratio is 16,000 pounds, while New York averages 18,639 pounds, Pennsylvania averages 18,722 pounds and the national average is 19,000 pounds. (T2, 131:7-11 and T2, 139:14-18). There needs to be an increased emphasis on improving New Jersey producer productivity and competitiveness. (T2, 106:4-7; T2, 158:16-23 and T2, 178:22-25). As was indicated in a First Pioneer Farm Credit publication, "The **Dairy Farm Summary** has often concluded that profitability had more to do with successful management than any other factor, including size. Also good profitability usually leads dairy operators to expand, and thus become even more profitable." (AP-611). Producers in New Jersey

need more education to learn how to be more financially efficient and to learn how to obtain the right price for their high-quality products. (T2, 275:6-11 and T2, 240:3-7).

While these financial management and milk quality programs already exist in New Jersey, the importance of producer participation in these programs was espoused by many witnesses throughout both hearings. Even those producers who may already be knowledgeable about financial viability, are productive (T2, 147:7-16 and T2, 167:14-168:22), and have high quality milk (T2, 84:16-19) could benefit from participating in these critical programs by learning new and innovative ways to keep their farms viable. Unfortunately, although beneficial, the Milk Quality Program and the Agricultural Reengineering Program are currently not fully funded. (T1, 78:6-23; T1, 129:7-17 and T2, 14-21). Thus, producer participation in these programs cannot be mandated unless a permanent funding source is identified.

Since budget times in this State are currently tough, finding a permanent public funding source in the near future may be difficult. Utilizing a combination of public and private resources to pool funding for these programs, as was done in the PA Dairy XP Program (T2, 225:10-226:21), will be explored by the Department. A number of witnesses at the August hearing indicated their willingness to assist the dairy producer. Specifically, the cooperatives pledged their support to improve the profitability of New Jersey dairy producer. (T2, 38: 2-4). Likewise, the New Jersey Food Council, and the Pennsylvania Association of Milk Dealers who supported the recommendations of the Food Council, welcomed the opportunity to work with the Department on identifying funding sources for the Agriculture Reengineering program. (T2, 106 13-14; T2, 221:15–18 and T2, 139: 22-25). In addition, Farmland Dairies also graciously offered to work with the Department to ensure long-term viability with the milk producers. (T2, 174: 2-5 and T2, 178: 7-9). Finally, New Jersey Farm Bureau pledged assistance to the dairy industry. (T2, 334: 19-20) Certainly the Department welcomes the assistance volunteered from the industry and looks forward to working with these groups to find funding sources for critical producer programs.

5. Hold Industry meetings and seek industry assistance:

In order to ensure the long-term viability of New Jersey's milk industry, a successful combination of public and private efforts must be utilized. Fortunately, as indicated above, witnesses at the hearing representing various industry groups graciously offered an outpouring of assistance to the New Jersey dairy producer.

Communication is a critical component of any good relationship, whether personal or professional. When communication breaks down, the relationship fails to function properly. Lack of communication between the various industry sectors has resulted in lack of understanding of the issues affecting the dairy industry and an inability to resolve them. (T1, 115:21-4 and T1, 117:8-13). Several individuals who testified at the hearing indicated that group meetings might be beneficial. (T1, 32:18-20; T1, 57:19-58:1; T1,

117:8-13 and T1, 130:20-25). As one witness explained, "I know as a processor we don't do very well if we don't have a supply of milk coming into a plant. As a dairy farmer I don't think that you do very well if you don't have somebody that's buying your milk. And the same thing happens for the next stage, which is getting the milk to the marketplace and selling it. So all of those components, to me seem to work together . . . ***The fact that we're sitting here at a hearing, to me, says that our industry has failed***." (T1, 115:25-116:11) (emphasis added).

Since it appears communication among the industry sectors has broken down, industry representatives need to find ways to increase regular communication among members of the dairy industry. (T2, 106:4-13). Instead of creating a task force, as was suggested by at least one witness (T2, 236:7-237:2), regular group or industry meetings should be held, whether annually, semi-annually or quarterly so that the various industry sectors can convene to discuss issues adversely affecting the industry and to resolve issues early. (T1, 57:19-58:1 and T1, 117:20-118:1). However, group meetings only work if everyone is willing to come to the table to address issues. Therefore, the Department intends to initiate and facilitate the first industry meeting and to garnish sufficient support to hold regular meetings in the future. Ideally these meetings can function as industry summit-type meetings for participants to discuss issues, get advice and learn from others in the industry. It should also provide a good opportunity to network with the other players in the dairy industry. The Department will be contacting various members of the industry in the near future to convene a meeting with representatives of the New Jersey milk marketing system. Should you be interested in attending, please contact my office.

C. OPTIONS UNWORKABLE AT THIS TIME

1. Social Payments or Subsidies Payable Direct to Producers

One suggestion that was generally supported by attendees at both the July and August hearings was to provide direct subsidy payments to the producers. Of course, not everyone agreed as to the exact method of funding to be used or how the payments should be administered. Such subsidies, as was suggested, should be in the form of a direct payment to dairy farmers (T2, 169:24-170:3), and should not be filtered through the co-op. (T2, 163:20-25).

One witness suggested that the Legislature appropriate $1 per hundredweight to the farmers for the next six months, or approximately $1 million. (AP-60). It was also stated "A dime here and a quarter there makes a lot of money when you're making it for 90,000 hundredweights." (T2, 92:5-8). Another witness suggested giving a tax break to the producer to lower costs (T2, 163:25-164:1), and requesting legislative relief on energy costs and taxes (T1, 128:19-23). Yet another witness suggested that New Jersey fund direct payments to the producers through a general budget appropriation similar to measures implemented in Vermont and North Carolina. (T2, 141:6-10 and T2, 190:17-191:15). Although it was suggested that the State treasury should make a commitment to the New Jersey producers and provide funding out of the State budget (AP-60 and T2,

147:20-148:2), it was also quickly recognized by the Department that it is not likely that funding will be made available through this year's State budget. (T2, 148:3-4 and T2, 193:7-13). Therefore, if direct subsidies are made available, funding must be obtained from another source.

Another suggestion included taxing milk at a few cents a gallon (T1, 84:6-22). Since New Jersey consumes 20 million hundredweight of milk and milk products (T1, 12:190-21), or when divided by 11.63 approximately 171,969,045.57 gallons (AP-703), a one-cent assessment on a gallon or gallon equivalent would generate slightly less than $2 million. Unfortunately, this suggestion is outside the authority of the Department. While the Director has broad authority to set the price for which milk can be purchased or sold in New Jersey (N.J.S.A. 4:12A-22 and 22.1), there is no authority to levy taxes on milk.

Finally, it was suggested that the funding for these direct subsidy payments be obtained by raising the licensing fee for selling milk in New Jersey. Specifically, one suggestion was to raise the minimum retailer license fee from $25 to $35 per license per year. (T1, 39:3-10). Another suggested that a few pennies per gallon be assessed on retail licensing fees. (T1, 99:2-13 and T1, 101:2-12). Utilizing a program that increased licensing fees could generate funds to be placed into a dedicated account that could assist the entire industry and not just the dairy producer. (T1, 147:1-9). Payments could be made from this fund which would operate much like the MILC program, based on profitability, thereby creating no unfair competitive advantage. (T1, 99:2-13).

While the Department has the authority to amend licensing fees, N.J.S.A. 4:1-11.1, the purpose for which the fee would be raised under this suggestion appears to make it an impermissible tax. In BTD-1996 NPC 1 L.L.C. v. 350 Warren L.P., 170 N.J. 90, 97 (2001), the New Jersey Supreme Court differentiated between a licensing fee and an impermissible tax: "In the first case the license fee is ordinarily the means of defraying the expense fairly attributable to the regulative process, while the broader sovereign power to tax for revenue to serve a public purpose of a general nature is confined by constitutional limitations, the terms of the grant itself, and the rule of reason and good discretion. The assessment of the cost of a license and the ensuing governmental supervision and control is sustained by the correlative benefits to the public. A license tax for revenue represents an exercise of the general taxing power." I find that it would be improper to use increased license fees as proposed to provide funding for direct payments or subsidies to New Jersey producers, as it is not related to administration of the retail component of the milk industry.

No other funding source has been identified at this time; therefore, I find that it is not possible to provide direct subsidy payments to producers.

2. Market Demand Should Take Care of Issue:

At least one witness suggested that supply and demand should dictate premium prices rather than an over-order type premium program. (T2, 241:7-22). Premium structures, as

it was suggested, should be determined solely based on supply and demand and good negotiating skills. (T2, 241:22-25). However, the expert economist admitted that "given the recent surge in milk production from the surrounding areas, [it] has made that much more difficult to do." (T2, 154:4-10). An even bigger concern with this supply and demand model is that the there has been significant consolidation among raw milk purchasers, leaving very little competition for producers to shop around for different buyers. (T1, 32:25-33:4 and T2, 87:12-15).

Similarly, it was suggested that the Department should stay out of the market place and allow cost-efficient processors, wholesalers, distributors and retailers to garnish demand and higher prices from their consumers. (T2, 242:17-24). Unfortunately, the elasticity of the market place has been lost since, "supply and demand will not work if there is no lowering of the price in the store." (T2, 92:9-16 and T1, 35:7-13). In order for the supply and demand model to work, the wholesale and retail markets must provide appropriate price signals to encourage the purchase of additional milk. (T2, 35:8-17).

While supply and demand generally is sufficient to correct irregularities in the market place, the supply and demand model as it relates to the milk industry has evolved in such a way that it no longer provides adequate protection to New Jersey producers. Therefore, I find that it would be inappropriate to rely solely on supply and demand to assist the producers in this time of financial struggle.

3. Producers Should Change the Federal Order Themselves:

It was suggested that the Federal government serve as the producer's sole outlet for "all pricing problems, matters, and solutions, not the individual states." (T2, 238:14-17). New Jersey is currently part of the Northeast Federal Milk Marketing Order. 7 CFR 1001.2. This system was established by the federal government to equalize milk payments received by dairy producers. The federal market minimum is a weighted figure that takes into consideration prices for Class I and Class II milk, butterfat, nonfat solids, and protein and provides a somatic cell count adjustment. 7 CFR 1000.50. However, the Federal milk marketing order system has failed to adequately protect New Jersey producers (T1, 99:19-23), particularly because it fails to take into consideration the variation in cost of production based on location. (T1, 133:13-16). New Jersey has extremely high costs of living, including high labor prices, and high property taxes (T1, 51:23-24 and T1, 95:19-24), and cost of production and processing is more expensive in New Jersey than elsewhere in the Northeast. (T2, 108:10-20 and T2, 129:20-21). Moreover, the Federal milk marketing order system forces New Jersey producers to deduct approximately $0.91 per hundredweight from their milk checks to be returned to the pool for the benefit of out-of-state producers. (T1, 144:17-22). Although it sets a minimum floor in which milk may be sold, the floor established is flexible and can result in situations where the federal market minimum is below the cost to produce milk. 7 CFR 1001.60.

While it was alleged that producers alone have authority and ability to change the Federal Milk Marketing Order (T2, 232:4-7), the only real choice a producer has to change the Order is to vote it out of existence entirely or live with the rules promulgated by the Market Administrator. (T2, 259:20-260:2). In fact, it was admitted that the Federal Milk Marketing Order system is outdated and results in continued Band-Aid type approaches to assist dairy producers. (T2, 238:14-17 and T2, 239:15-19). I find that limiting the relief to the producer to what is available under the Federal Milk Marketing Order would maintain the status quo. Such an action risks the loss of the remaining producers in this State and is therefore not tenable.

4. Encourage Organic Milk Production:

Another suggestion presented at the hearing was to encourage producers to transition to organic milk production. (T2, 178:25-179:6). Organic milk prices currently range from $25 to $30 per hundredweight. (T2, 89:21-22 and T2, 179:22-24). Part of the reason for the high raw milk price is that there is not enough supply to meet demand in the current market place. (T2, 118:16-18). Another critical factor contributing to high organic milk prices is the difficulty in producing organic milk. (T2, 179:3-6). Transitioning to organic is extremely costly and requires a three year commitment before milk can be sold under the organic label. (T2, 179:13-19 and AP-105). See also 38 N.J.R. 1899(a). Although it was suggested that producers could continue to sell conventional milk until they have fully transitioned to organic milk, thereby still bringing in milk revenue equivalent to their current milk sales (T2, 179:20-22), costs of transitioning to organic are extremely high for the third year of organic transition while milk prices remain at the low conventional milk price. (AP-105). Therefore, a producer who is currently struggling to make ends meet in these times of low milk prices may be forced to close up shop if they have to bear the additional cost burden of organic farming over the three year transition period.

Certainly the Department is not opposed to assisting any producer who wishes to transition to organic milk production. In fact, the Department is currently seeking accreditation as a certifying agent with the National Organic Program and has recently proposed rules to establish a State organic certification program. 38 N.J.R. 1899(a). That particular rule proposal includes a special labeling program for "Transitional Sustainable" producers that are working their way to the full organic label. 38 N.J.R. 1907. Once accredited, the Department will to assist any producer wishing to make that transition. However, due to the extremely high costs involved in transitioning, the decision to become organic should be left to the individual producer to determine whether his or her financial portfolio can withstand the financial strain of transitioning.

5. Regulate Hauling Costs:

At the initial hearing in July, it was suggested that hauling charges assessed to producers might be inappropriately applied to the producer. (T1, 73:17-74:6). Based on the information provided at the hearing in August, it does not appear that hauling charges

need to be regulated at this time. Currently, producers do reimburse cooperatives for their hauling costs, although at least one cooperative does not charge producers 100% of the hauling costs incurred. (T2, 35:23-36:4). Although some co-ops haul milk to New Jersey processors from as far away as New York state and Pennsylvania (T2, 44:23-45:13 and T2, 44:23-45:13) hauling rates are not being blended between in-state and out-of-state producers and New Jersey producers are not subsidizing hauling costs for out-of-state producers. (T2, 223:14-18). Concern was also expressed that should the Department attempt to regulate hauling, it might overcharge the producer or cooperative. (T2, 235:2-9). Since insufficient evidence was presented at the August hearing to suggest hauling charges are being inappropriately assessed to producers, there is no need to regulate hauling charges at this time.

III. CONCLUSION

In this decision, I have endeavored to meet the needs of the entire dairy industry by providing both immediate relief to the dairy producer while assessing the long-term options to assist in overall market viability. It is anticipated that all rule amendments proposed above will become effective on or around October 16, 2006.[11] Please note that the long-term and short-term options listed herein are not exhaustive or exclusive. As the Department obtains new information, it will continue to consider new and innovative ways to improve the viability of the New Jersey dairy industry.

Clearly, the issues raised herein are complex and will likely necessitate additional hearings and meetings to fully examine and implement the most appropriate programs for New Jersey. I look forward to working with all of the industry sectors to ensure that each can achieve profitability and remain viable.

IT IS HEREBY ORDERED, that effective October 16, 2006,[12] anyone required to be licensed pursuant to N.J.S.A. 4:12-2 shall pay to a New Jersey producer a fuel adjustment add-on for all milk purchased from a New Jersey producer. The fuel adjustment add-on shall be calculated as follows:

1. Begin with a base price of $1.40 which is the 2002 diesel fuel price for the Central-Atlantic region as posted by the Energy Information Administration of the US Department of Energy;
2. Calculate the premium by adding 3 cents for each 10 cents the fuel price increases over the base price or subtracting 3 cents for each 10 cents the fuel price decreases;

[11] This date changed to correct a typographical error in the order as originally filed due to the time frames required in N.J.S.A. 4:12A-23.
[12] This date changed to correct a typographical error in the order as originally filed due to the time frames required in N.J.S.A. 4:12A-23.

3. The premium calculations should be determined by using the monthly diesel prices for the Central-Atlantic region for the preceding month, as reported monthly by the Energy Information Administration; and
4. Adjust the premium calculation to reflect the existing Class utilization, which shall be calculated annually.

IT IS FURTHER ORDERED, that that effective October 16, 2006,[13] anyone required to be licensed according to N.J.S.A. 4:12-2 or N.J.S.A. 4:12A-28 who purchases rBST-free milk from a New Jersey producer, as defined in N.J.S.A. 4:12-1, will be required to pay the producer a premium in the amount of $0.76 per hundredweight. If the processor is already paying an rBST-free premium, and the premium is labeled as such as of the date of this Order, the processor will not be required to pay $0.76 in addition to the existing rBST-free premium so long as the total rBST-free premium actually paid is equal to or greater than $0.76 cents per hundredweight.

Respectfully Submitted,

Alfred Murray, Director
Division of Marketing and Development

[13] This date changed to correct a typographical error in the order as originally filed due to the time frames required in N.J.S.A. 4:12A-23.