State of New Jersey

DEPARTMENT OF AGRICULTURE
HEALTH / AGRICULTURE BUILDING
PO BOX 330
TRENTON NJ 08625-0330

CHRIS CHRISTIE
*Governor*

KIM GUADAGNO
*Lt. Governor*

DOUGLAS H. FISHER
*Secretary*

May 17, 2010

Lt. Governor Kim Guadagno
Secretary of State of New Jersey
Office of the Secretary
PO Box 300
Trenton, NJ 08625-0300

Re: Findings of Fact and Determination from the Dairy Hearing Held on November 19, 2009 and December 17, 2009 and January 28 and 29, 2010 and February 22, 2010

Dear Secretary of State Guadagno:

Please accept this document as my findings of fact and conclusions arising from the hearing opened on November 19, 2009 and continued on December 17, January 28, 29 and February 22, 2010 to receive testimony and other evidence and then continued through April 26, 2010 for the sole purpose of receiving briefs/comments and replies, if any, concerning proposals or issues raised during the receipt of testimony. This hearing was held to consider the current condition of the dairy industry and requested testimony as to whether action should be taken by the Director to impose an over-order premium for dairy producers and in connection with the continuation or modification of variable cost pricing of milk and milk products regulated by the New Jersey Department of Agriculture within the State of New Jersey in accordance with provisions of N.J.S.A 4:12A-21 through 23. I am required to file this decision with you within 15 days from the close of the hearing, which occurred on April 26, 2010.

For the reasons set forth below, I have determined that there is insufficient evidence at this time to take action(s) contemplated in the hearing notice, specifically, first, an over-order premium for dairy producers and/or second, in connection with the continuation or modification of variable cost pricing of milk and milk products. At the same time, evidence received does support the fact that many producers are currently operating at a loss. More evidence concerning costs of production needs to be obtained and reviewed by the Department. With respect to consideration of an over-order premium, against this backdrop, I find that insufficient evidence was presented to establish prices for milk to the producer. With respect to milk pricing issues relevant to variable cost pricing, some evidence was presented concerning enforcement concerns and market effects of extended variable cost pricing but I find that the evidence was insufficient to support a change in pricing regulation at this time.

Therefore, the Department will seek additional testimony and further documentary evidence needs to be received in order to determine and examine the average cost per hundredweight (cwt) for New Jersey producers. In addition, the Department will review variable cost compliance and variable cost figures for retailers, processors, and wholesale participants in the market, pursuant to existing regulations governing prices, including N.J.A.C. 2:52-7 and 2:53-6.

**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.

## II. Background

Pursuant to N.J.S.A. 4:12A-23, a hearing is required prior to any fixing or refixing of any price. In the spring and summer of 2009, letters were received from producers and the Sussex and Salem County Boards of Agriculture requesting a hearing to address the historically low milk prices. The Department monitored the dairy industry situation from May to August, 2009. A hearing was considered in response to the instability, low prices and requests from the industry. Pursuant to the authority under N.J.S.A. 4:12A-23, a hearing was noticed to open on November 17, 2009.[1] The hearing notice stated that the "purpose of this hearing is to receive

[1] The hearing notice for each day of the hearing was entered into the record. (T1, 11:17-14:9; T2, 9:7-12:18; T3, 10:24-13:22; T5, 10:2-14:3).

testimony from all interested parties regarding the current condition of the dairy industry.[2] The notice specifically invited testimony concerning whether action should be taken by the Director to impose an over-order premium for dairy producers in connection with the continuation or modification of variable cost pricing of milk and milk products regulated by the New Jersey Department of Agriculture within the State of New Jersey in accordance with provisions of N.J.S.A 4:12A-21 through 23.

The notice also specifically requested testimony concerning:

> the costs at each of the following points in the supply chain: production, procurement, processing (which may include packaging but does not include labeling), distribution, wholesale sale of milk and retail sale of milk to the consumer.

To allow the provision of relevant data, the Notice provided that any individually identifiable, confidential financial information would be reviewed in camera and be used by the Director to make his decision, but any such information used in the decision would be averaged (using no fewer than three sources of information) in order to maintain confidentiality of the producers, processors, dealers and retailers. Such information has been provided and it has been considered in this decision. To the extent there is reference to financial information, it has been averaged.

Evidence at varying levels was received on most but not all of these subjects. More evidence in specific areas set forth below is needed before there can be a decision as to taking action.

**III. The New Jersey Milk Industry**[3]

New Jersey's milk industry in 2009 consisted of 103 milk producers, both commercial and institutional farming operations, which produced 1.398 million hundredweight of milk pooled within the order (T5, 196:6-7 E, 3-17, 2009 summary) and .194 million hundredweight pooled outside the order or as non-exempted milk. (T5, 195:13-16 E3-10). Approximately 20 million hundredweight of fluid milk (T5, 195:13-16 E3-10 summary) is distributed by 298

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[2] The first hearing notice was for November 19, 2009. The notice also clarified that the hearing would not consider pricing for non-pasteurized milk and milk products prohibited for use or sale pursuant to N.J.S.A 24:10-57.18.

[3] Citation to the record is in the form transcript, page and lines, thus: The transcripts are delineated by number. The transcript (T) numbers and corresponding hearing dates are as follows: T1 is November 19, 2009; T2 is December 17, 2009; T3 is January 28, 2010; T4 is January 29, 2010; and T5 is February 22, 2010. Thus the citation (T1, 25:2-5) means November 19, 2009 transcript, page 25, lines 2-5. Citations to exhibits in the transcript are in the form transcript, page, lines, and exhibit number, with exhibit number signifying a witness and which exhibit in order was offered by that witness. Thus the citation (T5, 195:13-16 E3-10) means February 22, 2010 transcript, page 195 lines 13-16, Exhibit number 3-10.

licensed New Jersey milk dealers, and consumed annually by New Jersey's 8.6 million residents.[4]

## IV. FINDINGS AND CONCLUSIONS

Findings and conclusions are based on the facts submitted through oral and written testimony, as well as facts entered into the record concerning the state of the dairy industry in New Jersey and in the Northeastern Region. Live testimony given under oath and subject to cross examination was given more weight than was written testimony submitted for the record. Administrative notice was taken of certain published materials including *Dairy Market News* and similarly reliable source documents whose accuracy cannot reasonably be questioned. The Notice of this hearing identified the subject matter as the current condition of the dairy industry, requested testimony as to whether action should be taken by the Director to impose an over-order premium for dairy producers and in connection with the continuation or modification of variable cost pricing of milk and milk products regulated by the New Jersey Department of Agriculture within the State of New Jersey in accordance with provisions of N.J.S.A. 4:12A-21 through 23.

### A. Overview Of Evidence Submitted

The hearing concerning the condition of the dairy industry and to determine whether action should be taken by the Director to impose an over-order premium for dairy producers and in connection with the continuation or modification of variable cost pricing of milk and milk products regulated by the New Jersey Department of Agriculture within the State of New Jersey opened on November 19, 2009 in Trenton, N.J., and continued on December 17, 2009 in West Trenton, N.J., and January 28 and 29, 2010, in Chesterfield, N.J., and on February 22, 2010 in Columbus, N.J. The record remained open through April 26, 2010 for the sole purpose of receiving briefs/comments and replies, if any, concerning proposals or issues raised during the receipt of testimony.

Testimony was received from twenty-two (22) live witnesses (12 of whom also provided their testimony in writing); was received in the form of ten (10) written statements from individuals who did not testify. The witnesses included seven (7) producers, three (3) cooperatives, three (3) processors, seven (7) dealers, one (1) NJ Department of Agriculture representative and one (1) agricultural support industry.

Ninety-one submissions of evidence were marked as exhibits. Four submissions were marked as confidential.

### B. Federal Programs

There are some federal programs in place which provide some support to the industry, subject to budgeting decisions. One witness stated that the Department must take into account

[4] When the consumption in a state exceeds production in the state, as here shown in New Jersey, the term "deficit state" is frequently used. (T2,81:15-17; T2,176:10-13).

the level of assistance that the federal Milk Income Loss Contract (MILC) program has contributed to alleviate the recent low market raw milk prices. (T3, 135:16-23).

The MILC is a federal subsidy program that pays farmers a subsidy payment when the price of Class I milk drops below $16.94 per hundredweight or at a higher rate when the "Feed Cost Adjuster" is applied during times when the calculated feed cost is greater than the $7.35 per hundredweight benchmark. 7 CFR 1430.200 et seq. Currently, farmers receive payments in the amount of $0.45 per $1.00 when milk prices dip below $16.94 per hundredweight or feed adjusted trigger price. 7 CFR 1430.208. For example, if the price of milk were $12.94 per hundredweight, a farmer would receive an MILC payment on $4.00, equal to $1.80 per hundredweight sold at that price.

During December 2009, the USDA Farm Service Agency announced additional MILC assistance in the form of a one time payment to the producers[5] known as the Dairy Economic Loss Assistance Payment (DELAP) program. This was made available to all commercial milk producers through a one time payment issued at the rate of $0.3211 per cwt for milk produced in 2009 up to 6 million pounds.

## C. Federal Order System

New Jersey is currently part of the Northeast Federal Milk Marketing Order; Federal Order One (7 CFR 1001.2.). This system was established by the federal government to equalize milk payments received by dairy producers. However, the Federal milk marketing order system has failed to adequately protect New Jersey producers. (T1, 137:4-6) (T2, 149:11-16). The federal market minimum is a weighted figure that takes into consideration the prices for Class III and Class IV milk, butterfat, nonfat solids, and protein and provides for calculation of advanced pricing for Class I and II fluid milk. 7 CFR 1000.50.

However producers and dealers generally testified that the Federal Milk Marketing Order system has failed to adequately protect New Jersey producers. (T1, 137:4-6) (T2, 149:11-16). As one producer testified specifically, it fails to take into consideration the variation in cost of production based on location. (T2, 152:21-25). New Jersey has extremely high costs of living, including high labor prices, and high property taxes. (T2 152:15-16). One processor testified that "perhaps decoupling the Class I price from the other three classes would help stabilize 40% of the of the farm price" (T4, 89:5-11). A dealer also testified that the real problem exists with the Federal Order system and said if the Federal Order was "doing its job and they were getting enough money at the farm level to sustain them" there would not be a need for a hearing. (T5, 52:25, 53:1-3).

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[5] Written testimony dated December 17, 2009 was received from Linda Doherty, Executive Director of the New Jersey Food Council. The written testimony stated, that "...USDA is about to provide a generous subsidy and pay out $290 million to dairy farmers as required by Congress." (E. 14-1,T4, 15:2-4). The statement did not identify the origin of the "generous subsidy" and no one from the New Jersey Food Council was made available to testify and respond to questions.

States may establish their own, additional rules regarding pricing of milk and the conditions under which milk is to be sold. In New Jersey, the Milk Control Act provides the authority for the Director to control the milk industry regulatory scheme within the state. N.J.S.A.4-12A-21. The goal of the Act is to preserve the state's interests, as well as those of the consumer, at all levels of the industry. N.J.S.A.4:12A. The fundamental purpose of the Milk Control Act is to serve the public interest in the milk industry by preserving agricultural interests engaged in production of milk. McGovern v. Hoffman, 73 N.J.Super. 200,179 A.2d 523 (A.D.1962).

A 31-year employee of the Federal Market Administrator's Office testified "If you go on an over-order premium and you say to the processor… I want you guys to pay a premium to producers, they're willing to do it, but they also have to have an opportunity to recapture that. You're going to drive up their cost of milk. And if you don't give an opportunity to be able to recapture it, you're going to put them all at a competitive disadvantage. You're going to put them at a competitive disadvantage as it relates to out-of-state dealers because their cost of raw product is going to increase, they're going to pass it on to the consumer, which raises their street price. Out-of-state dealers will not have that." (T5, 51-52:12-25, 1-3).

## D. Producer Costs of Production and Financial Distress

During the hearing, testimony was received from producers and other sources that dairy farmers are not receiving a level of payment for milk sold which will cover the cost of production. One producer testified that his operation produced just over 1 million pounds of milk from his mixed herd of Jersey and Holstein cows. In 2008 he received revenue of $22.63 per hundredweight (cwt) (T1, 14:23 - 15:2). His 2008 expenses were $20.48 per cwt (T1, 15:3). This reflects a profit of $2.15 per cwt (T1, 15:4). In 2009, the same producer who had produced the same amount of pounds of milk up to the date of the testimony stated his payments for his milk sold was $15.48 per cwt (T1, 15:7) and he had reduced his cost of production to $17.16 per cwt. (T1, 15:9). This is a net loss of $1.68 per cwt (T1, 15:11), despite the reduction in the cost of production. The producer also stated one of the biggest portions of his reduction in costs was that of hired labor which he eliminated and replaced that time with his own additional unpaid labor. (T1, 15:12-16).

Cost of production and processing is more expensive in New Jersey than elsewhere in the Northeast. (T2, 163:13-164:14). One producer of substantial size testified that the producer's farm was "losing $100 per cow per month" (T1, 142:9) at a cost of production around $18 per cwt, with an anticipated increase due to interest payments on loans (T1, 151:2). The producer also stated that the Department must make sure that it takes into account all costs necessary to produce milk to determine costs and profitability of a dairy producer (T1, 142:22 – 143:15).

Although some of the inputs required for the production of milk have decreased recently, one producer testified that his out of pocket cost of production was in the $16.00 to $17.00 per cwt range (T2, 147:14-17). This number included paid family labor and a management fee since this operation is in a partnership business structure (T2, 153:23- 154:11). This number did not include a return on investment (T2, 153:18-20), taxes or depreciation (T2, 154:15). The producer's average payment per cwt for 2009 to date of this hearing was $12.70 per cwt. (T2, 147:19), reflecting a loss of $3.30 to $4.30 per cwt based on the $16.00 to $17.00 cost of production.

Additional cost of production information was also entered into the record by four (4) producers who testified. The confidential information submitted was for the 2009 fiscal year for each dairy. This information was received in camera and was reviewed by Department staff. These four (4) sets of numbers provide a weighted average operating cost, including paid labor, on a per cwt basis of $17.298 per cwt. (E5-1; E21-1; E, 20-1; E, 19-1). This number does not contain any credits for unpaid labor, cost of living or return on investment. This average is based on incomplete data and a number of producers of insufficient size to be conclusive.

The Greater Northeast Milk Marketing Agency (GNEMMA) entered into the record the established Pennsylvania Milk Marketing Boards cost of production information as a suggested cost of production (T1, E 4-1 GNEMMA; E-3). The adjusted average for September 2009 was $17.90. Testimony by North East Farm Credit also related to the use of the North East Dairy Farm Study to also be used as a benchmark. The study is published from data collected by the Farm Credit agency from their customers. This study is used to assess the financial health and progress of the North East dairy farm business (T5, 94:2-5). Data included in the study is primarily from New York (T5, 94:8-9). The witness did testify that the data set could be used as a reference to the average New Jersey farm (T5, 94:16-95:14). The data presented was based on the 2008 study and it was recommended that the 2009 data be used when published in the spring of 2010 (T5, 95:6-14). The 2009 Farm Credit, Northeast Dairy Farm Summary has been released and the 544 farms included in the summary reveals the adjusted cash operating expense for 2009 was $16.84 per cwt.

At this time there is evidence supporting the fact that some dairy producers in the state are losing money and are in financial distress. The levels of distress vary, based on individual farms and the input variables that exist within the industry. None of the figures above take into consideration any living expense for the owner operator, but did cover paid labor. There is no consideration for any return on investment, retirement or payments on outstanding debt or capital investments plus other total expenses, all of which are part of total cost and the daily cost of doing business.

## E. Processors

Three of the state's four major Class 1 processors testified at the hearing about their ideas for helping to stabilize the economics of the industry. They represent a range of different types of processors. One is a more traditional processor of fluid milk who sells through dealers to retailers. Another is part of a vertically integrated system in which both the processor and the retailer to which they ship the milk are owned by the same parent company. The third produces mostly specialty products.

One thing the processors did agree upon was their feeling that if the Department simply mandated an over-order premium to be paid by New Jersey processors to New Jersey producers without any other change to the marketing structure, the processors would be left with no choice but to seek cheaper sources of raw milk from producers outside the state.(T3, 28: 3-8; T3, 88:13-18; T1, 187:19-25 & 188:1-17). This, they said, was the result of the last over-order premium (other than the fuel-adjustment add-on) that occurred in the late-1990s.

The processors differed on approaches[6] they would recommend for ensuring that dairy farmers could be helped financially without unfairly burdening other segments of the milk marketing chain.

One advocated adopting a system similar to that employed in Pennsylvania, where minimum prices are set at each step of the milk-marketing chain. (T3, 28:22-25; T3, 29:1-2; T5, 42:23-25). The processor said such state-mandated programs also contain “protections” against out-of-state dairies being able to easily enter their markets and undercut prices. “There are different regulations in place in different states. Some of those are geared toward protecting the businesses, the dairy business, in this case, in those states.” (T5, 30: 12-17).

This type of system, which the witness said is currently in place in Pennsylvania, makes it possible for a Pennsylvania processor or dealer to sell its milk in New Jersey at a less-than-desirable price because it is guaranteed the profit margin set by regulation on its sales in Pennsylvania. (T5, 37, 6-17).

Another processor stated that the problem faced by producers is solely a function of the existing Federal Marketing Order. (T3, 87:19-25; T3, 88:1-6). The best approach to solving problems created by the Federal Marketing Order would be to “de-couple” the Class 1 price of milk from that used for butter, cheese, and dry milk powder, adding that such a change “would help to stabilize 40 percent of the farm price and help to minimize the constant volatility. At the same time, this action would not adversely affect the commodity trading on the world market by artificially inflating the price of the other three classes.” (T3, 89, 9-15).

The third processor stated a belief that the answer must come at the federal level and not from state action, adding that “(t)he focus for the state can be utilizing resources like the Rutgers University Extension Service to further improve dairy production at the farm and throughout the supply chain. Increasing one's efficiency will have much more far reaching effect than will mandating prices or further controls.”(T1, 188:19-25; T1, 189:1-25; T1, 190:1).

One processor, who said his company buys milk from “well over 50 percent” of the dairy farmers in New Jersey, (T5, 16:14), stressed the importance of New Jersey maintaining a local supply of milk to reduce the processor’s transportation costs and its impact on the environment. He said: “Well, there's a matter of cost, obviously, the transportation costs which someone has to pay is lower the closer to the source that you are. From an environmental perspective, being green and recognizing sustainability, we would want to be as close to the market as possible. And again, as I said earlier, we, as a company, choose to do business with local businesses, to the extent that it's practical, and being that the agribusiness, the dairy farming is an important part of

[6] The “approaches” suggested did not provide the level of detail necessary to be included with the Primary Proposals.

our state's economy, we seek out, whenever possible, to do business with New Jersey farms." (T5, 17:20-25; T5, 18:1-8; T5, 19:24-25; T5, 20:1-4).

The importance of a local supply of milk is magnified, he said, in times of extreme weather. He cited a period during a recent summer where extremely high temperatures caused cows to produce less milk, creating a shortage at the company of up to seven truckloads of milk per day. (T5, 22:2-13). The company attempted to procure milk from further distances, as far away as California, "…but really, on that kind of -- in that basis, it's really not practical to attempt to do that. It's very far. The distribution system is really not set up to handle that kind of emergency." (T5, 22:22-25; T5, 23:1). In addition to costs, he said, transporting milk from longer distances also raises the possibility that "there is a potential impact, as the milk is transported those distances, that it may not meet the quality specs."(T5, 23:10-12).

## F. Dealers

The New Jersey wholesale and retail milk market is unique, extremely competitive and is a market into which other states' dairies want to place their products. New Jersey is a "milk deficit" state, meaning its dairy farmers do not produce enough milk to satisfy the demand. Of the approximately 20 million hundredweight of fluid milk each year (DDI 2-4 and DDI 42),[7] only 161 million pounds were produced by New Jersey producers in 2009. (T5,196:3-5; E3-17, 2009 summary). In-state processors must look beyond state borders to complement the milk produced by New Jersey farmers (T5, 196:3-5 E3-17, 2009 summary), in order to supply the five Class 1 plants with approximately 17.4 million hundredweights annually.[8]

New Jersey is located in a major metropolitan area and is the most densely populated state in the union. Therefore, it is a prime market for most "milk surplus" states, where the dairy farmers produce more than is demanded by their in-state market.

The New Jersey market is currently experiencing retail prices which witnesses questioned as being too high compared to the raw milk supply price. Other witnesses gave testimony of wholesale milk prices being too low and that the current Sales Below Variable Cost regulations N.J.A.C 2:52-7 are "broken." These same witnesses requested a style of regulatory pricing similar to that of Pennsylvania's, in which minimum prices are set at each stage of the marketing chain, as a remedy to the current situation.

The three dealer representatives who testified collectively have well over 100 years' experience in the milk industry among them. They provided insight into the market in New Jersey and the impacts on that market from surrounding states.

[7] This information is from wholesale reports from dealers in Department files.

[8] This quantity is an average based on confidential processor information contained in Department files related to the Fuel Adjustment Add-On data.

Dealers described the competitive market, identifying difficulties with out-of-state companies coming into New Jersey and undercutting the market unfairly in order to gain market share. (T3, 106:11-14; (T4, 107:12-13; T4, 115:3-8; T5, 139:22-25; T5,140:1-7; T5, 132:4-16; T5, 138:17-25; T5, 139:1-9).

More than one spoke of dealers coming into New Jersey from out of state to capitalize on the New Jersey market. One stated that those dealers operate "with low pricing, unfair pricing, not following the guidelines of the Division of Dairy, and pricing below [his] cost, as a dealer, that [he] can't compete with." (T4, 129:18-21).

Another dealer said that New Jersey is an "open door," allowing anyone to come in and do "what they want," but that a similar situation does not exist in Pennsylvania because that state's regulations are too restrictive. (T3, 113:3-8) Another dealer pointed to the market as unfair, with low pricing and not following the change notice forms or payment of their existing balances. (T4, 133:1-6). There was agreement among dealers that what is needed is a "level playing field" and assurances that "the industry as a whole abide by the rules." (T3, 121; 24-25, 122:1).

More than one dealer argued for a system of pricing regulation similar to the system in Pennsylvania. (T3, 106:4-21) (T5, 55:2-9). Pennsylvania's system was said to be more effective because "they do have set pricing for stores based on volume." (T4, 145:2-10).

One suggested that New Jersey needs to tailor a program like Pennsylvania's to New Jersey by establishing a farm price through a premium, while not allowing the cooperative to re-blend that and while identifying the payment on the producer check, and establishing a wholesale price into the store (with in-state and out-of-state treated the same) and a price out of the store that is not below cost. (T5, 55:2- 25, 56:1-20, 58:1-18).

One dealer also urged a stepping-up of enforcement of complaints about people selling milk below variable cost. He stated: "If you go out to enforce and you find a violation in January, you deal with it in January. You don't put it off and deal with it in July or August, or you don't start a process and let it drag out too long, because if there is a violation, someone has an advantage and someone has a disadvantage. And when I mean meaningful, I mean that you build in, through your regulations -- let me describe it this way. In life there are incentives and there are disincentives. You give people incentives to perform. And if you follow any of the sports, Dan, you know that ball players have signed contracts laden with incentives, do this, you get that, do much more, you do this, you get that. And we all do that. But I'm talking about a disincentive. A disincentive is if you do this, it's going to cost you this. So I'm saying that the Department should consider penalties that are severe enough to make any one who wants to violate the rules think twice about doing it. In other words, you can't give them a slap on the wrist." (T5 60-61, 4-25 & 1).

There were dealers who would consider a Division-established price (T5, 58:20-21) with the need for a guarantee that stores would not be able to sell below cost. (T5, 59:14-24).

Enforcement of rules should be "timely, swift and meaningful;" (T5, 60:4), penalties should be severe enough "to make any one who wants to violate the rules think twice before doing it." (T5, 60:23-25). As one dealer said: "You have to guarantee that through that program that stores should not be allowed to sell below cost. You can't sell below cost. In fact, no one should be selling below cost." (T5:14-17).

In questioning whether New Jersey's variable-cost regulation provides too many opportunities for people to manipulate the minimum costs, one independent distributor suggested that the state should "establish a price, go to a hearing, take information… (and ask,) What should the cost be between the farm price and what is the wholesale price that can return the costs that processors and dealers have, plus a margin that they can make a profit?" (T5, 65:17-25).

One dealer advocated changes to the "variable cost" rules currently employed by the Department to try to stem efforts by one dealer to undercut another just to capture market share. He said the current definition of which costs should be considered in determining "variable costs" were "not fair for dealers." (T5,130, 5).

He said: "My cost is nowhere near the variable cost. So for me to be out in a store at what price I'm selling it for and they're coming in 50 cents lower than my cost, and they say they're making money, I don't see how they can do that. Unfair for my -- for any distributor in New Jersey who is not producing." (T5 130, 5-11).

If the dealers and other market segments along the chain could be guaranteed a price at which they could make a profit, there would be support for a premium paid to dairy farmers. He said that "the producers who supply the market, no matter where they come, they should get the premium. The processors and the distributors who are going to end up paying the cost of it should be able to get it out of the marketplace, and you do that by guaranteeing a price by wholesale so you guys don't get undercut by out-of-state dealers." (T5, 72-73, 19-25, 1).

## G. Primary Proposals

An assistance or over-order type program was requested by producers, producer groups and licensed New Jersey Milk Dealers, (T1, 20:11; T1, 53:17; T1, 120:12-15; T1, 147:11T2, 154:21-155:2;T4, 28:3; T4, 106:2-6; T5, 51:15-17). For example it was suggested that an increase in licensing fees to stores be used to establish a fund or producer payment program (T1,148:23-25, 149:1-4) or a collection of funds via the licensing fee system to purchase risk management tools or provide services for contracting-forward price protection for producers (T1, 149:4-7). In essence, this was said to increase the price of milk only fractions of cents per gallon, which could be absorbed into the final price. One other program was to collect a retail dairy sustainability fund or entrance fee on all fluid milk being sold in the state. This fund would be established from the product being sold to consumers, but the point was made that the program must be protected throughout the system. (T4, 55:25-56:1-4; T5, 57:1-25-58:1-10).

Several witnesses testified that financial assistance programs or over-order type payment programs such as the ones above were ill advised as well. (T1, 190:5-8; T2, 169:1-5; T3, 88:14-

18; T-3, 132:17-20; T-3, 136:25-137:1-4). As indicated above, if special assessments were imposed upon the New Jersey processors/dealers, the state would risk losing this invaluable sector of the industry.

While many ideas and suggestions were made by various participants in the hearing as to how best to address the issue of low prices, there were two actual proposals offered. One was offered by a Sussex County farmer, Peter Southway, and one was offered by Dennis Schad representing the Greater Northeast Milk Marketing Agency (GNEMMA). The proposals are summarized in terms of the two chief components – collection of the assessment funds and their disbursement to producers.

Both proposals would impose an assessment on all New Jersey retail fluid milk sales. The farmer's proposal would establish the premium by reference to the difference between the New Jersey state school milk program price and the federal milk market order statistical uniform producer price. While he could not provide specific numbers, he said using the school bid price would provide a good benchmark. His suggestion was that the federal minimum price for New Jersey be subtracted from the average bid price to arrive at a level of payment that would be extracted from the entire New Jersey milk-sales market and be given back to New Jersey dairy farmers. (T1:18:3-6; T1:20:2-7; T1:24:7-16).

The GNEMMA proposal stated only that the assessment should be established as an add-on to the current license fee imposed on New Jersey fluid milk retailers. He said GNEMMA favored "a premium assessed and collected in the downstream marketing system," such as a "vendor fee" that would be collected either from dealers selling milk into stores or from retailers selling milk to consumers. (T1:53:17-20). Mr. Schad did not offer a view on what the level of that fee should be, and upon direct questioning said that decision should be left to the Department (T2:27:9-14). The fee would be collected on all Class 1 milk products, regardless of their source, he said, so as not to single out in-state milk, and to result in a maximum overall collection from a "modest fee" on milk purchases. (T1:53:20-24).

The GNEMMA proposal would provide reimbursement to producers in two forms. First, a portion of the proceeds would be provided to producers as assistance for improving production efficiencies. Second, payment would be made to all producers who provide raw milk supply for the ultimate retail milk sales in New Jersey. These producers would include both those in-state and out-of-state farmers who supply in-state Class 1 fluid milk plants, and in-state and out-of-state producers who supply out-of-state Class 1 plants, for the plants' in-state retail sales.[9]

Mr. Schad acknowledged the interstate commerce challenges that could result from a fee collected on all milk sales regardless of source but distributed only to New Jersey producers. (T1:54:7-12). A remedy, he said, would be to distribute the funds to all Class 1 milk suppliers, regardless of state, while also using some of the receipts of the fee to fund dairy-improvement

[9] Subsequently through written submission, the proposal was clarified as not applying to the supply of non Class I plants, and also as not applying to the supply by New Jersey farmers of out-of-state Class I sales. Brief submitted on behalf of GNEMMA.

programs, such as those run by a cooperative extension, for the benefit of New Jersey dairy farmers. (T1:54:12-19).

He said New Jersey would do well to follow the system previously used by the Northeast Interstate Dairy Compact, in which "the compact enforced the pricing of milk inside the compact area and distributed the premium proceeds to dairy farmers residing in the compact area and to dairy farmers delivering bulk milk to plants inside the compact area, and additionally, to dairy farmers whose milk was packaged out-of-state and delivered into the compact area." (T2:15-16:17-8).

By contrast, the farmer's proposal would disburse the assessment proceeds only to New Jersey producers.

Mr. Southway urged that the Department be the entity to both collect and distribute the funds from any assessment on milk purchases because he felt that not all, or even a majority, of the money would get to the dairy farmer if it were collected and distributed by a co-op or other milk procurement entity. The pertinent exchange on that issue follows: (T1:122:21-25; T1:123:1-10).

Based on the information provided, neither proposal provides adequate information to evaluate the amount of the assessment to be imposed, and hence the amount that might be paid to producers. The farmer's proposal does provide the rudiments of a formula for calculating an over-order assessment, but no more than a bare outline. The formula's reliance on the pricing of school lunch milk containers as the basis for the formula would utilize product pricing in a market segment that is both different and extremely small, as compared with the bulk of retail fluid milk product sales that would otherwise be subject to the assessment. (T2, 170-171). This could lead to misconceptions as to the margins and costs associated with this package. The difference in processing costs between a half pint of milk and a gallon of milk is significant on a per point basis." (T2, 170-171, 22-25 & 1-4).

Although containing minimal detail, there is more in the farmer's proposal than was presented in the GNEMMA proposal in terms of a way to determine the exact amount of a payment that could be made to producers.

## V. Briefs

Following the receipt of testimony, the hearing remained open and interested parties were given the opportunity to submit briefs and replies addressing evidence that had been presented. Post-hearing submissions in the form of briefs and comments were submitted by the Pennsylvania Association of Milk Dealers ("PAMD"), the Greater Northeast Milk Marketing Agency (GNEMMA), the New Jersey Farm Bureau and Readington Farms (Donald Merrigan). The submissions presented the positions of each entity with respect to the hearing notice subjects, various approaches, proposals and positions that had been taken by witnesses. The basic positions are briefly summarized below. The Department continues to evaluate the bases and the related legal and policy import of each.

Donald Merrigan, of Readington Farms, in follow up to his testimony, took the position that the difficulties being experienced in the dairy industry are the result of the Federal Order system. He suggested that Class I price be decoupled from the other three classes for a period of time to stabilize the industry and help the consumer to know the value of milk. He did not support a government pricing solution and did not support a program of price controls, similar to the Pennsylvania program.

The PAMD supported no action by the Department, identifying complaints made concerning insufficient payment to NJ dairy farmers for their raw milk and the competitive marketplace. In the main, objections were based on potential violations of the Commerce Clause or potential violations of a Court order enjoining enforcement of a regulation in 1990. The PAMD supports enforcement of existing regulations, finding no basis for other proposals offered.

The Greater Northeast Milk Marketing Agency ("GNEMMA") assessed the decline in the New Jersey dairy market (contrasting NJ and PA) and outlining the available producer data. The pricing at the wholesale level, including reference to out-of-state dairies' low prices and the pricing system administered by the Pennsylvania Milk Marketing Board was reviewed against "variable cost" pricing. GNEMMA offered an option for additional income for NJ dairy farmers through a levy at the wholesale in-to-store point similar to the current licensing fee system. The imposition of cost on dealer sales would apply to in-state and out-of-state dealers and utilizes a distribution to other programs model of a modified Northeast Dairy Compact approach and outlined a distribution system to NJ dairy farmers, out-of-state processors serving NJ dealers (through credits) and out-of-state producers. A second option included a premium pricing scenario similar to the Pennsylvania system with recognition of impediments both legal and administrative.

The New Jersey Farm Bureau ("NJFB") generally agreed with the GNEMMA position relating to certain out-of-state marketing practices characterized as destructive to the marketplace, including low pricing from out-of-state dealers and the advantages in other states that enjoy controlled price levels, and backed more aggressive enforcement of variable cost regulations. NJFB also supports a pricing control system similar to that of Pennsylvania and rejected the argument of Pennsylvania dealers that an injunction entered against a previous pricing regulation in New Jersey would prohibit a Pennsylvania style program. The enjoined regulation was argued to be one that established a minimum price for each hander based in the handler's total cost of production – creating different price floors for different handlers. While basically supporting the GNEMMA pricing structure, the NJFB did not support "taxes and fees or other assessments" to provide a revenue source for producers "during periods of low milk prices."

## VI. Conclusions

There is evidence that producers have experienced significant negative economic effects in the marketplace and there are real consequences which may support need for the protection of the dairy industry. Testimony received also defined an unbalanced market, with both high and low extremes. These issues must be handled at the same time in order to have a balanced market.

If these competing interests are considered in light of fixing milk prices, there are certain analytical requirements that must first be met. "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).

For the reasons set forth above, I have determined insufficient evidence was presented at the hearing to permit me to take action consistent with Garden State Farms, Inc., 61 N.J. 406, 428 (1972) at this time. As to the two specific proposals offered, I find there is insufficient basis to accept either proposal as presented.

I am ordering Department staff, in reliance upon the facts obtained through the hearing, to draft a proposal to address the financial position of dairy producers within the milk marketing chain, which includes procurement, processing, dealers and retailers. This proposal is to be crafted for review by all interested parties by late June 2010 to be the subject of a hearing the week of July 19, 2010 with specific notice to be provided in advance of the day.

To assist with this proposal, with respect to producers, I am ordering Department staff to collect specific cost of production data from producers. Department staff should collect information and standardize such information so that a cost of production can be determined. The final estimate shall also include the methodology used to arrive at the standardized producer cost of production.

In addition, as a result of the issues identified during the hearing concerning alleged violations of variable cost regulations and notice of change of supplier regulations and the related impacts upon the orderly operation of the market, with respect to dealers and stores, I am ordering Department staff to collect from Department files facts concerning investigations and enforcement actions with respect to variable cost regulations codified in Subchapter 7 of Chapter 52 and Subchapter six of Chapter 53 and to collect enforcement actions and investigations concerning Notice of Intent to Change Supply codified in Subchapter 7 of Chapter 53.

Respectfully submitted,

ALFRED W. MURRAY, Director
Division of Marketing and Development