STATE OF NEW JERSEY
NEW JERSEY DEPARTMENT OF AGRICULTURE

In the Matter of:

Re Dairy Hearing of November 19, 2009; December 17, 2009; January 28-29, 2010; and February 22, 2010

POST HEARING BRIEF OF THE PENNSYLVANIA ASSOCIATIN OF MILK DEALERS

Submitted by:

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INTRODUCTION

This Brief is filed on behalf of the Pennsylvania Association of Milk Dealers ("PAMD"), a trade association of milk processors doing business in Pennsylvania and elsewhere including especially New Jersey. For the reasons discussed below, PAMD urges the Division to take no action as a result of the hearings held in late 2009 and early 2010 regarding the dairy industry. Cutting through all of the rhetoric there were two basic "complaints" raised during the hearing: (1) dairy farmers are receiving insufficient money for their raw milk; and (2) sales of packaged milk at wholesale are extremely competitive and, so the complainants claim, cut-throat and too low for New Jersey businesses to effectively compete. It is further alleged that prices for milk at retail are at times cut-throat or, in the alternative, too high, and that dairy farmers are not receiving a "fair share" of the retail dollar.

The proposed solutions are unsound policy and likely illegal. First, dairy farmers assert a claim for a new premium on milk sold in New Jersey. Under one proposal, this premium would be paid on all milk sold in New Jersey, but received only by dairy farmers in New Jersey; under the other proposal, the premium would be paid on all milk sold in New Jersey and shared, but unequally, among New Jersey and non-New Jersey dairy farmers. Another set of proposals would purport to deal with the competitive issues in New Jersey by adopting a "Pennsylvania style" (three tiered) – raw milk, whole and retail – minimum price program or a no sales below all costs prohibition. The problems with this set of proposals range from necessary, but illegal, regulation of interstate commerce to running afoul of the letter and spirit of a permanent injunction entered against the Division in the United States District Court for New Jersey.

Leaving aside the contradictory nature of testimony on the one-hand that dairy farmers are not receiving a fair share of the money for sales of fluid milk in New Jersey versus testimony that competition for milk sales in New Jersey is cut-throat and "below-cost," there is fundamentally no dispute that dairy farmer pay prices are presently relatively low because federal minimum prices are low nationally (although PAMD does take exception as described below to certain purported cost of production data) and that competition for sales of milk at wholesale are very competitive. The two complaints are also inextricably linked – with keen competition at the wholesale level for milk sales, any proposed increase in the regulated price paid to dairy farmers must be weighed in light of this existing competition. It is thus not surprising that witnesses tied the issues together in some way either by supporting a new premium on all milk sold in New Jersey (in order to insure that out-of-state raw and packaged milk could not undercut New Jersey businesses) or by supporting a change to New Jersey's prohibition against selling milk below variable cost and linking that change to producer prices (again in an effort to deal with out-of-state competition).

However, there is nothing in these two sets of claims that is inherently or actually unique to New Jersey. Worse still what is different about New Jersey from New York and Pennsylvania is that New Jersey is a huge importer of both raw and packaged milk. This means that New Jersey's ability to effectively and legally regulate milk prices is very difficult, if not impossible. Finally, the Division has available to it existing tools to enforce the prohibition against sales below variable cost. The problem, if any, appears to be the lack of actual enforcement prior to the recent spate of complaints. Before the Division engages in complex and potentially harmful and extra-legal new regulation,

PAMD respectfully suggests that the Division instead vigorously enforce the enforcement tools that it presently has. Thus, the Division should conclude that it should not, indeed as to many of the proposals cannot, act and this proceeding should be terminated forthwith without any action taken on the proposals before the Division.

ARGUMENT

Multiple witnesses, a processor (Tr. 31-32 (1/29/10)) and three distributors (Tr. 50-51 (2/22/10); 130 (2/22/10) and 105 (11/29/10)) all testified about keen competition for sales of packaged milk. While they mentioned competition from Pennsylvania, when pressed, witnesses acknowledged that “problem” competition came most from New York. Tr. 72-80 (2/22/10); 106 (1/29/10) and Tr. 148 (2/22/10). This fact is significant because New York has no known sales below cost prohibitions. Any person who can purchase milk across the border in New York at any available price (New York does have a presumed retail maximum price – N.Y. Gen. Bus. § 396-rr (McKinney 2009) that does not impact this analysis). In light of this testimony regarding existing competition, no witness credibly testified that New Jersey could increase the regulated cost of New Jersey produced raw milk sold to Class I processors in New Jersey only. With that background, the proposals instead looked to broaden the premium base and/or to have New Jersey adopt a much more extensive regulatory scheme that would regulate all three phases of milk transactions from the farm to the plant, from the plant to wholesale accounts, and at retail.[1]

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[1] It is also more than ironic that the proposals regarding minimum wholesale prices follows the implementation after litigation of the New Jersey fuel adjuster premium in 2007. New York State Dairy Foods in that earlier litigation pointed out that the Division’s adoption of a fuel adjuster would, as had happened in the past, make New Jersey processors uncompetitive and thus adoption of the premium was arbitrary and capricious. In re SEPTEMBER 28, 2006 ORDER OF DIRECTOR OF the DIVISION OF MARKETING AND DEVELOPMENT, 2006 WL 3783503 (N.J. Super. A.D. 2006). While the court disagreed and upheld that part of the Division's rule, apparently real world economics worked precisely as

1. The Co-operative and Southway Proposals to Impose a Fluid Milk Fee on All Milk Sold in New Jersey and Distribute that Collected Fee are Bad Policies and Would Violate the Dormant Commerce Clause of the United States Constitution.

The Cooperatives propose to address the existing New Jersey competitive issues by having New Jersey adopt at the retail level in New Jersey a fee imposed on all fluid milk sold in New Jersey. This fee would then be shared among all producers selling milk in New Jersey. The cooperatives assert that their proposal is superior to the Southway proposal because as they see it, the original proposal violates the dormant Commerce Clause of the U.S. Constitution. The cooperatives are correct that the original proposal violates the constitution as discussed herein. However, the cooperative proposal would also violate the dormant Commerce Clause; examination of the cooperative witness clearly shows that differences arise as to the treatment of New Jersey dairy farmers and out-of-state dairy farmers and New Jersey plants and non-New Jersey processing plants. These differential results amount to discriminatory treatment that is unlawful under dormant Commerce Clause analysis including analysis found in cases dealing with state dairy regulation.

Indeed the proposal would also take away competitive advantages inherent to the production of milk outside New Jersey precisely because the cooperative proposal would make out-of-state milk more expensive just for the privilege of being sold in New Jersey. Indeed the cooperatives point is that because of competition for wholesale milk sales in New Jersey, New Jersey needs to levy a premium on all milk, including especially out-of-

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predicted and the fuel adjuster premium has resulted in competitive problems for New Jersey players especially the one purchasing a substantial portion of the New Jersey farm milk. Tr. 16-18 (2/22/10). And the proposed cure now to impose burdens on out-of-state farmers and processors is both unjustified and illegal as discussed herein.

state milk sold as raw milk to New Jersey plants and as raw milk to out-of-state plants with sales in New Jersey. The Third Circuit as recently as 2006 vigorously condemned such practices in *Cloverland-Greenspring Dairy v. Pennsylvania Milk Marketing Board*, 462 F.3d 249, 258 (3rd Cir. 2006) and 298 F.3d 201, 213 (3rd Cir. 2002). New Jersey must avoid adopting such a proposal that can only give rise to federal court litigation.[2]

At the outset, in light of the overwhelming testimony regarding sharp competition for milk sales at the wholesale fluid milk level, it is not surprising that the cooperatives appear to recognize that New Jersey cannot further increase the regulatory price for New Jersey raw milk sold to New Jersey fluid milk plants only without also dealing with the competitive impacts that would result unless the cost of non-New Jersey raw milk and the value of packaged milk sold into New Jersey is also addressed. PAMD agrees with that premise. The problem is that the solution is so obviously then attached to out-of-state milk that the dormant Commerce Clause cannot help but be implicated.

The superficial analysis by the cooperatives that discrimination will not result from their proposal is undercut by the cross-examination of the cooperative witness. That witness acknowledged the following: (1) a New Jersey dairy farmer would be eligible for the shared value of the new fee regardless of whether such person's milk was received at a Class I plant or any other non-Class I plant in New Jersey (Tr. 92 (1/29/10) (referencing how the fuel adjuster works) and 96 (1/29/10)); (2) for raw milk sold and delivered to a New Jersey plant, a Pennsylvania dairy farmer would be eligible on its volume sold to a Class I operation only (Tr. 99-100 (1/29/10)); (3) a New Jersey dairy farmer delivering

[2] While PAMD does not concede that such a fee would qualify as a tax as that term is used in federal jurisdiction over tax injunction cases, New Jersey may for legal and public policy purposes view this as a tax raising both the legal question of whether the Division has the legal authority absent additional legislative action to so act and whether this Administration should in light of its public pronouncements about taxes, adopt a new and substantial tax on New Jersey consumers.

milk to a New Jersey fluid plant only would be eligible for the full value of the shared fee (Tr. 99 (1/29/10)); (4) a Pennsylvania dairy farmer delivering milk to a Pennsylvania plant with fluid milk sales in New Jersey would be eligible for the shared value of the New Jersey fee, but that value would then be shared on all the volume of the Pennsylvania plant (Tr. 94 (1/29/10)); and (5) New Jersey and Pennsylvania plants with sales into New Jersey would pay and receive different amounts to pay to their dairy farmers (Tr. 95-97 (1/29/10)).

For simplicity assume the following: (1) the fee is $0.86 per gallon or $0.10 per cwt; (2) the Class I utilization of New Jersey milk is 66% (using the Division's published Class I utilization for the fuel adjuster for February 2007 (the only month available on the internet); (3) a New Jersey fluid milk plant with 90% Class I utilization and 30% New Jersey milk; (4) a Pennsylvania fluid milk plant with 90% Class utilization and 100% Pennsylvania milk shipping 40% of its milk into New Jersey; (5) a New Jersey dairy farmer 100% of whose milk is received at the New Jersey plant described in (3) above; (6) a New Jersey dairy farmer 50% of whose milk is received at the New Jersey plant described in (3) above and 50% of whose milk is received at a non-Class I facility in New Jersey (Tr. 91 (1/29/10)); (7) a Pennsylvania dairy farmer 100% of whose milk is received at the New Jersey plant described in (3) above; (8) a Pennsylvania dairy farmer 50% of whose milk is received at the New Jersey plant described in (3) above and 50% is received at the same non-Class I plant as the milk from the New Jersey farmer described in (6) above; and finally (9) a Pennsylvania dairy farmer 100% of whose milk is received at the Pennsylvania plant described in (4) above.

The proposal requires the plants to receive the money and then pay it to the dairy farmers (Tr. 93 (1/29/10)) so initially the impact is on the dairy farmers. New Jersey dairy farmers (5) and (6) and Pennsylvania dairy farmer (7) would thus receive 6.6 cents per cwt (10 cents X 66%). However, Pennsylvania dairy farmer (8) who ships milk identically to New Jersey dairy farmer (6) would receive only 3.3 cents per cwt (10 cents X 66% X 50% of the milk). Pennsylvania dairy farmer (9) would receive only 2.38 cents per cwt (10 cents X 66% X 90% Class I utilization X 40% milk sold in New Jersey) – this is true even if the New Jersey plant only ultimately sells 40% of its milk in New Jersey.

The fact that a Pennsylvania farmer can only achieve the best price of 6.6 cents per cwt by finding a home for 100% of its milk at a New Jersey-located fluid milk plant while a New Jersey farmer could ship only 50% (or even less) to a New Jersey-located fluid plant and the remainder elsewhere in New Jersey is by itself fatal to the proposal's constitutionality. California unsuccessfully sought to accomplish a similar result in 1997 when it adopted a new regulation which reduced a California plant's credit for out-of-state milk from the prior accounting "wash" to a credit which required an out-of-state dairy farmer to ship raw milk only to Class I operations in order to get the best price available to California farmers. In particular, like the proposal here, but not as draconian in result as the New Jersey proposal, the shipment of milk to a non-Class I facility reduced the credit to the in-state plant below that available on in-state milk. The cooperatives' proposal of course effectively assigns no value to the Pennsylvania milk received by a non-fluid New Jersey plant. California's proposal was found to violate the U.S. Constitution and the provision was permanently enjoined in a Section 1983 Civil

Rights lawsuit that also resulted in a significant ($2.5 million) attorneys fees award in favor of plaintiffs and their counsel. *Hillside Dairy v. Lyons*, 317 F. Supp.2d 1194 (E.D. CA 2004).[3]

The out-of-state farmer is also disadvantaged as to his sale of milk in Pennsylvania. Even though a fee attaches to a portion of his milk, he too has his receipt adjusted downwards to reflect the fact that such person makes the mistake of selling its raw milk to a Pennsylvania plant because this farmer's receipt of the N.J. premium will be adjusted for the Pennsylvania's plant blend. Tr. 94 (1/29/10). In addition to violating the dormant Commerce Clause, individual dairy farmers who are not incorporated have a claim under the Privileges and Immunities Clause of the United States Constitution. *Hillside Dairy v. Lyons,* 123 S. Ct. 2142 (2003) (holding that practical effects of regulation can unlawfully discriminate against out-of-state persons and reaffirming *Chalker v. Birminghan & Northwestern R. Co.*, 249 U.S. 522 (1919).

The New Jersey and Pennsylvania plants are also treated differently. The in-state facility pays 9 cents per cwt to the pool, receives back and pays out 6.6 cents per cwt to its producers, but the Pennsylvania plant pays the pool 3.6 cents per cwt, receives back 2.376 cents (6.6 cents X 90% Class I utilization X 40% New Jersey), but this 2.376 cents received back must be shared with all of its dairy farmers at a rate of 1.224 cents per cwt. Even accounting for the fact that the New Jersey plant will have a net cost of 2.4 cents per cwt (10 cents paid in on 90% of its milk less 6.6 cents received in return) and the

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[3] The case later settled while pending appeal to the 9th Circuit, but it is a matter of public record that the injunction, while modified slightly, is permanent and the offending regulatory provision is no longer on the books. The case took some time to resolve primarily because California claimed that it was exempt from dormant clause analysis based upon specific California language in the 1996 Farm Bill. That issue was resolved when the U.S. Supreme Court reversed a 9th Circuit opinion in favor of California. *Hillside Dairy v. Lyons,* 123 S.Ct. 2142 (2003).

Pennsylvania facility will have a net cost of 1.224 cents per cwt (10 cents X 90% Class I X 40% New Jersey sales less 2.376 cents per cwt return to be paid out), the New Jersey plant has gained competitively in its pay price to dairy farmers in the amount of 3.048 cents per cwt (6.6 cents paid out less 2.4 cents net cost or 4.2 cents less 2.376 cents paid out less 1.224 cents per cwt net cost or 1.152 cents). The proposal thus also discriminates against the Pennsylvania plants selling into New Jersey. This too is unlawful. *See West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994).

Finally, in case anyone attempts to make the argument that the discrimination is somehow "small" or "insignificant" (PAMD would strongly disagree with such contention factually given the evidence of competition in this marketplace), the U.S. Supreme Court has held that there is no de minimis" defense to a charge of discrimination under the dormant Commerce Clause. *Camps Newfound/Owatonna v. Town of Harrison,* 117 S. Ct. 1590, 1601 n. 15 (1997).

It is also noteworthy that the Cooperatives' proposal claims to be based upon concepts drawn from the defunct Northeast Interstate Dairy Compact except that their proposal is more restrictive than the Compact in that out-of-area milk shipped to Class II, III, and IV operations did participate in the Compact pool, but the Cooperatives' proposal for New Jersey would only permit association of out-of-state milk with New Jersey fluid plants. That in and of itself is a discriminatory treatment problem as discussed above, but fundamentally relying on the Compact misses a fundamental point. The Compact came into being relying upon express Congressional authority and consent to the Compact. *Milk Industry Foundation v. Glickman*, 967 F. Supp. 564 (D.D.C. 1997). That authority lapsed, and the Compact was terminated precisely because it no longer had the legal

authority to interfere with interstate commerce even as the cooperative proposal would have New Jersey act without Congressional authority. Thus, PAMD agrees that looking at the Northeast Compact is instructive, but it is instructive in that New Jersey must understand that without the Congressional authority that the Northeast Compact had (for a short-time), it cannot take the same actions legally.

The cooperatives proposal is ill-advised policy in that it would increase prices to consumers in New Jersey on all milk sold in New Jersey for the purported benefit of 100 New Jersey dairy farmers, but also out-of-state dairy farmers.[4] But it is simply unconstitutional and the Division should avoid adopting an unconstitutional regulation that will undoubtedly subject the state to expensive Section 1983 Civil Rights litigation.

The Southway proposal is even more obvious than the cooperative proposal in terms of its adverse Commerce Clause implications. As explained herein, the proposal clearly discriminates against out-of-state dairy farmers by charging a premium on the milk they sell through their processors and distributors, but by only distributing the proceeds of that premium to New Jersey dairy farmers.

Although the Mr. Southway did not provide concrete details with respect to his proposal instead leaving details such as the level of the premium to the Department (Tr.

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[4] The proposals to add additional premiums under current circumstances are also unwise because the Department will be forced to incur added expense and possible litigation for premiums that will not necessarily redound to the benefit of individual New Jersey dairy farmers. The record reveals that the last premium that was instituted to help New Jersey dairy farmers, which was the fuel adjuster, did not necessarily do so. As Mr. Southway testified, the month after the fuel adjuster was implemented, the entity that markets his milk offset that premium with a fuel assessment. Tr. 120 (11/19/09). One cooperative witness, who did not disavow Mr. Southway's statement about DMS, indicated that following the implementation of the fuel adjuster, the cooperative for which he works did not add any new line items for deductions to offset the fuel adjuster, but on cross examination, the witness acknowledged that the existing lines for deductions, including the line covering transportation costs could have and did increase since the adoption of the fuel adjuster. Thus, the witness could not guarantee that the cooperative had not offset the fuel adjuster premium to New Jersey dairy farmers with additional deductions and the witness provided no assurances that similar offsets would not happen if a new premium were adopted in the future. Tr. 27, 29-31 (12/17/09).

26 (11/19/09)), he provided a framework that makes clear that the proposal will discriminate against out-of-state farmers and their processing companies. At its core, the proposal contemplates comparing the school milk price to the statistical uniform federal order price, calculating the difference, picking a percentage of that difference and passing that percentage back to New Jersey dairy farmers *only* by imposing a fee on all sales to retailers in New Jersey. Tr. 19-22 (11/19/09). Thus, rather than the schools bearing the cost of this premium, the proposal would distribute the cost across all sellers of packaged milk, including those processors and distributors from outside of New Jersey. Tr. 24 (11/19/09).

This proposal is strikingly similar to the program that was struck down in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 188 (1994), which held as follows:

> A Massachusetts pricing order imposes an assessment on all fluid milk sold by dealers to Massachusetts retailers. About two-thirds of that milk is produced out of State. The entire assessment, however, is distributed to Massachusetts dairy farmers. The question presented is whether the pricing order unconstitutionally discriminates against interstate commerce. We hold that it does.

In that case, as would be the case with the Southway proposal (Tr. 19-20, 24 and 30 (11/19/09)), the premium was imposed on all milk sold in Massachusetts but was only distributed to Massachusetts dairy farmers. There, as here, the vast majority of the milk consumed in Massachusetts came from outside of the state. As the Court went on to explain, the proposal had the leveling effect of making out-of-state milk more expensive (512 U.S. at 194), a goal that is prevalent on the record before this Department, that also served to prop up the Massachusetts industry at the expense of the out-of-state dairy industry *West Lynn* 512 U.S. at 194-95. The similarities between the Southway proposal

and the regulation at issue in *West Lynn* are so striking that the Department should readily decline to adopt the proposal on legal grounds.

Even if the proposal could be structured in a manner that does not run afoul of the negative Commerce Clause, Mr. Herbein's testimony suggested that the proposal would be based on bad policy. He indicated that calculating a premium based on the value of school milk would overstate any estimates of what the farmer's share of the finished product should be. Mr. Herbein's testimony suggested that the container, processing and delivery costs associated with half-pints involve significantly greater cost than other container sizes and thus the cost of a half-pint sold to schools reflects significant processing level costs that would be inadvertently recognized by the Southway proposal for purposes of establishing a dairy farmer premium. Tr. 170-171 (12/17/09).

Accordingly, the cooperative and Southway proposals are bad policy as well as unlawful as proposed and for the reasons enumerated above, the Department should not attempt to adopt and implement either proposal.

2. Increased Regulation of Wholesale and Retail Milk Prices would be Contrary to the Division's Federal Court Consent to a Permanent Injunction in 1990 in *Byers Farms* case.

PAMD has recently discovered and shared with the Division and interested parties the Permanent Injunction and most (but unfortunately not all as the Clerk's office is unable to locate one critical transcript) of the supporting documents in *Byers Farms, Inc. v. Brown*, Civil Action No. 87-3017 (D.N.J. 1990) (Docket Entry 84). The trend in New Jersey until recent proceedings late in this decade has been to move away from increased regulation of the dairy industry. In 1980, the Division repealed wholesale minimum price regulation such as that now suggested by one New Jersey processor and a

number of distributors and adopted in lieu thereof, no sales below cost prohibitions which covered all costs – fixed and variable (known as "total cost"). 12 N.J.R. 562-563 (October 9, 1980).[5] The controversy over wholesale price minimums in the form of a total cost rule did not end the matter in New Jersey.

As is evident from discussions of the *Byer Farms* case in a reported decision regarding preliminary matters (*Byer Farms, Inc. v. Brown*, 721 F. Supp. 644 at 645 (D.N.J. 1989)) and from the available docket entries in the official file (all of which has been shared with the Division and interested persons), Byer Farms and the State of New York sued the Division's Secretary and his Director of the State's Division of the Dairy Industry claiming that the prohibition against the sale of milk below total cost violated the dormant Commerce Clause. While a critical transcript is missing, it is quite evident from the docket entries leading up to the Permanent Injunction that the Judge had concluded that there were significant risks for the Division in continuing to proceed in the litigation. Regardless, the Division consented to a Permanent Injunction against the prohibition against the sale of milk below total cost. As part of that April 19, 1990 Injunction, the Court expressly permitted new proposed regulations which are the regulations presently in use today – the prohibition against the sale below variable cost. 22 N.J.R. 1629-1631 (May 21, 1990): "The average variable cost standard is, by definition, lower than the total average cost standard and allows sales at prices which are lower than those which were possible in the context of the total average cost standard."

The Division also repealed retail cost standard rules and adopted the variable cost standard as applied to retail stores expressly stating: "in order to comply with the spirit of

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[5] Official Notice requested of the New Jersey Register. Since the *Byers Farm* injunction was not available prior to the close of the hearing, references to the history leading up to that decision are also relevant.

the Court's order, the Division has adopted an emergency repeal of [retail total average cost rules]." The Division then invited and discussed comments on the emergency repeal of the average total cost rules and in response to a comment that a variable cost standard would fail to deter practices such as using milk as a loss leader, responded: "the use of the variable cost standard was mandated by the Federal court." 22 N.J.R. 2138-2140 (July 16, 1990).

In light of these circumstances it is not surprising that one distributor witness at the present hearing wistfully told the Division that "Woody Moffett was the Dean of Administration. He ran it like a czar." Tr. 107 (1/29/10). The problem is that those rules enforced by Mr. Moffett were enjoined. It is also not surprising that New Jersey witness after witness complained about interstate commerce affecting their sales in New Jersey and then proposing regulations which would deal with that interstate commerce. The proposed regulations would go at least as far as the enjoined regulations and most proposals would go beyond the enjoined regulations to have even greater regulation all with the purpose and effect of regulating interstate commerce. Moreover, the Division in 1990 in official state documents made it quite clear that adoption of "the use of the variable cost standard was mandated by the Federal court." PAMD agrees that the variable cost standard was mandated by the Federal court – and New Jersey agreed to that permanent injunction. Byer Farms and New York have never released New Jersey from the permanent injunction. The case has not been reopened. The injunction has not been modified or released.[6]

[6] As a now interested party, should the Division seek modification of that injunction, PAMD respectfully requests timely notice from New Jersey.

Moreover, since the Byer Farms case was not discussed in this hearing record by any proponent of changing the court mandated variable cost standard, it is necessarily impossible for the Division to make findings of fact and conclusions of law of what has changed since 1990 that would permit it to even consider adopting a new rule even if the permanent injunction didn't bar the proposed changes anyway. *See Motor Vehicle Manufacturers Ass'n v. State Farm Auto Insurance Co.,* 463 U.S. 29 (1983).

The proposals to alter or amend the variable cost standard cannot be pursued under the terms of the permanent injunction and the Division's own contemporaneous interpretation of it in 1990.

3. The Proposal to Adopt a Pennsylvania Style Milk Pricing System Cannot be Both Effective and Constitutional and Should Thus Be Denied Regardless of the Permanent Injunction.

A subset of witnesses testified in favor of a Pennsylvania style system for pricing raw, wholesale and retail milk in New Jersey. Tr. 30-34 and 39-42 (2/22/10); 53 (2/22/10). Again there was significant linkage of the competitive issues for packaged milk and the cost of raw milk. Tr. 49-55 and 75 (2/22/10). Most importantly, however, one witness with decades of experience as both a regulator and in the sale of milk testified that it would be of critical importance for New Jersey, if it adopted a Pennsylvania style system, to deal with New Jersey's unique milk market conditions – i.e. small dairy farm and processing capacity base with substantially large consumer base. Tr. 46-56, 60 and 67 (2/22/10).

This witness expressly concluded that the only way to make such a system work would be to make certain that the price of wholesale milk sold in New Jersey would also

apply to retailers who reached out of state to purchase their wholesale product. Tr. 55, 58-59 and 74-80 (2/22/10). And as a former administrator of the Northeast Compact he would know about the importance of being able to price milk that comes into New Jersey for the same reasons as discussed regarding the cooperative proposal above. The system of regulation must have controls to protect against out-of-area competition in order to be effective. Given the important facts, noted above, that New York does not have any sales below cost prohibitions and that New York sourced milk is a significant element of the perceived competitive problem in New Jersey (Tr. 148 (2/22/10)), the conclusion of this witness is logical and correct so far as it goes – in order to be effective, a New Jersey pricing system would have to reach out-of-state and price milk coming from out-of-state as it comes into the state. This much PAMD can agree to.

The problem, yet again, is the insurmountable one resulting from the dormant Commerce Clause. This solution is even more obvious, but by no means any more, illegal than the cooperatives' proposal. Reaching out of state and demanding the price be paid for merchandise was found to violate the dormant commerce as early as 1935 in the seminal case *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S.511 (1935) (State of New York unlawfully attempted to protect its dairy farmers from the adverse effects of Vermont competition by establishing a single minimum price for all milk, whether producer in New York or elsewhere). If one substitutes the words "New Jersey" for "New York", "processors or distributors" for "farmers" and "Pennsylvania or New York" for "Vermont" the proposal made is identical to the one struck down in *Baldwin*.

4. New Jersey's Market Characteristics Make a Pennsylvania Style System a Bad Policy Choice

Even if the proposals for a Pennsylvania style system would not violate the Byer Farms permanent injunction or violate the dormant Commerce Clause in order to be effective, the proposals are simply bad policy for New Jersey and especially New Jersey businesses facing existing regulation and New Jersey consumers during these tough economic times. Again there is no factual dispute that New Jersey is a very different market for milk then its neighbor states of Pennsylvania and New York. Both New York and Pennsylvania have significant dairy farmer populations and are states that export milk. Both states have significant processing and manufacturing capacity for milk and export finished products. New Jersey is neither of these and instead imports both its raw milk for processing and its finished products for sale to New Jersey consumers. Tr.46-56, 60, 67 and 148 (2/22/10).

But New Jersey has consumers who would ultimately foot the bill for this new program. And all New Jersey consumers would pay these increased costs. With no more than 100 dairy farmers in New Jersey, adoption of a Pennsylvania style system would impose costs on all New Jersey consumers that as to proposals such as the cooperative proposal are going to be diluted by the participation of out-of-state dairy farmers. Moreover, New Jersey does not appear to have presently the administrative staff available to construct and enforce such a program – testimony that the state has not been monitoring and enforcing the existing variable cost prohibition suggests strongly a lack of sufficient personnel to pull off a system like Pennsylvania's. And where is the funding to come from for this new administrative infrastructure? In any form it too would be a new tax or fee imposed on business or the taxpayers at large. PAMD respectfully submits that

such new regulations are in addition to being illegal, simply unwieldy and unwise. The attempt should be abandoned now before further costs are imposed on business.

The proposal for a Pennsylvania style system should be rejected.

5. The Existing Variable Cost Standard and Notice Requirements are Adequate and Enforceable.

PAMD provided cost accountant expert testimony regarding the viability and enforceability of the variable cost standard. Tr. 163-164 (2/22/10). No witness testified that the change of vendor two-day notice requirement is unworkable. No witness with this expert's credentials appeared to contradict this expert. Indeed other witness testimony suggested that the real issue has been that until recently there has been little if any effort to enforce this existing standard. Tr. 133-138 (2/22/10). Non-enforcement of a workable standard is no reason to move away from that standard. Moreover, the standard is the standard mandated by the 1990 permanent injunction.

6. Regulations Based Upon Cost of Production should use GAAP

The un-contradicted testimony of PAMD's cost accounting expert witness supports using Generally Accepted Accounting Principles if Cost of Production is to be used as the basis for adopting a regulatory price mechanism. Tr. 159-162 (2/22/10). While superficially helpful, the Northeast Dairy Farm Summary simply does not qualify as being GAAP compliant. *Id.* Whether or not another regulatory agency outside of New Jersey agrees with this approach (Tr. 177 (2/22/10)) ought to be irrelevant, especially since there is no clear recognition by any such agency on this record that they affirmatively rely on non-GAAP compliant cost of production data . When one combines this underlying evidentiary problem with all of the legal and policy reasons for rejecting

further action, the Division ought to conclude that this matter should be closed without any action taken.

CONCLUSION

For all of the foregoing reasons, PAMD respectfully requests that the Southway and cooperative proposals for a new fluid milk fee and the proposals to pursue a Pennsylvania style milk pricing system or otherwise to abandon the variable cost standard be denied. The hearing should be concluded without further action being taken on any matter.[7]

Respectfully submitted,

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[7] There was a little, but very little, discussion renewing the call for an rbST free premium. PAMD respectfully incorporates the prior briefing by New York State Dairy Foods on this matter as to why this is yet another bad policy that should be rejected. The record evidence, such as it is, is also sparse.