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Dr. Ron Cotterill
Food Marketing Policy Center
University of Connecticut
Storrs, Ct. 06269-4021

Re: Proposed state legislation for a Ct. Milk Marketing Board.

Dear Ron,

You have asked for my legal opinion and comments on three pieces of draft state law legislation under case law dealing with the negative or "dormant" Commerce Clause: (1) "An Act Establishing Milk Handler Fees," (2) "An Act Concerning the Establishment of a Connecticut Milk Commission," and (3) "An Act Concerning the Establishment of a Connecticut Milk Marketing Board." I provided my comments on the first two bills last week. I now address the third bill, in the most recent version supplied to me. But first, I will summarize federal "dormant Commerce Clause" jurisprudence.

The "Commerce Clause" of the Constitution affirmatively authorizes the federal Congress to regulate interstate commerce. For nearly 200 years, the Supreme Court has construed that authority to proscribe state laws that erect tariffs, discrimination or protectionism in interstate commerce. This aspect of the Commerce Clause, sometimes called "dormant" or "negative," derives from the history of the Constitution and the undesirable practice of states to erect protectionist barriers to interstate trade under the Articles of Confederation. *Camps Newfound/Owatonna, Inc., v. Town of Harrison*, 520 U.S. 564 (1997). The Commerce Clause intended to create a unitary market in all goods and services within the United States, subject to the authority of Congress to allow states to erect trade barriers or directly to regulate interstate commerce.

Attempts by states to protect local milk producers from the rigors of interstate commerce played a significant role in the development of the Supreme Court's Commerce Clause jurisprudence during the 20th Century. *West Lynn Creamery Corp. v. Healy*, 512 U.S. 186 (1994), is the most significant recent addition to the string of milk cases. *Baldwin v. GAF Seelig, Inc*., 294 U.S. 511 (1935), laid the foundation. These, and other cases dealing with diverse commodities from apples to waste, establish the following simple principals:

1. State laws may not discriminate against interstate commerce.
    a. Discrimination simply means differential treatment that benefits in-state interests and burdens out-of-state interests.
    b. Discrimination may be demonstrated three ways: (1) on the face of state laws, (2) by effect or application of facially neutral laws, or (3) by proof of discriminatory intent.

c. Where discrimination is apparent to any degree by any of these measures, the state law is almost certainly unlawful under the dormant Commerce Clause, with some exceptions not relevant to your inquiry.

West Lynn is an example of discrimination against interstate commerce in its combination of interstate milk price levies and in-state subsidies to local producers.

2. State laws may not regulate activities outside of the state. Extraterritorial regulation was the primary focus of *Baldwin*, in which New York attempted to regulate minimum prices for milk purchased in Vermont in order to protect in-state milk prices. The 1st Circuit, in *Grant's Dairy v. Commissioner*, 232 F.3d 8 (2000), however, observed that "direct regulation" of interstate commerce might not invalidate a state law if it does not also burden interstate commerce. The *Grant's* opinion explained that the Maine program fit "comfortably within the mold" of *Milk Control Bd. v. Eisenberg Farm Prods*., 306 U.S. 346 (1939), decided four years after *Baldwin*, in which the Court approved a Pennsylvania rule that fixed farm milk prices for milk purchased in Pennsylvania destined for export to New York. *Eisenberg* may yet have some life, particularly with a more conservative Supreme Court, but it has more frequently been cited in minority opinions by Justices who feel that the Court has unduly expanded the reach of the dormant Commerce Clause in opinions of the last two decades.

3. Finally, state laws which are non-discriminatory and do not burden interstate commerce by extraterritorial reach might nevertheless violate the Commerce Clause if, after a fact-intensive review (i.e., trial), it appears that the law indirectly burdens interstate commerce and those burdens, on balance, outweigh the local benefits of state law. *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142 (1970), applied in *Grant's Dairy*. Under this "balancing test," many laws are challenged; few challenges succeed.

The legislature's objective in the draft Milk Marketing Board bill should be to avoid discrimination in interstate commerce or extraterritorial reach of state regulatory burdens so that the new law, and any regulations issued by the Board, are likely to survive a Commerce Clause challenge. There is, of course, no guarantee that the state will not be sued; but if the suit boils down to a balancing test, the program is very likely to survive challenge. The devil, as they say, is in the details.

The revenue distribution aspects of the Milk Marketing Board bill are apparently based in part on an inference derived from *West Lynn* opinion that a milk producer subsidy program would be constitutionally palatable if payments are made to out-of-state producers as well as in-state producers, and in part on the post-*West Lynn* success of the Maine Milk Tax and subsidy program. The Supreme Court in *West Lynn* made a decision on the facts of the case before it. One should not conclude that a different revenue distribution method would have cured Commerce Clause problems in the Massachusetts program. It would simply have produced a different judicial analysis, and possibly a different result. The proposed Marketing Board bill authorizes regulations that are less vulnerable to Commerce Clause scrutiny than *West Lynn* and prior Commerce Clause cases dealing with commerce in milk. Notably, the taxable transaction at retail sale or premises consumption to a Connecticut consumer is entirely in-state. Thus *Baldwin* problems are avoided. The revenue distribution or subsidy contemplated includes out-of-state milk suppliers, so *one* of the problems identified in *West Lynn* is also avoided. The Marketing Board Act will likely be viewed as mere economic regulation rather than tax and appropriation.

The combined program, therefore, falls somewhere between *West Lynn* and the Maine Milk Tax in its structure.

A bit of historical caveat is due before the sponsors of the Milk Marketing Board bill rely on the Maine program. At the time of the *West Lynn* litigation, Maine had a packaged milk tax and producer subsidy from proceeds of the milk tax. Relying on *West Lynn*'s disposition of a co-joined tax-and-rebate scheme that the 1st Circuit felt was similar, the Maine Program was held to be unconstitutional in *Cumberland Farms v. LaFaver*, 33 F.3d 1 (1994). The Maine legislature moved promptly to decouple the tax from the subsidy, and to make the tax payable to the state's general fund. Monies were then appropriated from the general fund for payment of direct subsidies to Maine producers. This was upheld in *Cumberland Farms v. Mahany,* 943 F. Supp. 83 (D. Me. 1996), but the district court decision was vacated on appeal, and the case dismissed, because federal courts do not have jurisdiction to enjoin state tax laws. Cumberland Farms apparently abandoned the effort, and no other handler has taken up the gauntlet. As a result, Maine's laws continue without any dispositive judicial opinion on their lawfulness under the Commerce Clause. My personal opinion is that they would pass muster under Commerce Clause scrutiny, and that the 1st Circuit, in any event, went out on a Commerce Clause limb in the *LaFaver* because the tax was assessed entirely on in-state transactions – the sale of packed fluid milk – not bulk raw milk in interstate commerce at issue in *West Lynn*.

Maine's current procedure followed a roadmap (or loophole, depending upon the beholder) derived from the *West Lynn* opinions. The constitutional infirmity in *West Lynn* was the co-joined tax on milk produced in other states *and* subsidies paid only to in-state producers. *The* 5-judge majority opined, however, that "a pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business," and implicitly perceived no problem if the tax generating the subsidy was not assessed on interstate transactions. The concurring opinion by Scalia and Thomas went much further in approving state subsidies for in-state businesses, even if the subsidies provide demonstrable advantages to the home team. The 2-judge dissent went even further, and found the Massachusetts tax and subsidy scheme acceptable under the Commerce Clause. A milk tax and subsidy scheme under *West Lynn* and *Cumberland Farms* is most likely to avoid Commerce Clause infirmity where: (1) tax and subsidy laws are decoupled, particularly if the tax is borne heavily by interstate commerce and the subsidy is limited to in-state interests; (2) taxes are collected by state tax authorities and deposited into the general fund; (3) subsidies to in-state business are appropriated from the state's general fund, and (4) the tax is imposed on a wholly in-state transaction (such as the retail sale of packaged milk).

I have some specific comments on, and suggested edits to, the Ct. Milk Marketing Board bill.

The bill does not appear to structure the milk "premiums" to be regulated in the form of state taxes. This is a strategic mistake. If the charges are deemed "taxes" by a federal court – understanding that the label of "tax," "fee," "assessment," or "premium" does not control the inquiry, but may influence it – the federal court cannot exercise jurisdiction as limited by the Tax Injunction Act, 28 U.S.C. § 1341. In such a case, a complaint must be brought first in state court and gets to a federal court only if the U.S. Supreme Court agrees to review a decision by the state's highest court. I suggest for this reason that "premiums" to be fixed by the Board be called taxes, expressly authorized by the legislature, however politically unpalatable that may be. If the premiums are simply a form of economic regulation, a federal court will likely assume

jurisdiction and the odds of a successful Commerce Clause attack at an early state of administration is increased.

Several parts of the bill appear unnecessarily to micro-manage the conduct of the Board. For example, limiting premiums and threshold price regulation to "white fluid milk," and defining conditions under which premiums may (and shall) be promulgated. This problem is beyond my charge, but it would be better to grant general authority to the Board and allow the Board to work within the range of authority delegated. Some changes are suggested in the edited draft, attached, but more work can be done along this line.

I suggest that the "supply channel distortion" provision be eliminated because it would very likely fail to survive Commerce Clause scrutiny. It would appear to limit a dealer's ability to exploit interstate sources of milk for economic reasons, including mitigation or response to Connecticut's regulations designed to protect local producers. It is interference with interstate commerce, whether the actor's conduct is economically rational or not to the Board, that is the problem here. It does not matter in this analysis that commerce from production areas close to Connecticut are treated equitably. It is precisely because some suppliers distant from Connecticut may be disfavored by application of this section (or because a local buyer may be restricted in selecting a distant supplier) that I find it troublesome. I have, however, inserted in edits a new section 4(b)(7) that authorizes regulation of unfair competition and trade practices. Perhaps the Board may come up with better anti-supply distortion rules following investigation and hearing. In any event, a rule of this type by the Board is better because it removes a potentially vulnerable element from the Act, and allows you to defer the issue until the Board promulgates its rules.

For similar reasons, I have omitted a requirement in Section 4(b)(4) that premiums redistributed to Connecticut farmers be pooled. This would raise a Commerce Clause red flag on the face of the bill by differential treatment of in-state versus out-of-state producers. It is better to allow the Board to determine the manner in which revenues are to be redistributed, thereby deferring the issue to rule promulgation and perhaps providing a system that is more likely to pass Commerce Clause scrutiny at that time. I am not aware of any judicial opinion that would preclude, for Commerce Clause reasons, award of a subsidy by one state to entities located in another. Allowing the Board to decide revenue redistribution will also permit more fully-developed legal analysis on this important aspect of the Marketing Board's authority.

In Section 8, I have substituted the word "agreements" for the word "compacts" in the bill. Compacts, as you know, require approval by Congress and use of the word "compact" is likely to doom the bill or this section. Not all agreements between states, however, require Congressional approval as "compacts." State regulation of Grade A milk quality standards, for example, is coordinated by NCIMS under nominal oversight by the FDA, with reciprocity given to approval in other states. States routinely adopt uniform or coordinated laws and law enforcement practices after consulting with each other, and work through organizations such as the National Association of State Departments of Agriculture for this purpose. States are certainly not precluded by the Compact Clause from consulting with each other to fix consistent regulation of milk prices in the same manner that corporations are precluded by antitrust laws from getting together to coordinate their sale or purchase prices.

If *Eisenberg* is given new life, for example, states might agree to regulate minimum prices for raw milk originating on farms within the jurisdiction of the regulating state and destined for

export. To take advantage of this potential opportunity, I have added a new subsection 4(b)(6). Reciprocal regulation in other states would allow all milk to be price-regulated, regardless of its origin. Whether states may thereafter authorize export and import of funds created by price regulation in order to provide proceeds to farmers across state lines raises another question. The closer such a system comes to tax and appropriation, the more likely state rights advocates in the Supreme Court will find it acceptable.

I have no Commerce Clause comment on the retail price threshold proposal. It appears on its face and effect to regulate only in-state transactions, and does so in a uniform way. That is not to say that it would not face a *Pike v. Bruce Church* challenge by an affected dealer represented by innovative counsel. But this has not, notably, happened yet in New York.

You did not ask my opinion on the wisdom or efficacy of the three bills, or of regulations the Marketing Board may adopt pursuant to statutory authority. Having devoted 33 years of law practice to the arcane subspecialty of economic regulation of the dairy industry, I do have strong opinions on statutory and regulatory merit, but that is beyond the scope of my assignement.

I hope these comments are helpful to you.

Sincerely,

John H Vetne

Attachment:
Edited Milk Marketing Board bill

Draft Dec. 18, 2006

An Act Concerning the Establishment of a Connecticut Milk Marketing Board

Section 1 (NEW)

Purpose of the Connecticut Milk Marketing Board

It is in the public interest of the citizens of this state to promote and ensure an adequate supply of fresh, wholesome white fluid milk products at reasonable prices to consumers and to dairy farmers. The Milk Marketing Board shall serve the public interest by monitoring the supply and availability of raw farm milk, and the cost and pricing of white fluid milk products at the farm, dealer (wholesale) and retail levels in the state of Connecticut, and by promulgating policies and regulations that 1) promote the supply of such products by enhancing the price to farmers that supply milk to the state when on-farm economic conditions, including but not limited to low raw fluid milk prices, threaten the availability of fresh milk or the viability of farms that produce milk, and 2) promote consumer welfare by restraining unreasonably high retail prices.

Section 2 (NEW)

Definitions as used in this act.

(1) "Books and records" means any book, ledger, record, account, memoranda or other data pertaining to the purchase and distribution of milk.

(2) "Board" means the Connecticut Milk Marketing Board

(3) "Consumer" means any individual who purchases milk for fluid consumption on or off the premise.

(4) “Department” means the Connecticut department of agriculture.

(5) "Market" means any city, town or parts thereof of this state.

(6) "Milk" means the lacteal secretion of a healthily bovine animal and includes but is not limited to whole milk, skim milk, partially skimmed milk, flavored milk and buttermilk.

(7) “White fluid milk” does not include flavored milk, buttermilk, lactose free milk, and low-carb milk.

(8) "Person" means any individual, partnership, firm, corporation, association or other unit created to conduct business in this state, including state and municipal owned and operated institutions.

(9) "Producer" means any person who produces milk and sells such milk only to dealers.

(10) "Dealer" means any person who purchases or receives milk for sale as the consignee or agent of a producer, or handles for sale, shipment, storage or processing and shall include a

producer-dealer and a sub-dealer, but shall not include a store other than an integrated operation.

(11) "Integrated operation" means a person who is a dealer and who also sells at retail the milk which he handles for sale, shipment, storage or processing within this state.

(12) "Producer-dealer" means a dealer who processes and sells milk of their own production.

(13) "Sub-dealer" means any person who does not process milk and who purchases milk from a dealer and sells such milk in the same containers in which he purchased it, but shall not include a store or a person that sells milk for consumption on premise.

(14) "Store" means a grocery store, dairy product store, canteen, milk vending machine operator, milk dispensing operator or any similar commercial establishment or outlet or any other sale where milk is sold to consumers for consumption off the premises.

(15) "Retail sale" means a doorstep delivery and over-the-counter sales by stores.

(16) “Retail store” means a grocery store, dairy product store, or any similar commercial establishment where milk is sold to consumers for consumption off the premises.

(17) "Wholesale sale for on premise consumption" means sale by a dealer to any person, that is not a store, that sells milk for on premise consumption.

(18) "Base price" means Federal Milk Market Order 1 statistical uniform price plus cooperative premiums for 3.5% butterfat milk at Hartford, Connecticut.

(19) "Target price" means the average short run break-even price for Connecticut producers.

(20) “Raw fluid supply price” equals the base price plus any payment per hundredweight by the Board to Connecticut farmers.

(21) “Raw fluid pay price” equals the base price plus any premium paid that is mandated by the Connecticut Milk Marketing Board.

Section 3 (NEW)

Connecticut Milk Marketing Board, organization.

(a) Members. The Connecticut Milk Marketing Board shall consist of the following 5 members:

(1) The Commissioner of Agriculture or the Commissioner’s designated agent, ex officio; and

(2) four members, who must be residents of this state. Each shall have no financial interest in the production, processing, distribution or sale of milk products including but not limited to fluid milk products. Each shall be appointed by the Governor, subject to review by the executive and legislative nominations committee of the legislature and subject to confirmation by the legislature.

(b) Members of the Board appointed under subsections (a)(2) and a(3) of this section, shall serve for a term of four years or until their successors are duly appointed and qualified, except that the initial terms of these members are for one, two, three or four years so that the terms of the members of the Board are staggered. A vacancy in the membership of the Board shall be filled by appointment by the Governor.

(c) The members of the Board shall elect a chair. The Board shall employ an executive director, and other employees as the Board determines necessary to assist in the execution of the Board's policies. Such employees shall be considered designated agents of the Board and may argue cases and bring actions before the Board, recommend action to be taken by the Board; present evidence and provide the Board with expert opinions and information. The Board may also seek outside expert services in areas including but not limited to the law, and economics of milk marketing.

(d) The Board shall maintain a suitable office with all necessary equipment and supplies. Each of the members of the Board appointed under the subsection (a)(2) of this section shall receive one hundred dollars for each day the member attends a meeting of the Board plus reasonable travel expenses.

Section 4 (NEW)

Board powers, general.

(a) The Board shall set a target price at Hartford, CT that is deemed sufficient to maintain and promote the state's dairy farming industry. . The Board shall review the target price level on a quarterly or monthly basis taking into consideration changes in the costs of producing fluid milk and the economic well being of the State's dairy farming industry.

(b) The Board shall act as follows:

(1)The Board may hold hearings that elicit testimony from interested parties to gather facts and information.

(2) Whenever the price received by milk producers in this State falls below the target price the Board may ascertain, determine and fix a system of milk taxes or assessments for the various classes and types of white fluid milk sold in this state; and collect such taxes or assessments from retailers or dealers that supply retailers, and from dealers for wholesale sales for on premise consumption.

(3) The Board shall use a portion of collected taxes or assessments to cover the administrative costs of the Milk Marketing Board.;

(4) The Board shall on a monthly basis distribute or provide a method for distribution of funds collected, net of administrative costs, to farmers that supplied milk to the plants that distribute white fluid milk in Connecticut.

(5) The Board shall have authority to limit unconscionable high retail prices and flat milk pricing across white fluid milk with different butterfat content in retail stores. To do this the Board may set a retail threshold price level to be expressed as a per cent markup over the Raw Fluid Pay Price at Hartford, CT for each type of white fluid milk. The Board may require

retailers to show cause and justify prices above the threshold level by documenting that costs, including the wholesale price, plus a reasonable return on investment, requires above-threshold retail prices. If such cost justification is absent the Board shall find the party in violation of this law and assess civil penalties in an amount not exceeding $ X per day per retail store until such illegal pricing ceases.

(6) The Board may establish and fix, or provide a method for fixing, minimum prices to be paid by dealers that purchase raw milk from producers in this state.

(7) The Board may promulgate regulations incidental to, and not inconsistent with, the terms and conditions specified in this Act and necessary to effectuate the other provisions of regulations issued by the Board, including but not limited to regulations prohibiting unfair methods of competition and unfair trade practices in the purchase, sale, or distribution of milk and fluid milk products.

(c) In administering this act the Board may:

(1) subpoena and examine under oath persons whose activities are subject to the jurisdiction of the commission, including producers, dealers and stores and their officers, agents and representatives; and

(2) subpoena and examine the business records, books and accounts of persons whose activities are subject to the jurisdiction of the commission, including producers, dealers and stores and their officers, agents and representatives.

(d) Any officer of the Board and any agent designated by the Board may sign subpoenas and administer oaths to witnesses.

(e) The Board shall have authority to ensure that milk dealers and milk distributors give up to 30 days' notice before terminating delivery to any customer in their delivery area or in the delivery area of a milk dealer or milk distributor they have purchased. Any notice limitation adopted by the Board shall not apply to cancellation of milk delivery resulting from a failure to pay bills.

(Section 6 (NEW)

Board meetings.

(a) The Board shall:

(1) Meet at least quarterly;

(2) keep a record of all its proceedings;

(b) The Board chair may call special meetings of the Board whenever the chair determines a special meeting is necessary or a special meeting has been requested in writing by two or more members of the Board.

(c) The Commissioner of Agriculture or the Commissioner's designated agent shall have no vote except to break a tie.

Section 7 (NEW)

Reporting, records.

Every producer, producer cooperative, milk handler, milk dealer and store shall keep and render to the Board, at such times and in such manner and form as may be prescribed by the rules of the Board, accounts of all business transacted that is related to the production, purchasing, processing, sale or distribution of milk. Such accounts must reasonably reflect, in such detail as the Board considers appropriate, income, expense, assets, liabilities and such other information as the Board considers necessary, to assist the Board in making its determinations.

Section 8 (NEW)

Interstate conferences and agreements.

The Board shall have power to enter into agreements with legally constituted milk commissions or similar authorities of other states or of the United States of America to promote coordination and uniformity in regulating, and insuring an adequate supply of, pure and wholesome milk to the inhabitants of this State. .

Section 9 (NEW)

Administrative enforcement.

When the Board, after such investigation as it considers appropriate, believes that a violation of this act, or of any regulation, order or decision of the Board has occurred, the Board may by majority vote, order any person to cease that violation. When issuing any order, the Board shall notify any person who would be aggrieved by the order of their right to a hearing. If a person is aggrieved by an order of the Board, the aggrieved party may request a hearing; such hearing shall be held within thirty days of the date of the hearing request. After such hearing the Board shall publish it's findings and issue a final order within thirty days. Any person aggrieved by a final order issued pursuant to this section may obtain judicial review of the order in the Superior Court for Judicial District of Hartford in Hartford. In responding to such a petition, the Board may seek enforcement of its order, including civil penalties for any violation found, and the court, if it upholds the order, may order its enforcement, including civil penalties.

Regulations.

The Board shall adopt regulations to carry out the provisions of this act and regulations that establish procedures to enable the Board and agents authorized by the Board to inspect the records, books and accounts of milk dealers, milk distributors, milk producers and stores selling milk in a location acceptable to the Board.

Section 10 (NEW)

Section 22-231 is repealed and the following substituted.

Grounds for refusal, suspension or revocation of license.

The Commissioner of Agriculture may refuse to grant or renew a license, or may suspend, revoke or refuse to transfer a license already granted, after the commissioner has determined that the applicant or dealer: (1) Has failed to comply, or has been a responsible member or officer of a partnership or corporation which failed to comply, with any provision of this part or any order, ruling, regulation or direction issued hereunder; (2) has insufficient financial responsibility, personnel or equipment to properly to conduct the milk business; (3) is a person, partnership, corporation or other business entity, in which any individual holding a material position, interest or power of control has previously been responsible in whole or in part for any act on account of which a license was or may be denied, suspended or revoked under the provisions of this part; (4) has failed to file a bond required by the commissioner under the provisions of this part; (5) if located out of the state, has failed to obtain a satisfactory milk sanitation compliance rating from a certified state milk sanitation rating officer or is not in compliance with all laws and regulations of the state pertaining to health and sanitation in the production, processing, handling or sale of milk; (6) has rejected, without reasonable cause, any milk purchased from a producer, or has refused to accept, without either reasonable cause or reasonable advance notice, milk delivered by or on behalf of a producer in ordinary continuance of a previous course of dealing, except when the contract has been lawfully terminated; provided, in the absence of an express or implied fixing of a period in the contract, "reasonable advance notice" shall be construed to mean not less than one week nor more than two weeks; (7) has continued in a course of dealing of such nature as to show an intent to deceive, defraud or impose upon producers or consumers; (8) has violated any stipulation or written agreement entered into with the commissioner in the course of any proceeding under this part; (9) has made a false material statement in his application; [or] (10) has failed to provide information required under this chapter[.]<u>; or has failed to comply with the provisions of this act or any order, rule, or regulation of the Connecticut Milk Marketing Board.</u>