ECONOMICS INFORMATION REPORT

REVIEW OF MILK REGULATION AND COURT DECISIONS IN NORTH CAROLINA AND THE SOUTHEAST

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ECONOMIC RESEARCH REPORT NO. 49
DEPARTMENT OF ECONOMICS AND BUSINESS
NORTH CAROLINA STATE UNIVERSITY AT RALEIGH

ERR 49 FEBRUARY, 1985

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Economic Research Report No. 49
Department of Economics and Business
North Carolina State University at Raleigh

February, 1985

Acknowledgements: Funding for this research was provided by the North Carolina Agricultural Research Service. Special thanks are due Dr. Richard A. King for his reviews, guidance, and assistance. I would also like to thank Geoff Benson, Daniel Sumner, and Richard Perrin for their reviews. In addition, the staff of the North Carolina Milk Commission, including Grady Cooper and Neill Sinclair, have generously supplied much valuable information. This paper should be seen as a contribution to the USDA project S-166: The Impact of Changing Costs, Institutions, and Technology on the Southern Dairy Industry. All opinions, analyses, and conclusions are solely mine and are not intended to represent the views of any group or organization.

Abstract

Milk regulation in North Carolina is extensively analyzed, including regulations affecting producer prices, classification of milk, base provisions, and interplant and interstate milk movements. Also reviewed are regulations affecting processor and retailer prices, the rationale for milk regulation, and some aspects of federal marketing orders. In addition, there is a legal analysis of the leading constitutional court challenges to state milk commissions in the Southeast. In several instances state milk commissions have had their regulations declared unconstitutional because of the Interstate Commerce Clause in the U.S. Constitution.

Key Words: Milk regulation, state milk commissions, Interstate Commerce Clause.

REVIEW OF MILK REGULATION AND COURT DECISIONS
IN NORTH CAROLINA AND THE SOUTHEAST

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Review of Milk Regulation and Court Decisions in North Carolina and the Southeast

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I. Introduction

Virtually all fluid grade (or Grade A) milk produced in the United States is subject to extensive regulation. About two-thirds is regulated under federal milk marketing orders, while most of the remainder is regulated under state milk commissions. North Carolina Grade A milk production is regulated by the North Carolina Milk Commission (Commission), established in 1953. Virtually all milk produced in North Carolina is Grade A milk.

Milk regulation in North Carolina is both extensive and complex. It involves sanitation grades, regulation of producer prices, processor prices, retail prices, interstate milk movements, base plans and transfers, distributor licenses and many other aspects of milk marketing. In what follows, an attempt is made to articulate North Carolina milk regulation in a manner that is technically correct but not so detailed that only milk aficionados can follow.

In this paper, there are two foci of attention. First, current regulations regarding prices paid to dairy farmers are examined. This examination entails a discussion of the rationale for the North Carolina Milk Commission. Milk marketing in North Carolina before regulation is examined and some of the major changes in regulation from 1953 until the present are highlighted.

In the second part of this paper, the focus is upon constitutional legal challenges to milk

commissions in the Southeast and to the North Carolina Milk Commission. A number of milk commissions in the Southeast have had their regulations declared unconstitutional. In several instances where state milk regulation laws have been declared unconstitutional, federal milk marketing orders have followed and replaced the state milk commission. The Commission's regulations have been and are currently being challenged in state and federal courts.

A short review of regulation of dairy processors, distributors, and retailers is contained in the appendix. Also in the appendix are a chronology of major regulatory changes and a glossary of terms.

Throughout this paper, readers should keep in mind that the main features of milk regulation in North Carolina were fashioned in the early 1950s. Since that time, significant technological innovations have occurred in the industry. In particular, fluid milk now can be stored longer and transported more easily. In federally regulated areas, the response to improved transportability of fluid milk has been the merger of smaller federal milk orders into larger orders. In states regulated by milk commissions, the effect of improved transportability of fluid milk often has been court litigation. Not infrequently, regulations promulgated by state milk commissions have been declared unconstitutional because the courts ruled they were unreasonable burdens on interstate commerce.

A purpose of this paper is to inform policy makers of the substance of state milk regulation. Additionally, those in the industry should have an awareness of the main features of milk

regulation and an appreciation of the liklihood of regulatory change.

II. Milk Marketing In North Carolina Before 1953

An appreciation of milk marketing conditions in North Carolina before 1953 is helpful in understanding the current regulation. World War II created an upheaval in milk marketing in North Carolina. North Carolina changed rapidly from a situation in which dairy farmers typically used milk they produced on their farms for butter and cream production and/or processed and retailed fluid milk themselves, to a situation in which most dairy farmers sold raw milk to commercial processors. For example, in 1939 North Carolina Board of Health records show that there were 687 milk producers who retailed their own milk. By 1948 that number had dropped to 166.[1] Production of butter by North Carolina dairy farmers declined steadily between 1929 and 1944 while the percentage of milk sold to processing plants for fluid consumption rose sharply over the same period. Both of these trends were accelerated during the war years.[2]

During the late forties, a substantial portion of fluid milk consumed in North Carolina was imported from out-of-state sources. For example, in 1947 about 15 percent of Grade A milk consumed in the state was produced out of state.[3] Given a reasonable reserve for seasonal demand shifts of, say, 20 percent, North Carolina was termed a "deficit" market in the late 1940s. A surprising feature was not only the volume of out-of-state milk, but also the sources. Milk shipments on a regular basis originated from as far away as Illinois, Ohio, and Pennsylvania.[4]

Given the substantial inflows of milk, the price surface in North Carolina reflected the cost of obtaining alternative sources of milk. Milk prices increased from west to east and from north to south.[5]

Market Stability

During the late forties, there was a good deal of experimentation was taking place in milk regulation, at both the state and federal levels. Essentially, during the 1940s, in the dairy industry nationally and in North Carolina, three related problems lead to "instability" or high riskiness in dairy production without regulation. First, fluid milk was neither storable nor easy to transport. Second, supply and demand were seasonally unsynchronized, and finally, an equitable means of sharing the cost of springtime surpluses of Grade A milk was difficult to implement without regulation.[6] Various economists have characterized "instability" in milk marketing many ways, but it should be noted that milk is extensively regulated throughout the world and not just in the United States.

Since fluid milk could not be stored, there was always a problem of disposing of surplus Grade A milk during the spring and early summer. In areas that relied on out-of-state sources for "winter" milk, there was considerable pressure from out-of-state suppliers on North Carolina receiving plants to receive this milk year-round. Except for cooperatives, milk plants in North Carolina typically did not have written contracts with either in-state or

out-of-state producers to buy their full supply of milk throughout the year.[7]

The price commanded by excess Grade A milk often was less than 50 percent of the price paid for milk used for fluid products. In 1948 and 1949, out-of-state milk used for fluid purposes in central North Carolina received prices per cwt. of $7.12 and $6.51, respectively. In-state cheese milk received an average of $3.92 per cwt. in 1948 and $2.91 per cwt. in 1949. Local Grade A milk during the same years was priced at $6.21 and $5.99 in central North Carolina.[8] Given the magnitude of this price differential, the Grade A dairy farms not receiving the fluid milk product's price during the spring, suffered substantial decrements in revenue.

Profitability of Milk Production Without Regulation

Before regulation, 71 percent of the Grade A farmers identified dairying as the most profitable enterprise in relation to time spent at the activity.[9] Most of these farmers also produced crops and livestock, and dairy production was deemed the most profitable by a wide margin. The next most profitable farm activity was tobacco, listed as most profitable by 22 percent of the farmers polled.[10] The fact that dairy production in North Carolina was listed as the most profitable activity by most farmers is also consistent with the widespread perception that dairying was among the most risky of farm activities. The average rate of return typically is higher in risky activities to compensate for the additional risk.

The Cotton Report

A report by Dr. Walter Cotton in 1950 presented many recommendations for the regulation of milk that were adopted by the North Carolina legislature in the 1953 act that established the North Carolina Milk Commission.[11] Specifically, he recommended that Class I prices (prices for fluid milk products) be based on a composite index composed of all farm prices, cost of production indices for dairy production, the prices of manufacturing (or Grade B) milk, and federal order blend prices in Philadelphia and Chicago. He suggested that Class I prices be adjusted based on the percentage of Class II milk (milk used to produce nonfluid dairy products). He also suggested that North Carolina milk prices be aligned with out-of-state prices for Class I milk, and proposed higher prices for milk produced east of Raleigh.[12] This recommendation has not been adopted by North Carolina milk regulators.

Dr. Cotton proposed that milk regulation take place through a milk commission. He discussed the merits of combining classified pricing with producer base plans and individual plantwide pooling.[13] Such a combination would reduce production seasonality and provide for a sharing of the costs of surpluses. He also contended that transfers of milk between plants should not be allowed as a vehicle to lower Class I prices. Most of Dr. Cotton's recommendations have been enacted into law either through statute or through regulations issued by the North Carolina Milk Commission.

III. Establishment of North Carolina Milk Commission

Goals of Regulation

Before analyzing North Carolina milk regulation in more detail, it is relevant to examine the goals of the regulation as stated in the preamble to the North Carolina Milk Commission Law. In the original 1953 preamble, "milk is a primary and necessary food....and it is necessary that there shall be constantly available a uniform and adequate supply of wholesome milk..." Later in the preamble it is stated that "...it is necessary for the safety, health, and welfare of the people of this State that this industry be subjected to some governmental restrictions, regulations, and methods of inspections." These governmental regulations are necessary to prevent "...unfair, unjust and destructive trade practices...." According to the same preamble, experience has shown that milk is subject to "a great deal of fluctuation in price and destructive and dangerous practices...." which cannot be avoided by health regulation alone. The preamble relates disorderly marketing directly to the perishability of fluid milk which is easily contaminated and cannot be stored. Among the evils to be avoided by regulation are prices below costs and "sudden invasions of an orderly marketing area with cut-throat competition."

A major revision of milk regulation occurred in 1971 and some of the new concerns of regulators are reflected in the revised preamble. The first paragraph of the revised preamble notes that in the past most of the members of the North

Carolina Milk Commission have had direct involvement in milk production or milk sales (see Table 1). The revision in 1971 requires a majority of the Commission's members to be "public" members. A public member is defined as a person who has no direct interest in the production or sale of milk. In 1975 the composition of the Commission was changed again to require that 5 of the 10 members on the Commission be either producers, processors, or retailers and the other 5 to be "public" members.

The remainder of the revised 1971 preamble is similar to the original 1953 version except that the reasons for regulation are more specifically delineated. Thus, the 1971 preamble repeats the 1953 wording in declaring that government regulation is necessary "...to suppress unfair, unjust, and destructive trade practices." Also identified as undesirable is the use of milk as a "loss leader" by retail grocery establishments. Such practices have the effect of causing some distributors and producers to become bankrupt, thus leading to a few giant firms "(which fact has been demonstrated in neighboring states to the south)".

Powers of the Commission

Powers of the North Carolina Milk Commission are defined by state statute and the statute specifically allows the Commission to fashion its own regulations. Among the Commission's enumerated powers are the power:

(1) To confer with regulatory authorities in other states to make uniform milk regulations.

Table 1

Composition of the North Carolina Milk Commission
1953 to Present

Years	Dairy Farmers	Distributors*	Retailers	Public
1953-55(7)	2	2	1	1+Comm. of Agriculture
1955-71(9)	2	2	1	3+Comm. of Agriculture
1971-75(7)	1	1		5
1975-present (10)	2	2	1	5

*Distributors: The term distributors includes processors of fluid milk.

Source: N. Allen, "Milk Regulation in North Carolina: More Than a Lot of Bull," North Carolina Insight, Spring, 1980: p. 13.

(2) To investigate the production, processing, storage, distribution and sale of milk.

(3) To supervise and regulate the transportation, processing, storage, distribution, delivery and sale of milk provided that there be no limits placed on the quantities produced by existing producers or prohibitions of new producers. The Commission is also given the power to classify milk according to use and the power to approve base plans for allocating the classes of milk. The Commission is also given the power to pool milk receipts on a marketwide or statewide basis and may provide for equalization payments in order to obtain the highest utilization possible for producers. (Producers are earlier defined as dairy farmers within the State).

(4) To act as mediator in issues that arise among and between producers and distributors.

(5) To examine the books of any producer, association of producers (cooperatives), or distributors, their affiliates and subsidiaries. The Commission is given the power to subpoena both documents and people.

(6) To take depositions of witnesses.

(7) To make, adopt, and enforce all rules, regulations and orders necessary to carry out the purposes of the statute.

(8) To exercise its powers only if it calls a public hearing and determines that regulation is in the public interest. The impetus for the hearing may arise from the Commission itself, from producers, or from distributors.

(9) To fix prices paid to producers and/or producer cooperatives and may fix different prices for different classes or grades of milk;

(10) To fix maximum and minimum wholesale and retail prices of milk depending on grade or class;

(11) To consider costs in determining prices paid to producers. The Commission may adopt a formula which will move prices automatically. If the Commission adopts a formula, it must call for a public hearing.

(12) To require all distributors to be licensed by the Commission. Distributors are defined as persons in the business of distributing, marketing or in any manner of handling fluid milk. This definition includes processors of fluid milk. The Commission may decline to grant or suspend or revoke a license already in force whenever an applicant or licensee violates regulations adopted by the Commission. Among the grounds for revocation are that a distributor failed to maintain records as required by the Commission's rules and regulations.

(13) To define after a public hearing a natural-market area and to define and fix limits of the milk shed within which milk shall be produced to supply any such area; provided that producers and producer-distributors now shipping milk to any market may continue to do so (G.S. §106-266.8).

Given the goals of milk regulation as explained in the preamble, it would seem that the enumerated powers of the Commission are sufficient to enable it to accomplish those goals. A primary goal of milk regulation is ensuring "...a uniform and adequate supply of wholesale milk." An adequate supply can be achieved through the Commission's price-setting powers, since the supply of milk is directly related to its price. Supply uniformity is accomplished through base plans and classified pricing of milk, which are described below. The Commission can prevent "...

unfair, unjust, and destructive trade practices..." through its price setting powers, its inspection of records powers, its power to license distributors and regulation of nonprice competition. These same powers can also be used to stop the use of milk as a "loss leader" by retailers. Retailers, however, are not licensed by the Commission. Finally, the preamble identifies "...sudden invasions of an orderly marketing area..." as a manifestation of the market chaos that occurs without regulation. The power of the Commission to classify milk prohibits these "invasions."

IV. Regulation of Producer Prices

Classified Pricing

The most characteristic feature of milk regulation is classified pricing. Physically indistinguishable Grade A milk is priced differently to distributors (processors) depending on the ultimate use made of the milk. Grade A is the highest sanitation grade milk can receive, and only Grade A milk can be sold for human consumption in fluid form. Manufacturing grade or Grade B milk is the next highest sanitation grade and both Grade A and Grade B milk can be sold for human consumption if they are sold as manufactured milk products such as butter, cheese, ice cream, or other nonfluid dairy products.

Almost all of the milk produced in North Carolina is Grade A milk. Milk sold for human consumption in fluid form is designated Class I milk.[14] Grade A milk used to produce a manufactured milk products such as butter, cheese, or ice cream receives a Class II designation. Class

I milk is always priced higher than Class II milk and the amount by which the Class I price exceeds the Class II price is called the Class I differential. Although distributors must pay separate prices for milk depending on the use (Class I or Class II) made of the milk, producers receive a single price called a blend price for all milk sold. The blend price is simply a weighted average of the Class I and Class II prices.

There are several justifications for the classified pricing. There are greater costs associated with producing raw fluid milk relative to manufactured milk products. Also, since the demand for fluid milk is very inelastic (most estimates fall between -.15 and -.30) and the demands for manufactured milk products are much more elastic, classified pricing of milk will increase producer revenues relative to single price for all Grade A milk.

In addition, classified pricing provides market stability. If we ignore recent technological advances such as UHT (ultra-high temperative pasturization) milk, and reconstituted milk (milk in which the water is separated from the other ingredients and later added back) fluid milk is very perishable. Given constant raw product prices, an adequate supply of fluid milk in the fall necessarily generates a surplus in the spring. In the period before regulation, the rapid perishability of fluid milk precluded the storage of spring surpluses for use in the fall. The "unfair, unjust, and destructive trade practices" referred to in the preamble, occurred during the spring as processors often abruptly terminated their purchases from some producers

when there was a surplus of Grade A milk. Producers who were cut off in spring had to try to find outlets for their milk in butter and cheese plants or with other processors in distant areas or they had to slaughter their herds.

Given the perishability of fluid milk, an effect of classified pricing is that the lower springtime percentage of Class I milk is shared by all the producers in an area. The dislocations that accompanied abrupt cut offs of some producers by fluid processors are less likely to occur because with classified pricing, surplus Grade A milk receives a lower, Class II price. In most areas regulated by federal marketing orders, all producer receipts in the order are pooled and each producer receives a single blend price. In other words, the price all producers receive depends on the Class I and II prices in the order and on the marketwide percentage of Class I and II milk. In North Carolina, producer receipts are pooled by plant even though the Commission has the authority to require pooling on a marketwide or statewide basis. The effect of plantwide pooling in North Carolina is that the price a producer receives depends on Class I and II prices announced by the Commission and on the percentage of Class I and II milk at that plant.[15]

In short, minimum milk prices for producers are based on the class of milk. Class I milk is generally milk consumed in fluid form, whereas Class II milk is made into manufactured milk products. For milk produced, processed, and sold in the state of North Carolina, the Commission sets Class I and Class II prices. If milk is produced in North Carolina but sold to a

processor out of state or sold to an in-state processor, and the processor sells packaged milk out of state, then the Commission requires that the prices received by those in-state producers are those established by the appropriate out-of-state milk authorities (4 NCAC 7.0507). Virtually all of the milk produced in North Carolina that is shipped out of state is sold in South Carolina or in federal order markets 7 (Georgia) or 11 (Tennessee Valley).

Class II Price Formula

For in-state milk, the Commission is empowered to use a formula for setting Class I and Class II prices. The current formula for setting Class II milk prices is based on a price series used by USDA called the Minnesota-Wisconsin (M-W) price series. The M-W price is determined from a survey of prices paid by butter and cheese plants in the upper Midwest for manufacturing grade milk. Such milk is designated Grade B milk in federal marketing orders. Recall that Class II milk is "surplus" Grade A milk used to manufacture storable dairy products such as butter and cheese and ice cream. Since manufacturing grade milk is a perfect substitute for Class II Grade A milk, the M-W price series is used to set Class II prices. Regulation 4 NCAC 7.0507(3) calls for averaging the M-W price with two Chicago-based price series for butter and nonfat dry milk powder adjusted to a price per hundredweight (cwt.) basis. The regulations also require an adjustment in price based on butterfat content, with 3.5 percent butterfat representing the standard.

An often used economic definition of a market is an area in which a single price prevails with adjustment for space, form, and time. The effect of using this formula for setting Class II prices is that North Carolina Class II prices are about the same as manufactured milk prices in the rest of the country since Class II prices in federal marketing orders are also based on the M-W price. This recognizes that the markets for butter and cheese and other nonfluid dairy products are national because of their relatively low transportation costs and the fact that they can be stored.

Class I Formula

For in-state Class I milk, the statutes allow the Commission to adopt a formula based on costs of production, distribution, and sanitary regulations (G.S. § 106-266.8(10)(d)). Regulation 4 NCAC 7.0507 defines a formula for setting Class I prices. The Commission, however, reserves the right to suspend any price movement indicated by the formula. G.S. § 106-266.8(10)(d) requires that the Commission hold a hearing if such a formula is adopted or amended, but no hearing is required to validate a price movement indicated by the formula.

The current formula for Class I prices as given by regulation 4 NCAC 7.0507 is based on a composite index. The elements of the composite index are:

1. An index of prices paid in North Carolina for 20 percent dairy feed as computed in "North Carolina Farm Report," Federal-State Crop and Livestock Reporting Service, NCDA/USDA.

2. The formula index of prices paid for production items, interest, taxes and wage rates in the United States as computed by USDA in a publication titled, "Agricultural Prices."

3. The formula index of consumer prices as reported by the Bureau of Labor Statistics.

4. The formula index of producers' prices as reported by the Bureau of Labor Statistics.

5. The formula index of earnings in N.C. manufacturing plants as published in "North Carolina Labor Market Newsletter," Employment Security Commission of North Carolina.

The Class I price currently is adjusted quarterly and effective August 6, 1984, the Class I price was $16.34 per hundredweight (cwt.) for milk containing 3.5 percent butterfat. The next quarterly adjustment was to have taken place in October 1984.

To calculate changes in the Class I price, the Commission uses the following formula based on the composite index:

$\frac{x_t - x_{t-3}}{x_{t-3}} \times 0.80 \times IP_{t-3}$, where x is the composite index,

t is time in months, and IP is the current Class I price. Basically, the formula changes Class I prices by 80 percent of the changes in the composite index.

The indicated price change is subject to the following constraints or adjustments:

1. If the change in formula Class I price in a previous quarter is less than 15 cents/cwt., then a carryover adjustment is made.

2. If the Class II utilization rate is more than 12 percent, then the increase in the Class I price shall be reduced by 20 cents/cwt. If the effect of this "Supply Mover" is to reduce the change in the Class I price to less than 15 cents/cwt., then the Class I price will not be changed and the carryover procedure (1. above) is used in the next quarter.

3. If the Class II utilization rate is less than 4 percent, then the Class I price is raised by an additional 20 cents/cwt. The carryover procedure is implemented if the indicated Class I price movement is less than 20 cents/cwt.

4. If the resulting North Carolina Class I price exceeds by 3 percent a simple average of the latest Class I prices announced by the Commission to be paid to farmers for packaged sales in South Carolina, Virginia and the Tennessee Valley federal milk order, then the price movement is suspended or snubbed at that point. The same procedure works in reverse if the formula indicates a price decrease 3 percent lower than this three-state average price.

These adjustments in the Class I price are based on supply and demand. The Class II utilization rate indicates the amount of surplus Grade A milk available. If that rate is less than 4 percent, then supply is considered to be tight and it is appropriate to raise Class I prices as a signal to producers to increase production. This same logic provides the rationale for Class

I price decreases when the Class II utilization rate is greater than 12 percent because production is too great. Prices of milk in other states also change the formula price since out-of-state milk is an alternative source of supply.

The above formula is the current method of adjusting Class I prices. In 1980, basically the same formula was used, but the multiplier was .93 instead of .80. In other words, 93 percent of the quarterly movement in the composite index was reflected in Class I price changes. There have been several modifications to this formula since it began in 1977.

Relationship to National Prices and Policies

North Carolina milk prices are linked to national milk prices and policies in a number of ways. Class II prices in North Carolina are set by use of the same price series (M-W price) used to set Class II prices in federally regulated areas. The M-W price is quite sensitive to national price support policies. On January 31, 1984, the Commission announced a reduction in the Class I price in North Carolina because of a 45 cent/cwt. drop in the M-W price.[16] The M-W price dropped because the 1983 Dairy and Tobacco Act lowered the support price by 50 cents/cwt. The effect in North Carolina of lower price supports was a 45 cent/cwt. reduction in both Class I and Class II prices.

Milk Prices Received by Farmers in the Southeast and the United States.

In Table 2, blend prices in North Carolina for the last 10 years are displayed in relation

Table 2

Blend Prices of Fluid Grade Milk

St	B82	B81	B80	B79	B78	B77	B76	B75	B74	B73
Alabama	14.60	14.70	14.40	13.30	11.60	11.00	10.90	10.50	10.13	8.48
Arkansas	14.60	14.70	13.90	13.00	11.40	10.40	10.60	9.15	9.06	7.83
Florida	16.40	16.80	15.80	14.50	12.80	12.20	11.90	11.30	11.30	9.34
Georgia	14.40	14.70	14.00	12.90	11.40	10.50	10.70	9.80	9.95	8.35
Kentucky	13.80	14.00	13.10	12.10	10.70	9.90	9.90	8.70	8.56	7.37
Louisiana	14.70	14.90	14.10	13.20	11.50	10.70	11.00	10.30	9.90	8.25
Mississippi	14.30	14.50	13.90	12.70	11.20	10.20	10.30	9.55	9.25	7.94
North Carolina	14.80	15.10	14.10	12.80	11.50	11.00	10.80	10.40	10.27	8.64
South Carolina	15.30	15.60	14.50	13.20	11.90	11.40	11.30	10.60	10.35	8.70
Tenn.	13.90	14.20	13.60	12.50	10.90	10.00	10.10	9.10	9.10	7.60
Texas	14.60	14.80	13.90	13.10	11.60	10.70	10.60	9.45	9.22	8.18
Virginia	14.00	14.20	13.40	12.40	11.10	10.50	10.40	9.80	9.50	8.05
US	13.80	14.00	13.20	12.20	10.80	9.96	9.93	9.02	8.66	7.42

Source: Agricultural Prices Annual Summary, U.S. Dept. of Agriculture p. 49

to average blend prices received by dairy farmers in the Southeast and throughout the United States. Data suggest that North Carolina blend prices have been increasing recently relative to prices in these other areas. Since 1981, only dairymen in South Carolina and Florida have received higher prices than North Carolina dairymen among the Southeastern states. South Carolina's Milk Commission recently had its key regulation, its power to set minimum prices, declared unconstitutional by the state supreme court.[17] In 1979 Alabama had the highest blend prices in state-regulated areas and in 1980 its state milk commission had several key regulations declared unconstitutional. Two observations are not a firm foundation for making inferences, but with the demise of the South Carolina Milk Commission, North Carolina prices will be relatively higher, thus possibly implying increased legal vulnerability.

Base Plan Regulation

Another distinct and important feature of North Carolina milk regulation is the Class I base plan. Base plans in North Carolina must operate within the parameters set by the Commission's regulations. These rules do not guarantee an outlet for any producer's milk. Essentially, the Commission's regulations establish a method of payment for producers who do have an outlet for their milk. Regulation 4 NCAC 7.0510(e) does, however, require a processor to purchase the full supply of a base holder at the processor's plant.

Base regulations are quite complicated. Processors are allowed to fashion their own base

plans, however and most or all producers in North Carolina operate under base plans developed by processors. Such private base plans must be approved by the Commission. There are many possible variations, but the main characteristic of a base plan is to pay the Class II price for a producer's output above a certain amount. In general, the producer receives the Class I price on his base milk. There is a wrinkle in this analysis because the producer receives the Class I price only on his base milk that also receives a class allocation. A producer's base and class allocations are directly related. To calculate a producer's class allocation, the base milk of all producers at that plant are summed and divided by the total Class I sales of the processor/distributor. This ratio is then multiplied by the producer's base milk to compute the producer's class allocation. If a producer had 1000 cwt. of base and the ratio of total base at that plant to Class I sales is .9, then the producer's quota milk would equal 900 cwt. The producer receives the Class I price on 900 cwt. and production over 900 cwt. receives the Class II price.

A producer's base milk is determined by his fall production during the last three years. A producer will lose base if his production during the fall decreases. He will also lose base if he goes "off the market" by shipping some or all of his production to other processors.

In most federal orders, there are no base plans and therefore a producer receives the same blend price on all units of production. In some federal order markets, cooperatives fashion their own base plans, but these plans are not subject to regulation.

The effect of a base plan can be illustrated by an example. Suppose a dairy farmer operated in a federal milk order where:

Class I Price = $12.00 cwt.
Class II Price = $10.00 cwt.
Market-Wide Class I Utilization rate = 75 percent.

If the farmer produces 1000 cwt., his milk check will be $11,500 ([.75X12 + .25X10] X 1000). Now suppose one farmer increases production by 10 percent to 1100 cwt. With marketwide pooling, it is fair to assume that the blend price will not change with a 10 percent increase in production by one farmer. With an output of 1100 cwt., the farmer will receive $12,650 for his milk, 10 percent greater than $11,500.

Now suppose the same producer (with current output of 1000 cwt.) sells to a plant regulated by the North Carolina Milk Commission. Assume further, that the Class I and II prices are the same and Class I utilization (at the plant) is 75 percent. Now let us introduce the effect of base. Assume the producer has base equal to 800 cwt. Suppose, however, the producer's class allocation is 750 cwt. To keep the mathematics simple, suppose at this plant there are 10 producers with identical outputs of 1000 cwt. and each owns 800 cwt. of base. If the plant sells 7500 cwt. of the Class I milk products, then each producer will have 750 cwt. of quota. This computation could easily be made more complicated. Under these conditions, the producer's milk check for 1000 cwt. would be $11,500 ([$12(base milk price) X .75 + $10x.25] X 1000). Now suppose this one hypothetical producer during the summer increases production 10 percent to 1100 cwt. and again we disregard the effect of a 10 percent

increase by one producer on the utilizaion rate of the plant. The farmer's paycheck would then be $12,500 ($11,500 + 100 X 10.00), which is less than a similarly situated producer would earn in a federal order market. On the additional 100 cwt. of milk, the North Carolina producer would receive $10/cwt., whereas the producer in the federal order market would continue to earn the $11.50/cwt., the blend price.

Other things being equal, in the short term a base plan should reduce output relative to federal order blend-pricing since increases in output are paid a higher price under blend-pricing with no base plan. However, a producer's future base is determined by his current production, so the effect of a base plan on production is unclear. The data in Table 3 mildly suggest that the former effect has outweighted the latter in North Carolina. Table 3 shows that Class I utilization rates both in North Carolina and nationally have fallen during the last 10 years. This fall is primarily due to increases in price supports, which have created the huge national stockpiles of butter and cheese. In comparing federally regulated areas with North Carolina, the percentage drop in Class I utilization rates is greater in the federally regulated areas. The data suggest that North Carolina farmers, base plans might have reduced incentives to expand.[18]

Also, since producers typically earn or lose base depending on their fall production, the production and consumption for fluid milk should be more closely aligned in North Carolina than in federally regulated areas. Table 4 shows monthly Class I utilization rates for both North Carolina

Table 3

Comparison of Percentage of Class I Milk in North Carolina with Federal Order System 1974 - 1983

Year	North Carolina Class I Percent*	Federal Order Class I Percent**
1974	88.3	58
1975	88.0	58
1976	85.3	55
1977	85.2	53
1978	86.1	53
1979	86.0	51.6
1980	81.9	48.8
1981	78.7	46.3
1982	77.6	44.5
1983	77.1	44.5

* Source: U.S. Dept. of Agr. and N.C. Dept. of Agr., 37 North Carolina Dairy Report No. 1, at 6 (April 25, 1984).

** Source: U.S. Dept. of Agr., Federal Milk Order Marketing Statistics: Annual Summaries, Agr. Mkt. Serv., Wash. D.C., published annually.

Table 4

Class I Utilization Rates in North Carolina and in Federal Order Markets, 1982

Month	North Carolina*	Federal Order System**
January	75.3	46.9
February	76.7	46
March	75.9	44.8
April	77.1	43.4
May	76.1	39.9
June	77.4	40.0
July	81.2	41.9
August	77.7	43.1
September	81.7	47.4
October	80.2	47.4
November	79.8	48.9
December	72.7	46.1
Standard Deviation	2.5313	2.856
Coefficient of Variation	.0325	.0640

*Source: U.S. Dept. of Agr. and N.C. Dept. of Agr., 37 North Carolina Dairy Report No. 1, at 4 (April 25, 1984).

**Source: U.S. Dept. of Agr., Federal Milk Order Marketing Statistics: 1982 Annual Summary. Agr. Mkt. Serv. Stat.

and the federal order system. Class I utilization rates are an inverse measure of the amount of surplus Grade A milk. The lower the variability in Class I utilization rates, the more closely production is aligned with consumption and vice versa. The table shows using two standard statistical measures of variability, standard deviation and coefficient of variation, that the variability of production in relation to consumption is slightly greater in federally regulated markets.

Although base plans in North Carolina may have some attractive features in terms of controlling total supply and reducing intra-year variability, one previous study contended that base plans and plant-wide pooling unduly favor processors.[19] Professor Moorhouse contends that effective base as opposed to statutory base is controlled by processors. According to Moorhouse, a producer cannot profitably increase his base unless the processor expands his Class I sales. Statutory base tends to rise and fall with changes in the processor's Class I sales.

Transfer Regulations

Transfer provisions refer to Commission regulations governing purchases of milk by processors from dairy farmers who are not North Carolina base holders at the processor's plant. Note that North Carolina base holders can reside in other states. These regulations also govern transactions between out-of-state processors and licensed in-state processor/distributors. Under some circumstances, out-of-state milk produced by nonbase holders will not be subject to any additional charges imposed by Commission regulations. In other circumstances, North Carolina

regulations will raise the cost to North Carolina processors of purchasing from nonbase holders through provisions often labeled within the dairy industry, as "down allocations" and "compensatory payments." Down allocation provisions require that some or all of the imported milk be (down) allocated to Class II, thus raising the percentage of Class I sales attributed to local producers. Compensatory payments essentially are a tax on imported milk equal to the difference between the Class I and Class II prices or equal to the difference between the Class I price and the blend price.[20] The proceeds of the tax are distributed to producers in the importing market.

In North Carolina, there are no regulations labeled "down allocation" or "compensatory payment," but the effects of North Carolina milk regulations are similar. According to the regulations, a distributor must obtain fresh or packaged milk from producers who hold North Carolina base or from licensed distributors who purchased milk from North Carolina base holders or from other approved sources (4 NCAC 7.0505(a)(1)). If a distributor is unable to obtain a sufficient supply of Class I milk from approved sources, he should notify the Commission and the Commission will assign to him bulk milk of other North Carolina base holders. If a distributor does not notify the Commission and simply makes arrangements to procure his own supply, he must pay into an "equilization fund" an amount equal to the difference between the Class I and Class II prices times the quantity of hundredweights purchased from unapproved sources (4 NCAC 7.0505(a)(5)).

This penalty for buying from unapproved sources when local supplies are adequate is analogous to compensatory payments required in federal order markets when a handler purchases other source milk (milk from a plant not regulated under the federal system). Funds received by the equalization fund are to be distributed to North Carolina base holders who are pooled at plants where the volume of Class II milk available exceeds 8 percent. If there are no plants where Class II milk exceeds 8 percent, then the amounts assessed the importing distributor shall be remitted back to the distributor. The foundation for this provision is that imports of milk from any source should be allowed in times of genuine shortages, but when North Carolina base holders have sufficient Class II milk available, an assessment to the equalization fund will encourage purchases from local sources of milk.

Regulation 4 NCAC 7.0505(b) explicitly provides that milk sold by North Carolina base holders should receive the highest classification possible. If a plant imports other sources of milk and receives supplies from its North Carolina base holders equal to 118 percent or more of its Class I, IA, and IB sales, then all of the imported milk possible is designated as Class II milk. The imported milk in this case means any milk from sources other than base holders at the processor's plant. If the North Carolina supplies are less than 118 percent of Class I, IA, and IB sales, then the imported milk is allocated pro rata according to the Class I utilization rate at that plant. The federal equivalent of this provision is called a "down

allocation" provision. From a processor's perspective, the cheapest means of allocating milk among classes is to classify all of the imported milk as Class I. The regulations attempt to do just the opposite by requiring that North Carolina base holders receive the highest paid classification (Class 1) unless there is a shortage as defined by the 118 percent rule. If the 118 percent rule is not satisfied, then to the extent possible all of the imported milk is classified as Class II milk.

The data in Table 5 are consistent with the hypothesis that Commission regulations discourage purchases from nonbase holders.
This table does not measure imports from North Carolina base holders located in Virginia or imports of packaged milk by retailers. Table 5 illustrates the quantity of purchases from out-of-state nonlicensed processors by in-state distributors, precisely the transations affected by down allocations and compensatory payments.

On the sale or transfer of bulk milk from one distributor to another, the selling distributor must pay producers at least an amount that reflects the class-use prices plus one-half of any premiums (or prices above those set by the Commission (4 NCAC 7.0505)). The distributor can deduct handling allowances to a maximum of 30 cents per cwt. for Class I milk which is diverted at either the farm or a plant. However, no handling allowances are given for Class II milk. An additional allowance is permitted for higher transportation costs on diverted milk but the existing charges for transportation must be taken into account. If milk that is normally part of a producer pool in North Carolina is shipped to an

Table 5

Fluid Milk Imported*

	1981	1982	1983
	(Thousands Pounds)		
Imports[a]	0	1,796	0
In-State[b] Sales	1,465,265	1,511,387	1,536,043

[a]From sources other than direct from producers.

[b]Includes milk produced by resident N.C. producers regardless of where shipped.

*Source: North Carolina Dairy Report 37 (April 1984):2,5

out-of-state producer, such milk will be considered Class I milk except to the extent that the out-of-state purchaser documents use of the milk to produce non-Class I products. Conversely, for milk received by a North Carolina distibutor from another distributor, the purchaser shall furnish the seller with a utilization report.

In North Carolina, the sale or transfer of packaged milk is also regulated (4 NCAC 7.0505). Basically, all packaged milk sold by a processor to another distributor is to be classified as Class I except when processed products are from a plant in another state and when both plants are from the same regional pool or group of producers. Regulation 4 NCAC 7.0507 requires generally that all milk producers be paid the North Carolina Class I price for milk shipped to North Carolina plants. This regulation appears to call for the same price to be paid to in-state and out-of-state producers.

V. Constitutional Constraints on State Milk Regulation

The legal constraints within which state milk commissions operate are significantly different than those of federal marketing orders. The main constitutional difference is the effect of the Interstate Commerce Clause which acts as a limitation on state regulation.[21] As the U.S. Supreme Court noted in the Polar Ice Cream and Creamery Co. v. Andrews et al., Constituting The Florida Milk Commission et al. (1964), the controlling cases on the topic of state regulation of milk are Baldwin v. Selig (1935), H. P. Hood & Sons v. Du Mond (1949), and Dean Milk Co. v. Madison (1951).[22] In these

cases, state regulations of milk were held unconstitutional because of the Interstate Commerce Clause. Basically the Commerce Clause delegates to the federal government the responsibility for regulating commerce among the states and prohibits states from enacting regulations that discriminate against out-of-state businesses or unduly burden interstate commerce.

In the Baldwin case, a milk distributor in New York bought milk from farms in Vermont and transported the milk for resale in New York City. The New York State Commissioner of Farms and Markets refused to grant the distributor a license because of a state statute that forbade the purchase of milk from out-of-state producers at below-minimum milk prices set within the state of New York. The U.S. Supreme Court ruled that this state regulation was unconstitutional under the Commerce Clause because the effect of the statute was to insulate in-state producers from competition by out-of-state producers. The Supreme Court likened the minimum price requirement on out-of-state milk to the erection of a tariff equal to transportation costs.[23] Since transportation costs on out-of-state milk were higher than those for in-state milk, out-of-state milk was discriminated against.

In H. P. Hood and Sons v. Du Mond, a Boston-area milk distributor obtained much of its milk from New York. In the distribution process, Hood established three receiving depots in New York and wanted to open a fourth depot in Greenwich, New York. Hood was required to obtain a license from the New York Commission of Agriculture and Markets. The criteria for issuing a license depended on whether the area

was already adequately served and whether a new depot would promote "destructive competition." Pursuant to this provision, the Commissioner refused to issue a license. The U.S. Supreme Court viewed this refusal as a barrier to interstate commerce and struck down the New York regulations. Again, the court identified the constitutional shortcoming of these regulations as the protection of in-state economic interests at the expense of out-of-state producers.[24]

In Dean Milk Co. v. City of Madison, a processor contended that the city of Madison's health permit system was unconstitutional. Basically, the city ordinance made it impossible for farms located more than 25 miles from Madison to receive a Grade A rating, thus preventing the sale of fluid milk in the city of Madison by out-of-state dairymen. Dean Milk Co. purchased milk from out-of-state sources and was prevented from selling its milk to retailers in Madison. In striking down the health ordinance, the Supreme Court noted that the out-of-state milk did receive a Grade A rating from Chicago officials under a health statute very similar to Madison's. The court clearly indicated that it did not sympathize the practice of using health ordinances that were a disguised means of insulating a group of Wisconsin dairymen from out-of-state competition.[25]

In Milk Control Board v. Eisenberg Farm Products Co. (1939), the Supreme Court indicated that a state can set minimum prices that must be paid to in-state producers even if the milk was being shipped out of state.[26] In reconciling the Baldwin case with the Eisenberg case, the

court stated that the welfare of in-state consumers and dairy farmers was sufficient rationale for setting minimum prices even if some of the milk moved across state lines. This rationale, however, would not justify a state's requirement of minimum price for milk produced out of state and sold in state. The viability of the Eisenberg ruling has been called into question in a recent suit by Dairymen, Inc. against the North Carolina Milk Commission.[27] In their motion for a preliminary injunction, Dairymen, Inc. cites two cases that held states cannot set prices for commodities produced within the state and sold out of state.[28] Neither of these cases related to milk and both were decided before the Eisenberg ruling.

To summarize the Supreme Court rulings, the consistent theme is that economic barriers to protect in-state dairy farmers by state milk commissions will not be tolerated under the Commerce Clause. The Court has struck down pricing barriers, licensing barriers, and health barriers where the effect was to insulate in-state producers from out-of-state exporters of milk.

VI. Recent Decisions Affecting Milk Commissions in the Southeast

Court decisions since 1960 regarding state milk commissions in the Southeast are summarized in Table 6. In five out of nine states, regulations of their state milk commissions have been declared unconstitutional.[29] The Southeast increasingly is subject to federal marketing orders, generally with a two-year lag between the time the state milk commission is declared unconstitutional and enactment of a federal

Table 6

Southeastern States by Type of Regulation and Ruling on State Milk Commissions

State	Types of Regulation (Date)	CFR No.[a]	Provision of State Law Ruled Unconstitutional (Date)
Alabama	Federal Order (1981)	1093	Requirement of Purchases from Alabama base holders (1980)
Florida[b]	Federal Order (1966)	1012 1013	Down Allocation of Out-Of-State Producers (1964)
Georgia	Federal Order (1969)	1007	Contrary to State Constitution (1968)
Louisiana	Federal Order (1976)	1096	Uniform Minimum Prices for Out-of State Producers (1974)
Mississippi[c]	Federal Order (1976)	1094	
North Carolina	State Commission (1953)		Litigation Pending
South Carolina	State Commission (1953)		Uniform Minimum Prices for Out-of-State Producers (1984)
Tennessee[d]	Federal Order (1949)	1011	
Virginia[e]	State Commission (1934)		

a. CFR is Code of Federal Regulation.

b. Southeastern Florida has been federally regulated since 1957. Upper Florida became federally regulated in 1967.

c. The federal order was reinstated in 1976 after three years of unregulated competition.

Table 6 (continued)

d. Knoxville is the first area in Tennessee to be federally regulated. Subsequently, four federal orders merged to form the Tennessee Valley Order.

e. A small portion of the state is federally regulated by the Middle Atlantic Order, CRF No. 1004.

marketing order. Recent cases involving Southeastern milk commissions are examined in chronological order below. Then cases involving the North Carolina Milk Commission are discussed.

Florida

In Florida in 1963 a processor/distributor in upper Florida, Polar Cream & Creamery Co., challenged regulations of the Florida Milk Commission that required all in-state base holders to receive the highest classification possible.[30] The effect of this provision was that all in-state Florida base holders were receiving the higher Class I sales. Only if Polar was short in supplying its Class I outlets could out-of-state producers receive a Class I price. Other regulations required Florida processors to accept the full supply of any base-holding Florida dairymen for the entire year unless "just cause" was shown. Just cause could not be shown by demonstrating the availability of lower-price milk elsewhere. In effect, the Polar Co. could only obtain milk from out-of-state sources if the supplies of its in-state base holders were exhausted. Furthermore, most or all of the out-of-state milk would only be allocated to the lower Class II and Class III prices.

In ruling the Florida Milk Commission's regulations unconstitutional, the Supreme Court stated

> "These barriers are precisely the kind of hinderance to the introduction of milk from other states which Baldwin condemned as an unreasonable clog on the mobility of commerce. They setup what is equivalent to a rampart of custom duties designed to neutralize advantages belonging to place of origin. They are

> thus hostile in conception as well as burdensome in result."[31]

Within two years of this ruling, two new federal orders were promulgated in Florida.

Georgia

In 1968 a state court ruled that a Georgia Milk Commission regulation was in violation of the Georgia state constitution.[32] The regulation in question prohibited the sale of "filled" milk, which is milk that has had some nondairy fats added to it. Since there were no fraud or adverse health consequences associated with filled milk, the court ruled the Georgia Commission was without authority to issue a regulation prohibiting filled milk. In 1969 most of Georgia was regulated under a new federal order.

Louisiana

In Schwegmann Brothers Giant Super Markets v. Louisiana Milk Commission (1974) the importance of the Baldwin case was again apparent.[33] The Louisiana Milk Commission set minimum prices that it attempted to enforce on purchases for which title passed out of state. Schwegmann purchased ice milk in Tennessee at prices substantially below the minimum price set by the state milk commission. In the decision the court made its opinion clear: "This Court finds that the case of Baldwin v. G.A.F. Seelig ... [cite omitted] controls the determination of the Commerce Clause issue."[34] Following this quote, long passages from Baldwin are cited. The final outcome was that the Louisiana Orderly

Milk Marketing Law was declared unconstitutional because it set minimum prices on purchases of out-of-state milk.

Alabama

In Alabama, state regulators apparently were cognizent of Baldwin and the cases that followed. To avoid the Baldwin result, the regulations set minimum prices for all milk sold to in-state processors but declared that all sales took place F.O.B. the processor's dock.[35] However, the Alabama regulations had a provision that required processors who imported nonquota (base) milk to pay the Alabama quota holders the difference between the Alabama Class I price and the price received by the quota holder in the sale of his milk to other sources. Dairymen, Inc. analogized this regulation to a compensatory payment.[36] Also, Alabama had a down allocation provision that required a producer to hold quota in order to participate in the Alabama Class I market. About 25 percent of the quota holders were out-of-state farmers.[37]

The litigation began when Alabama Milk Producers (AMP), in-state dairy cooperative with quota holders as members, sought an injunction against a contract in which an in-state processor was obtaining milk from Dairymen, Inc., an out-of-state cooperative. Under the regulations, AMP members were entitled to all the Class I sales or the compensatory payments described above. Even though 25 percent of the quota holders were out-of-state producers, the court concluded that Alabama's quota regulation "reserves to historic Alabama producers a substantial share of the Class I milk market."

Citing Polar, Schwegmann and Baldwin, the court held that "The obstruction to commerce between the states is as clear in this case as it was in the New York system struck down in Baldwin, supra."[38]

South Carolina

In 1983, several cooperatives and processors were in violation of regulations promulgated by the State Dairy Commission of South Carolina.[39] The defendants were ignoring the Commission's minimum price regulations on Class I milk by accepting rebates or by imposing "excessive hauling fees." Underlying this dispute was the fact that South Carolina's regulated prices were higher than those in North Carolina and Georgia. The defendants contended that the South Carolina Dairy Commission's price regulation requiring the same minimum prices to be paid to in-state and out-of-state producers was unconstitutional under the Commerce Clause of the U.S. Constitution. A state circuit court in South Carolina agreed with the defendants, citing the Baldwin case. The court went on to rule that since only some of the South Carolina processors would be subject to the Commission's price regulations, whereas others who dealt with only in-state producers would not, the Equal Protection Clause of the 14th Amendment would be offended. The court held that there was no rational basis for distinguishing between South Carolina processors who trade only with in-state producers and those trading with out-of-state dairymen. Because of the possibility of such dissimilar treatment, the court held that the Commission was without power to set any minimum prices. In a

short opinion, the South Carolina Supreme Court affirmed the ruling of the circuit court on all counts. The South Carolina Milk Commission is the latest victim of a series of unfavorable court rulings against state milk commissions in the Southeast.

VII. Court Challenges to the North Carolina Milk Commission

Transport Costs

The Commission's power to set minimum prices and transportation rates was first contested in court in 1959.[40] The Commission's formula for transportation charges required the defendant/cooperative to calculate total transportation costs for all its members and then divide the total charges equally on a per-hundredweight basis. The cooperative wanted to charge each producer his own transportation costs. The Commission viewed nonuniform transportation charges as a means evading minimum price regulation. The court agreed with the Commission, holding it did have power to set minimum prices and transportation charges. In State ex rel. v Nat'l Food Stores, Inc. (1967) the 1959 decision was upheld.[41]

Two points should be noted in relation to these decisions. First, uniform hauling rates will create a preference among processors for nearby as opposed to distant milk supplies. The processor can only charge the average transportation cost, which will be lower than the marginal (or actual) cost of moving the milk, if the milk originates from distant sources. Second, in some federal marketing orders, transportation

charges are based on distance rather than a flat charge to all producers.[42]

Interstate Exports

In 1968 a cooperative, Southeast Milk Sales Association, contended that the Commission's regulations on interstate transfers were unconstitutional.[43] In this case, the cooperative exported a significant amount of milk produced by North Carolina dairymen to a distributor in South Carolina servicing military bases. At issue were Commission regulations that allowed the deduction of handling allowances for milk diverted from farm routes and base reductions of base holders who went "off the market" at times.[44] The cooperative found that its members were reluctant to export their milk because of the regulatory penalties. The cooperative contended that the handling allowances and base loss provisions constituted unreasonable burdens on interstate commerce.

A federal district court ruled against the cooperative. The court noted that in contrast to the Polar Ice Cream case, there were no state regulations prohibiting North Carolina producers from exporting their milk. The rationale for the base reduction regulations was that processors need a reserve supply of milk and if producers are allowed to export their over-base milk, processors would suffer. Since fluid milk could not be stored, small shifts in supply or demand could leave a processor short. This case also appears consistent with Eisenberg in which the U.S. Supreme Court held that a state can set minimum prices and other terms of trade for in-state producers even if the milk is sold out of state.

Compensatory Payment

More serious challenges began in 1976 with the Petition of Arcadia Dairy Farm, Inc. for a review of Amendment 27 to Milk Marketing Order #2.[45] In this case Arcadia, a producer/distributor, challenged a Commission regulation that required it to pay a compensatory payment to a producer equilization fund in an amount equal to the Class I price minus the Class II price.[46] Arcadia had been importing milk powder from Wisconsin and reconstituting the milk in North Carolina. There were no allegations of health hazards and consumer acceptance of the reconstituted milk apparently was satisfactory. Even though consumers can buy nonfat dry milk powder themselves, the court noted that when the reconstitution process was done by a commercial operation the product was much more palatable.

Reconstituted milk ingredients had a competitive advantage because it could be purchased cheaply in Wisconsin and transported at about one-tenth the cost of transporting regular whole milk. In testimony taken by the Commission, proponents of the compensatory payment regulation said "To go a step further, if Arcadia Dairy is allowed to continue with its raw product cost advantage, no doubt every processor in the State will quickly go in this direction...The only alternative [for North Carolina dairy farmers] is higher class prices for their produce."[47]

The precise wording of the disputed regulation was:

> "To protect the stability of the supply of producers' milk, no Class I or Class IA milk shall be purchased, received, handled, or obtained from any source other than from approved producers or other

North Carolina licensed distributors without the express permission of the Commission."

"If a distributor reconstitutes milk for Class I sales, such distributor shall pay into an equalization fund an amount equal to the difference between the price of Class I and Class II milk."[48]

The regulations go on to indicate that if the distributor is unable to obtain adequate supplies from his own producers and other licensed distributors and if the distributor gives notice to the Commission of his inability to obtain such milk, then the distributor would not be required to pay the compensatory payment. If those conditions are not met, the amount collected in the equalization fund would then be distributed to producers in the market area who had Class II utilization rates greater than 5 percent. In effect, the regulations required an importing distributor to compensate in-state fluid producers in the area for the Class I sales "lost" to the imported milk. In other regulations, a North Carolina distributor was required to accept all milk produced by a dairyman who was a base holder of that distributor.

In ruling for Arcadia, the North Carolina Supreme Court cited the Baldwin, Hood, Dean Milk and Polar Ice Cream cases. The court reiterated the well established precedent in constitutional law that protection of in-state economic interests is not a legitimate rationale for imposing burdens on interstate commerce. Application of the Commerce Clause compelled a ruling of unconstitutionality because the prohibitions on reconstituted milk were not based

interests is not a legitimate rationale for imposing burdens on interstate commerce. Application of the Commerce Clause compelled a ruling of unconstitutionality because the prohibitions on reconstituted milk were not based on health considerations but rather upon supply conditions within the state.

In 1979 the North Carolina Court of Appeals again was petitioned by Arcadia Dairy Farms because the Commission assessed an equalization (compensatory) payment against Arcadia and suspended its license as a distributor.[49] The suspension occurred pursuant to a Commission regulation 4 NCAC 7.0505(a)(1), which provided that "Each distributor shall obtain a supply of packaged milk or fresh fluid milk from producers who hold a North Carolina base..." or from licensed North Carolina distributors or from other approved sources. In this second case involving Arcadia, the compensatory payment was again equal to the difference between the Class I and Class II milk prices. The only substantive change was an amendment to G.S.§ 106-266.8(3) passed in the interim by the North Carolina State Legislature, which supposedly supplemented the Commission's powers by giving the Commission express power to provide "for an equalization payment in order that producer [N.C. base holders'] milk will not be paid for in a lower class through the recombining of water and milk constituents." The second dispute began when Aracdia again found it was cheaper to import milk constitutents (ingredients) from Wisconsin and reconstitute the milk in North Carolina.

At the trial court, Judge Godwin held that 4 NCAC 7.0505 (which imposed compensatory payments)

was unconstitutional under both the state and federal constitutions, and that under each constitution there were several grounds for the unconstitutionality.[50] What had occurred between the 1976 case and the instant case is that the Commission revised its compensatory payment regulation in a way that did not change its substance. Not only did the court rule that compensatory payments were unconstitutional under the Commerce Clause, but it went further and "permanently enjoined and restrained [the Commission] from enforcing 4 NCAC 7.0505, as amended November 10, 1977, and further said Milk Commission is permanently enjoined and restrained from enacting other rules or regulations requiring an equalization payment pursuant to G.S. § 106-266.8(3)."

The appellate decision, written by Judge Ervin, was not too sympathetic to the Commission.[51] The court noted that the North Carolina Supreme Court previously had ruled in Arcadia's favor on..."the exact question which we have before us today." Since a basis for the ruling of the North Carolina Supreme Court was the Commerce Clause, the actions of the North Carolina Legislature in authorizing the Commission to collect equalization payments were irrelevant. In other words, whether the equalization payment was administered pursuant to a state statute or to a regulation of any agency of the state is irrelevant to the issue of whether equalization payments unreasonably burden interstate commerce. In ruling for Arcadia, Judge Ervin simply cited the language used in the 1976 Arcadia case.

In 1980 Arcadia Dairy Farms, Inc. made a motion to withdraw its case against the North

Carolina Milk Commission. At that time, Arcadia was experiencing financial difficulties and nearly $50,000 was in an escrow fund paid by Arcadia pursuant to Rule 7.0505, the equalization fund provision. Basically, in return for Arcadia's motion for a voluntary dismissal, the Commission allowed Arcadia to retain the equalization fund. Because of this dismissal, Rule 7.0505 remains as a Commission regulation and G.S. § 106-266,8(3) is part of the state statute that enables the Commission to require compensatory payments on out-of-state reconstituted milk. These court decisions strongly suggest that North Carolina regulations requiring compensatory payments on reconstituted milk are potentially vulnerable to a constitutional challenge.

Out-of-State Producers

Dairymen, Inc., the same cooperative that initiated suits that led to the demise of the Alabama and South Carolina milk commissions, filed suit in federal district court alleging that the North Carolina Milk Commission's regulations are unconstitutional. More specifically, Dairymen charged that the Commission's regulations[52] reserve to North Carolina base holders the Class I market.[53] In their complaint, Dairymen challenges the constitutionality of G.S. § 106-266.8 and several Commission regulations listed below.

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1. 4 NCAC 7.0507(a), which establishes a minimum Class I price to be paid by North Carolina processors for milk produced by North Carolina and out-of-state farmers for milk moving in interstate commerce.

2. 4 NCAC 7.0510(c), which prohibits producers in other states from earning base in North Carolina unless the other states recognize base transfers to North Carolina farmers.

3. 4 NCAC 7.0510(b) and (f)(8), which allegedly make it difficult for new out-of-state producers to obtain base except by purchase.

4. Through regulation 4 NCAC 7.0508(f), the Commission has discriminated against Dairymen, Inc. in that allowable service charge rebates are allegedly greater for in-state cooperatives other than Dairymen, Inc. Dairymen, Inc. claims the effect of this regulation is to limit its ability to compete in North Carolina.[54]

The overall thrust of the Dairymen complaint is that the Commission's regulations discriminate against out-of-state producers. Discrimination is accomplished through regulations that extend "...the North Carolina classified pricing system into other states, and thereby isolating and protecting certain North Carolina producers and processors (some of whom are members of the Commission) from outside competition and increasing Class I receipts to them to the exclusion of non-North Carolina producers and processors."[55] Essentially, the complaint contends that the cost advantages of producers in other states are eliminated by requiring payment of the same minimum prices regardless of location, and that interstate milk shipments are further diminished by base regulations which allocate the lucrative Class I sales to the current base holders and make it difficult for new out-of-state farmers to obtain base except by purchase. Currently the suit is in discovery.

Other Provisions

In addition to the challenges of the current Dairymen suit, other regulations mentioned above

appear potentially vulnerable to a constitutional challenge. In particular, 4 NCAC 7.0505 (a), which imposes a compensatory payment on milk imported from unapproved sources, appears to have a tenuous legal foundation given the Arcadia decisions. Regulations 4 NCAC 7.0505 (b) and (c) require North Carolina base holders to receive the highest paid classification and down allocate other source milk under some circumstances. These regulations may be in conflict with the court decisions in Polar and Dairymen, Inc. v. Alabama Dairy Commission. On the other hand, North Carolina classification regulations can be distinguished from their Florida and Alabama counterparts. Unlike North Carolina, the Florida reguLations did not allow out-of-state base holders. In the Alabama case the classification regulations required the automatic imposition of a compensatory payment if base holders were displaced by other source milk. In North Carolina, the compensatory payment is imposed only if purchases from other source milk is not approved the Commission. The North Carolina classification regulations are arguably less restrictive than those in Florida and Alabama.

Regulation 4 NCAC 7.0507(h) requires the payment of North Carolina Class I prices on milk sold in North Carolina regardless of where the milk is produced. This regulation may be in conflict with the Baldwin ruling. However, it could be contended that because of North Carolina's regulations on transportation charges, the net price actually received by producers varies according to distance and therefore in-state and out-of-state net prices received by producers are not uniform.

If any of these regulations are challenged in court, no one can predict the outcome with certainty. The trend of recent court decisions does not appear favorable to state milk commissions. However, even if the Commission did incur an unfavorable ruling, modifications in the regulations could be accomplished to preserve the basic structure.

Summary

Unregulated competition in the dairy industry after 1930 produced results generally viewed as unsatisfactory in both North Carolina and the United States. By 1953, both North Carolina and most of the United States instituted extensive regulation. In both areas, classified pricing was adopted to stabilize markets. As the storability and transportability of fluid milk improved, federal marketing orders became larger through mergers. Since this option was not available to state milk commissions, court litigation often ensued following disputes concerning interstate milk shipments. The result was usually that state milk commission regulations that impeded interstate milk movements were declared unconstitutional.

Appendix I

I. Regulation of Processors and Retailers

Fair Trade Practice Orders

From 1953 to 1974, processors in North Carolina operated under Fair Trade Practice Orders. The Fair Trade Practice Orders required distributors (processors) to file with the Commission the prices they charged for dairy products. It was illegal for processors to sell dairy products at prices below those filed with the Commission except when such sales were made in good faith to meet competition and notice was given to the Commission. If a processor wanted to lower prices, it had to provide the Commission with 10 days notice.

In 1954, the "Home Market Rule" was promulgated. This rule prohibited processors or subdistributors from charging a price less than those filed in the market or county in which processor's plant was located except, again, cases in which the lower prices were to meet competition and the Commission was provided with notice.

Fair trade practice laws basically are a means of reducing or eliminating price competition. The effect of these regulations is government enforcement of resale price maintenance. Processors willing to cut prices are prevented from doing so by the regulations. Government-enforced resale price maintenance can only be effective if disguised price competition is prohibited. Disguised price cuts occur when, in connection with the sale of milk, distributors and processors offer to retailers goods or services free of charge or at below-market

rates. In examining Table 7, it is apparent that much of the Fair Trade Practice Orders dealt with prohibiting disguised price cuts in the form of rebates, discounts and free services.

Below-Cost Sales

The General Statutes give the Commission the authority to set milk prices at all stages of production. Currently the Commission sets minimum prices to be paid producers, but it has chosen not to set prices charged by processors.

All processors, distributors, and sub-distributors are required to be licensed and they can lose their licenses for not obeying Commission regulations. The General Statutes specifically enumerate "sales of milk below cost which injures or destroys competition" as a prohibited practice by either processors, distributors or retailers. There is, however, an exception -- when below-cost prices are set to meet competition. To qualify for this exception, the licensee or retailer must provide notice to the Commission.

In enforcing prohibitions on below-cost sales, the Commission must be able to determine cost. Pursuant to regulation 4 NCAC 7.0514, in 1982 the Commission issued "User's Manual and Guide to the North Carolina Milk Commission's Uniform Procedure for Determining the Cost of Processing and Distributing Milk." Cost, as defined by the User's Manual, means full cost or average total cost. The regulation specifically prohibits a procedure whereby marginal or variable costs are used to define costs. Full costs require allocations of cost on a per-unit

Table 7

North Carolina Milk Commission - Fair Trade Practice Orders
1953 - 1973

Rules of Fair Trade Practices adopted for Areas I, II, III and IV, effective November 16, 1953.

- -Retail and wholesale price filings, effective December 1, 1953
- -Ten days prior notice of change to the Commission
- -Rebates, discounts, free services, equipment prohibited
- -Same rules were adopted for Areas V, VI and VII, effective December 15, 1953

Rules rewritten for all areas under MMO #1 - effective April 10, 1954 - expanded the services and practices prohibited.

- -Clarified furnishing of ice cream equipment and vending machines
- -Authorized local milk boards to establish rules relating to signs, advertising, store demonstrations, product contributions to charity, samples

Milk Marketing Order No. One (Section V) Amended, effective June 10, 1954.

- -Retail, wholesale and platform price filings, ten days prior notice of change to the Commission, permitted filing to meet prices of the competitor
- -Exempted schools, hospitals, public and non-profit institutions from filed prices
- -Prohibited discounts, rebates, free services and equipment, etc.
- -Home Market Rule

Rules of Fair Trade Practice Adopted, effective September 15, 1955, to supercede MMO I, Section V and issued on a separate rule.

- -Retail and Wholesale price filings, ten days notice of price change and ten days notice to any distributor affected by price change. Provided for meeting competition by filing on date competitive prices are met
- -Required filing of prices for schools and institutions
- -Home Market Rule
- -Prohibited discounts, rebates, free services and equipment, etc.

Table 7 (continued)

Fair Trade Practice Order No. IV, effective October 1, 1957

- -Retail and wholesale price filing, ten days notice of price change, ten days notification to any distributor effected
- -Provided for meeting competition by notifying Commission
- -Required filing either a uniform schedule of prices for schools and institutions or separate filings for schools or institutions for each school or institution where a different price is offered or charged
- -Home Market Rule
- -Prohibited discounts, rebates, free services, equipment, etc.
- -Regulated: conditions for equipment sales, signs and display material, milk samples, vending machines, and dispensers

Fair Trade Practice Order No. V, effective February 1, 1960

- -Contains same basic provisions as Fair Trade Practice Order No. IV
- -Added provisions governing loans, restrictions on refrigeration services, neon signs and display materials

Amendment # One, effective January 1, 1961

- -Clarified school and institutional price filings to provide for "percentage off" of wholesale filing
- -Clarified Home Market Rules regarding schools and institutions

Amendment Two, effective February 25, 1961

- -Further clarification on schools and institutions

Amendment Three, effective August 15, 1962

- -Conditions for sale of milk and ice cream equipment

Amendment Four, effective August 15, 1962, regarding equipment

Amendment Five, effective March 1, 1963

- -Added 10 ounce units to price filings required for vending machine

Amendment No. Six, effective September 16, 1963

- -School and institutional prices to be filed one day prior to first day of delivery (removed the ten day requirement).

Table 7 (continued)

Fair Trade Practice Order No. Six, effective September 25, 1963

- -Same basic provisions as FTPO #5 (rewrite of 5 with amendments)
- -Retail and wholesale price filings, ten days notice, notice to competitors
- -Schools and institutions, one day's prior notice

Amendment No. One, effective May 18, 1964

- -Required a filing of uniform prices for schools and institutions and percentage discount applicable to filing
- -Required ten days notice for change
- -Competitive information available to distributors when prices are on file

Amendment No. Two, effective January 1, 1965

- -Clarified eligibility of institutions for exempt or special prices

Amendment No. Three, effective May 1, 1967 (First rebate provision)

- -Added provision for volume rebates (from 2 to 7 percent) to qualifying wholesale customers
- -Volume rebate certificates

Amendment No. Four, effective July 1, 1967

- -Clarified delinquency provision

Amendment No. Five, effective January 1, 1968

- -Established qualifying period for volume rebates to be calendar months of August, September and October (or corresponding accounting periods)

Fair Trade Order No. 6, suspended, effective April 21, 1968

Fair Trade Practice Order No. Seven, effective July 1, 1968

- -Distributors to file price and rebate schedules
- -Pet Dairy appealed this order on July 8, 1968
- -Revoked, effective September 1, 1968

Fair Trade Practice Order No Eight, effective September 1, 1968

- -Distributors to file retail and wholesale prices

Table 7 (continued)

-Volume rebates, 3 to 10 percent to qualifying full service customers; back door drop, 13 to 16 percent to qualifying customers; platform or dock 23 percent to qualifying customers

-Appealed by Pet and Maola, Commission restrained from enforcing order

Fair Trade Practice Order No. Nine, effective January 19, 1969

-Distributors to file retail-wholesale prices
-Volume rebates, 3 to 10 percent to full service customers
-Platform or dock rebates, 18-21 percent
-Maola appealed, restraining order issued, January 20, 1969
-Revoked by Commission May 11, 1969

Fair Trade Practice Order No. Ten, effective May 11, 1969 (adopted with an expiration date of November 22, 1969, extended to February 1, 1970)

-Price filings, ten days notice, ten days notification to effected distributors
-Price filings for private label milk sold to customers purchasing in excess of 6000 gallons per month
-Uniform school and institutional price filing
-Provision for deviation with ten days notice
-Competitive information available to distributors with schools and institutional prices on file, one day's notice to meet competition
-Volume rebates, full service 2 to 13.3 percent
-Average per delivery, 4 to 15.5 percent
-Platform or dock, 18 to 21 percent

Fair Trade Practice Order No. Eleven, effective February 1, 1970

-Price filings, same basic provisions as FTPO #10
-Eliminated ten-day prior notice on school and institutional filings, required one day's notice
-Superseded by Fair Trade Practice Order No. Twelve, effective July 3, 1972

Fair Trade Practice Order No. Twelve, effective July 17, 1972

-Distributors file their own standard price schedules for retail, wholesale, school and institutional customers
-Required filing of standard rebate or discount schedules based upon quantity and type of service
-Require ten days prior notice of change

Table 7 (continued)

-Provided for meeting competition on an account by account basis
-Order temporarily suspended, effective June 26, 1973

basis for inputs that are often considered fixed in the short run.

Cost for regulatory purposes is defined as a company's average total costs in the previous January through June period. If a company makes drastic changes in its facilities or changes its accounting principles, an adjustment in cost can be obtained upon a petition to the Commission. Since all processors in North Carolina must be licensed, the Commission could levy a heavy sanction on violators of this regulation. In practice, the Commission has never revoked a license; however, fines have been assessed (see Table 8).

Retail Prices

The General Statutes also give the Commission authority to set retail prices. The use of milk as a "loss leader" is prohibited by statute and regulation. However, retailers are not subjected to the same kind of scrutiny and detailed regulations as processors. There is no User's Manual for retailers that specifies accounting techniques for calculating cost. Apparently, in practice, retailers incur liability only if they sell milk for a price below their acquisition cost. Retailers are, of course, subject to antitrust laws and therefore are liable if they engage in predatory pricing within the meaning of Section 2 of the Sherman Act.

Table 8

Penalties Assessed in Lieu of License Suspension

Company	Hearing Date	Order Date	Penalty	Charge
Pine State	5/16/78	7/25/78	$1000	Below Cost Sales
Flav-O-Rich, Wilkesboro	5/16/78	7/25/78	1000	Below Cost Sales
Flav-O-Rich, Durham	5/16/78	7/25/78	1000	Below Cost Sales
Coble Dairy Products	5/16/78	7/25/78	1000	Below Cost Sales
Flav-O-Rich, Greensboro	5/16/78	7/25/78	1000	Below Cost Sales
Borden, High Point	5/16/78	7/25/78	1000	Below Cost Sales
Pet, Greenville, S.C.	6/13 & 25/78	9/26/78	1000	Below Cost Sales
Coble Dairy Products	10/12/82	12/21/82	1000	Below Cost Sales
PENALTIES ASSESSED - ON APPEAL				
Coble Dairy Products	6/23/81	6/23/81	5000	Records Refusal
Pet, Charlotte	9/25/79 & 1/8/80	2/12/80	1000	Below Cost Sales
Pet, Charlotte	9/25/79	2/12/82	5000	Records Rufusal
Flav-O-Rich, Wilkesboro	2/24/81	10/12/82	1000	Below Cost Sales
Flav-O-Rich, Wilkesboro	5/25/82	8/24/82	2000	Below Cost Sales
Flav-O-Rich, Greensboro	5/25/82	8/24/82	4000	Below Cost Sales
Flav-O-Rich, Durham	5/25/82	8/24/82	1000	Below Cost Sales
Maola Milk & Ice Cream	5/25/82	8/24/82	2000	Below Cost Sales
Pet, Charlotte	8/24/82	10/12/82	2000	Below Cost Sales
Flav-O-Rich, Durham	5/24/82	8/24/82	5000	Records Refusal

North Carolina Milk Commission
April 25, 1984

Appendix II

Chronology of Major Changes in North Carolina

Milk Regulation

Year	Event
1953	Establishment of North Carolina Milk Commission.
1954	Milk Marketing Order #1. -Distributor licenses. -Basic features of classified pricing. -Rules of classification. -Base plans.
1963	Milk Marketing Order #2. -Rules of classification defined in more detail. -Producers' base plan regulations defined in more detail.
1971	Milk Commission Law (G.S 106-266.6 et seq.) rewritten. -Majority of Commission members must be "public."
1973	Fair Trade Order No. 12 suspended.
1975	Milk Commission Law rewritten. -Five of ten Commission members must be public.
1977	Milk Commission Law rewritten. -Commission given power to establish a formula for milk prices.
1982	User's Manual and Guide to the North Carolina Milk Commission's Uniform Procedure for Determining the Cost of Processing and Distributing Milk.

Appendix III

Glossary

1. Base Plan - The distinguishing characteristic of a base plan in milk marketing is that a dairy farmer receives a higher price for his base milk than for his overbase milk. In areas without a base plan, the farmer receives the same price on all units of production. The Commission's regulation states that "Base for a producer means the average deliveries of a producer for a designated period that is established on an equitable basis with all other producers, for allocating the classes of milk." In North Carolina producers receive a Class I price on their base milk that is given a class allocation and the rest of their milk receives a Class II price.

2. Blend Price - The blend price is a weighted average of the Class I and Class II prices. This is the price per cwt. the producer actually receives for his milk. The weights are based on the Class I utilization rate in the plant or in the marketing area, depending on whether the producer is subject to plantwide pooling or marketwide pooling. In North Carolina milk is pooled on a plantwide basis. With the addition of base plans, the computations become more complex. On average producers in North Carolina receive a plantwide blend price. Average rates received by individual producers will vary according to their total production in relation to their base milk. The greater a producer's overbase production, the lower his average price received.

3. Class I - Class I milk is milk used for fluid consumption, including homogenized and pasteurized milk, buttermilk, lowfat milk, flavored milk drinks, skim milk, reconstituted and recombined milk except for Class IA milk.

4. Class IA - Class IA milk is Class I bulk milk that is transferred among branches of the same company or to other distributors or to the military for which the Class I price announced by the Commission does not apply. Class IA milk basically is bulk milk sold to military bases at negotiated prices, and these prices are often lower than the Class I price announced by the Commission.

5. Class II - Class II milk is all Grade A milk received and not accounted for as Class I or Class IA. Class II milk includes milk shake mix, heavy cream, half and half, eggnog, yogurt, ice cream, butter, and cheese.

6. Class III - Currently in North Carolina there is no Class III milk. In the federal system, Class III milk is Grade A milk that is made into butter and cheese. North Carolina began with a similar three-class system but abandoned it in 1967. When North Carolina had three classes of milk, Class II milk included buttermilk and skim milk.

7. Compensatory payment - As the name implies, it is basically a charge imposed on a processor for importing milk from out of state or from out of the order. The payments are intended to compensate local producers who have lost Class I sales to imported milk. In North Carolina when the compensatory payment is imposed, it is equal to the Class I price minus the Class II price times the quantity in hundredweights. The compensatory payment is labeled in the North Carolina Milk Commission regulations as an "equalization" charge. In federal orders the compensatory payment is equal to the Class I price minus the blend price times the quantity of imported milk allocated to Class I.

8. Distributor - In North Carolina a distributor includes anyone in the business of distributing, marketing, or in any manner handling fluid milk. The definition includes processors and retailers according to the General Statutes. In the federal system "handlers" are regulated in the way that distributors are regulated in North Carolina.

9. Down Allocation - This term refers to milk regulations that allocate other source (outside, out-of-state, imported) milk to classes lower than Class I. The other source milk is thus "down allocated" and local milk therefore receives a higher classification. The effect of such regulations is to discourage purchases of other source milk. In North Carolina, to the extent possible, all other source milk is down allocated if base holders at the plant of the importing distributor supply more than 118 percent of the distributor's

Class I sales. If the 118 percent rule is not satisfied, then the imported milk is allocated pro rata with the Class I utilization rate of base holder milk. In the federal system, imported milk generally is allocated pro rata according to the lower of the importing handler's Class I utilization rate or the marketwide Class I utilization rate.

10. Equalization Payment - This is the North Carolina version of the compensatory payment described in 7 above.

11. Federal Milk Marketing Orders - These are marketing agreements between USDA and dairy producers who sell milk to handlers, who in turn sell milk to retailers in the area. The main difference between federal and state orders is that only dairy producers participate in federal orders, whereas retailers, processors, producers, and public representatives typically participate in state orders.

12. Grade A - Grade A is the highest sanitation grade for milk. Only Grade A milk can be sold for human consumption in fluid form. In North Carolina Grade A milk is often referred to as fluid grade milk.

13. Grade B - Grade B is the second highest sanitation grade for milk. It can be used to manufacture butter and cheese but not fluid milk products. In North Carolina Grade B milk is often referred to as manufacturing grade milk.

14. Manufacturing Grade - This grade of milk can only be sold for human consumption as manufactured dairy products such as butter or cheese. In most of the rest of the country, manufacturing grade milk is labeled Grade B milk.

15. Pooling - Milk receipts are pooled under both state and federal regulations. In North Carolina milk receipts are pooled on a plantwide basis. Out of the plantwide pool producers are paid pro rata according to the Class I sales of the processors and the base of the producer. In the federal system, milk receipts are pooled on a marketwide basis. All producers in a federal order receive basically the same blend price, which is equal to the marketwide weighted average of the Class I and Class II prices.

16. Processor - A milk processor purchases raw milk from cooperatives or producers, pasteurizes, homogenizes, packages, and/or bottles milk and later resells milk to independent distributors (sub-distributors) or directly to retailers. In North Carolina processors are referred to in the Commission's regulation as distributors. In the federal system processors are referred to as handlers.

17. Producers - Dairy farmers are producers.

18. Sub-Distributor - A sub-distributor is an independent contractor who transports milk from processors to retailers or consumers. A sub-distributor is not a processor, and purchases milk from processors for resale.

Footnotes

1. Cotton, Walter P. "Milk Marketing Problems in North Carolina." Agr. Exp. Sta. Bull. No. 370, N.C. State University. June 1950, p. 9.
2. Ibid., p. 17.
3. Ibid., p. 35.
4. Ibid., p. 14.
5. Ibid., p. 12.
6. An effect of milk regulation is that all producers share equally the costs of lower springtime prices because of the seasonal surpluses.
7. Cotton op. cit. note 1 above, p. 9.
8. Ibid., p. 13.
9. Ibid., p. 37.
10. Ibid.
11. Ibid., p. 81.
12. Ibid., p. 52.
13. Classified pricing is explained below.
14. In North Carolina, a relatively small fraction of milk receives a Class IA or Class IB designation. Class IA milk generally is military milk (milk sold to military bases) for which a different producer price may apply (4 NCAC 7.0505(b)). Since military units typically award contracts through sealed bids, state milk commissions will allow milk contracts with the military to have prices below the minimum Class I prices set by the commissions. Class IB milk is lowfat or skim milk (4 NCAC 7.0504 (c)).
15. An additional complicating factor is the effect of base plans, which are described below.
16. Grady Cooper, Jr., Executive Secretary, N.C. Milk Commission, "Memorandum to: Producers, Distributors, and other Interested Parties" (January, 1984).
17. State Dairy Commission, et al. v. Pet, Inc. et al., Opinion No. 22177 (State of S. Carolina, Sp.Ct., Nov. 2, 1984).
18. These figures may be interpreted in more than one way. During the last 10 years in

North Carolina, the percentage of Class II milk has increased from 11.7 to 22.9, almost a doubling of the percentage of Class II milk. In federal order markets, the Class II utilization rate has increased 32 percent over the same period.

19. Moorhouse, John C., "A Government Sponsored Cartel: The Case of the North Carolina Milk Processors," paper presented at the Southern Economics Associations Meetings, Atlanta, Georgia, 1976.

20. In North Carolina compensatory payments, called "equalization" payments, equal the Class I price minus the Class II price. (4 NCAC 7.0505(a)(5)). In federal orders the compensatory payment equals the Class I price minus the blend price.

21. The Interstate Commerce Clause, Art. I. 8[3], gives the federal government power "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

22. 375 U.S. 361, 84 S.Ct. 378, 11 L.Ed. 389; 294 U.S. 511, 55 S.Ct. 497, 79 L.Ed. 1032; 336 U.S. 525, 68 S.Ct. 657, 93 L.Ed. 865; 340 U.S. 349, 71 S.Ct. 295, 85 L.Ed. 329.

23. Justice Cardoza stated that "Such a power, if erected, will set a barrier to traffic between one state and another as effective as if customs duties, equal to the price differential, had been laid on the thing transported...."

24. Justice Jackson notes

> "Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will, by custom duties or regulations, exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any."

25. "In erecting an economic barrier protecting a major local industry against competition from without the State, [the city of] Madison plainly discriminates against interstate commerce. This it cannot do, even in the exercise of its people, if reasonable nondiscriminatory alternatives, adequate to conserve legitimate local interests, are available...." The Court further noted that "It is immaterial that Wisconsin milk from outside the Madison area is subject to the same prescription as the milk moving in interstate commerce...."

26. 306 U.S. 396.

27. In Dairymen, Inc.'s current suit against the North Carolina Milk Commission, discussed below, they contest the authority of the Commission to set minimum prices for in-state producers shipping out of state. See Memorandum in Support of Plaintiff's Motion for Preliminary Injunction Civ. Act. No. 83-405 - CIV -S (E.D. of N.C., 1983).

28. Ibid. p. 21 Public Utilities Commission v. Attleboro Steam and Electric Co., 273 U.S. 83, 47 S.Ct. 294, 71 L.Ed. 549 (1927); Lemke v. Farmers Grain Co. of Emden, 258 U.S. 50, 42 S.Ct. 244, 66 L.Ed. 458 (1922).

29. The ruling in Georgia was that the milk commission was exceeding its constitutional and statutory authority under state law in prohibiting reconstituted milk. Dept. of Agriculture v. Quality Food Products, Inc., 224 Ga. 585 (1968).

30. Polar Cream & Creamery Co. v. Andrews et al., 375 U.S. 361, 366 (1964).

31. Ibid.

32. Department of Agriculture v. Quality Food Products, Inc., 224 Ga. 585 (1968).

33. 365 F.Supp. 1149, (M.D. La. 1973), aff'd 416 U.S. 922, 94 Sup.Ct. 1920, 40 L.Ed. 2d Ed. 2d 279 (1974).

34. Ibid., 1153.

35. Dairymen, Inc. v. Alabama Dairy Commission 584 F. 2d 707, 713 (1978).

36. Brief of Appellant Dairymen, Inc. U.S.C.A. in Dairymen, Inc. v. Alabama Dairy Commission (5th Cir. 78-1087) at 24. Processors were not required to take the entire output of quota-holders as in the Polar case.

37. Note 35 above, at 712.

38. Ibid., 713.

39. State Dairy Commission of South Carolina and Steve Hamm, Consumer Advocate for the State of South Carolina v. Pet,Inc; et al, Calendar No. 83-CP-40-2192.

40. State ex rel North Carolina Milk Commission v. Galloway 107 S.E.2d 631, 249 N.C. 658 (1959).

41. 270 N.C. 323.

42. In federal system, the price a producer receives depends on the zone he is in. These differences in prices are called zone differentials. See U.S. Dept. of Agr. Summary of Major Provisions in Federal Milk Marketing Orders, Agr. Mkt. Serv./Dairy Division (Jan. 1979) p. 50.

43. Southeast Milk Sales, Ass'n v. Swaringer, 290 F. Supp. 292 (1968).

44. At that time, the Commission used a different numbering system. Regulations in dispute were IV-B-2 and V-C-2. IV-B-2 allowed a processor to deduct a handling allowance from North Carolina dairymen who diverted milk directly from farm routes. V-C-2 called for a reduction of base for producers who went "off the market" for periods of time.

45. Appeal of Arcadia Dairy Farms Inc., 289 N.C. 456, 223 S.E.2d. 323 (1976).

46. Amendment 27 to Marketing Order No. 2 (April 1974).

47. Note 45 above, at 327.

48. Note 45 above, at 325.

49. Appeal of Arcadia Dairy Farms, Inc., 43 N.C. App. 459, 259 S.E.2d 368 (1979).

50. The Superior Court judgment was that 4 NCAC 7.0505 is an unreasonable, and therefore unconstitutional, burden on interstate commerce in violation of Art. I

§8(3) of the U.S. Constitution, Id. 369. The Court also ruled that compensatory payments were in violation of the 14th Amendment because they amounted to a deprivation of property without due process. Id. 370. In addition, the court ruled that G.S. § 106-266(8), which authorizes the establishment of a compensatory payment by the Commission, was an unconstitutional delegation of power under Art. II § I and Art. I § 19 of the Constitution of the State of North Carolina. Judge Godwin also found other grounds for declaring the statute and the regulation unconstitutional.

51. State milk commissions are not receiving sympathetic treatment because the judicary and others view them as anachronisms. In South Carolina the court in the 1983 Pet, Inc. et. al., case at 10 notes that "raw milk, whole milk or bulk milk can be transported, by way of refrigerated tankers on interstate highways, has greatly facilitated the movement of milk.... The State of South Carolina is not an island, and we certainly need fear no milk embargo from our sister states." In the 1978 Dairymen, Inc. et al., v. Alabama Dairy Commission case, the court admonished the milk commission by saying "It is apparent that some regulators have not kept abreast of this changing reality. Emergency, depression, regulatory schemes, which were of uncertain wisdom but were constitutionally permissible in another era under very different facts, will not pass muster when brought to bear against today's fast moving streams of interstate commerce" 584 F. 2d 707, 713 (1978).

52. Dairymen Inc. v. North Carolina Milk Commission, Civ. No. 83-405-CIV-S (E.D.N.C. 1983).

53. Memorandum in Support of Plaintiff's Motion for Preliminary Injunction Civ. Art. No. 83-405-CIV-S (E.D. of N.C. 1983).

54. The regulations listed below are just those that Dairymen claimed were unreasonable burdens on interstate commerce. In its complaint, Dairymen alleged that the Commission's regulations were illegal for other reasons. E.g., pp. 11-15. Regulations challenged for other reasons are not listed here.

55. Complaint of Dairymen Inc., Civ. No. 83-405-CIV-5 (E.D.N.C. 1983), 11.

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