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ATTORNEYS AT LAW

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8 Attorneys for **Plaintiff**

9 **IN THE UNITED STATES DISTRICT COURT**
10 **FOR THE DISTRICT OF ARIZONA**

11 BASIC FOOD MARKET, L.L.C.;
12 BASIC FOOD MARKET II, L.L.C.,

13 Plaintiffs,

14 v.

15 UNITED STATES DEPARTMENT OF
16 AGRICULTURE FOOD AND NUTRITION
17 SERVICE,

18 Defendants.

No. 2:06-cv-02780-HRH

**PLAINTIFFS’
CONTROVERTING AND
SUPPLEMENTAL
STATEMENT OF FACTS IN
OPPOSITION TO
DEFENDANT’S MOTION TO
DISMISS OR, IN THE
ALTERNATIVE, FOR FOR
SUMMARY JUDGMENT**

(Hon. H. Russel Holland)

19 Pursuant to F.R.Civ.P. 56.1, Plaintiffs Basic Food Market, L.L.C.and Basic Food
20 Market II, L.L.C. (collectively “Basic Food Market”) hereby submits the following
21 Controverting and Supplemental Statement of Facts (“CSSF”) in Opposition to the
22 USDA’s Statement of Material Facts Submitted in Support of its Motion to Dismiss or,
23 in the Alternative for Summary Judgment. This Controverting and Supplemental
24 Statement of Facts is submitted with Plaintiffs’ Motion to Conduct Discovery Pursuant
25 to Rule 56(f). As stated in that Motion and its supporting Affidavit, this matter is in its
26 early stages of litigation, and no formal discovery has been completed. Basic Food

1 Market, therefore will supplement this pleading with facts and testimony obtained
2 through discovery subject to the Court's decision on Plaintiff's Motion to Conduct
3 Discovery Pursuant to Rule 56(f).

4 1. Basic Food Market does not controvert the allegations contained in
5 Paragraphs 1 through 3.

6 2. Basic Food Market has not obtained through discovery sufficient
7 information to controvert the allegations of Paragraph 4. Basic Food Market has
8 alleged in its Complaint, however, that the Food and Nutritional Services Division
9 ("FNS") of the USDA directed through its oversight authority that the cost containment
10 requirements be implemented in a way that eliminated from the marketplace Above-50-
11 Percent vendors such as Plaintiffs. As set forth more fully in Plaintiffs' Motion to
12 Conduct Discovery Pursuant to Rule 56(f), Basic Food Market maintains that evidence
13 sufficient to controvert the allegations of this paragraph will be produced through
14 discovery as set forth in Plaintiffs' Motion and this controverting statement can be
15 supplemented accordingly upon completion of such discovery.

16 3. Basic Food Market does not controvert the allegations of Paragraph 5.

17 4. Basic Food Market does not controvert the allegations of Paragraph 6.

18 5. Basic Food Market does not controvert the first sentence of Paragraph 7.

19 However, Basic Food Market controverts the remaining statements made in Paragraph
20 7. Based on the information presently available to Basic Food Market, and as alleged
21 in Basic Food Market's Complaint, Basic Food Market maintain that FNS essentially
22 told Arizona officials that it would not approve a plan that grouped Above-50-Percent
23 vendors with comparable vendors. This communication is reflected in ADHS' letter of
24 October 13, 2006, to counsel for Plaintiffs. **Ex. 1**, Letter from Ms. Gerard at p. 2.

1 6. Basic Food Market does not controvert the first sentence of Paragraph 8.
2 However, without discovery, Basic Food Market is without information necessary to
3 assess and determine the reliability of the remaining allegations. Aside from the
4 assertions made in the Vogel Declaration, Basic Food Market has no information
5 concerning the cost containment plan certified by FNS for implementation in
6 Massachusetts.

7 7. Basic Food Market does not controvert the allegations of Paragraph 9.

8 8. Basic Food Market controverts the allegations of Paragraph 10. Basic
9 Food Market faces the same competitive pressures as traditional vendors. **Ex. 2**, Aff. of
10 Ms. Lively at ¶ 17.

11 9. Basic Food Market is without sufficient information to controvert the
12 allegations of Paragraph 11. However, Basic Food Market believes it will determine
13 through the discovery requested in its Rule 56(f) Motion that the policies FNS has
14 approved nationwide similarly discourage or eliminate Above-50-Percent vendors from
15 the marketplace.

16 10. Basic Food Market does not controvert the allegations contained in
17 Paragraphs 12 through 20.

18 11. Basic Food Market does not controvert the allegations of Paragraph 21.

19 **PLAINTIFFS' SUPPLEMENTAL STATEMENT OF MATERIAL FACTS**

20 12. Basic Food Market, L.L.C., is an Arizona limited liability company that
21 operates seven stores in Maricopa County, Arizona. **Ex. 2**, Aff. of Ms. Lively at ¶ 2.
22 Basic Food Market II, L.L.C., is also an Arizona limited liability company. **Ex. 2**, Aff.
23 of Ms. Lively at ¶ 3. It operates one store in Pima County, Arizona. *Id.* The
24 companies and their retail outlets are collectively referred to as "Basic Food Market."

25 13. Basic Food Market provides basic food, nutritional, and related products
26 to parents in Arizona who participate in the Women Infant and Children ("WIC")

1 program. **Ex. 2**, Aff. of Ms. Lively at ¶ 5. The Arizona WIC program serves the needs
2 of nearly 152,000 participants each year. **Ex. 2**, Aff. of Ms. Lively at ¶ 9. Basic Food
3 Market has been operating in Arizona since 1996. **Ex. 2**, Aff. of Ms. Lively at ¶ 6. It
4 employs 51 people in Arizona, and it services around 11,000 WIC customers each
5 month. **Ex. 2**, Aff. of Ms. Lively at ¶ 7.

6 14. Under the Arizona WIC program, participating women and children
7 receive vouchers from the Arizona Department of Health Services (“ADHS”). **Ex. 2**,
8 Aff. of Ms. Lively at ¶10. These vouchers are then exchanged for supplemental food
9 packages that are customized to fit the participant’s needs. *Id.*

10 15. Participants can redeem their vouchers at any authorized retailer. **Ex. 2**,
11 Aff. of Ms. Lively at ¶ 11. These include both traditional grocery stores and stores that
12 specialize in selling WIC products. *Id.* Such stores are referred to in the industry as
13 Predominately WIC stores (“PWICs”), WIC-only stores, or Above-50-Percent vendors.
14 Basic Food Market is an Above-50-Percent vendor. It provides WIC products to WIC
15 participants as its main form of business. *Id.*

16 16. Basic Food Market goes to great lengths to insure that its customers
17 receive every product listed on their voucher. **Ex. 2**, Aff. of Ms. Lively at ¶ 12.

18 17. As an Above-50-Percent vendor, Basic Food Market provides WIC
19 participants with a more respectable shopping experience than they tend to encounter in
20 traditional grocery stores where they can be subjected to embarrassment or discomfort
21 at being identified as a WIC recipient, or at being unable to purchase a certain item
22 because it is not part of their approved food package. **Ex. 2**, Aff. of Ms. Lively at ¶ 13.

23 18. WIC transactions can be very complicated and pose problems for many
24 cashiers who do not experience the transaction often in comparison to regular sales
25 transactions. **Ex. 2**, Aff. of Ms. Lively at ¶ 14. Because Basic Food Market deals
26 predominantly with WIC items, its stores have the knowledge and day-to-day

1 experience to handle WIC transactions efficiently. *Id.* Many of Basic Food Market's
2 staff members are former WIC participants, so they are knowledgeable about the
3 program's rules, and they relate well to their customers. *Id.* In short, Basic Food
4 Market provide a non-threatening and dignified shopping experience. *Id.*

5 19. Basic Food Market collectively operates eight stores in Arizona.
6 However, one store will soon be closing due to the losses it has sustained as a result of
7 how FNS has directed that the cost containment measures be implemented in Arizona.
8 **Ex. 2**, Aff. of Ms. Lively at ¶ 15. Basic Food Market has been operating in Arizona
9 and providing an important service for eleven years. *Id.* Many of its stores carry
10 specialty baby formulas that no other grocer in the state stocks. *Id.* Many customers,
11 some of whom are not WIC participants, can only obtain their baby's formula at Basic
12 Food Market. *Id.*

13 20. Since its inception, Basic Food Market has charged fair and reasonable
14 prices for all products. **Ex. 2**, Aff. of Ms. Lively at ¶ 16. It is an honorable,
15 responsible, authorized WIC retailer, that takes pride in the valuable role it serves in
16 assisting WIC participants. *Id.* Basic Food Market enjoys a good reputation in the
17 community and, prior to cost containment, a positive working relationship with ADHS.
18 *Id.*

19 21. Basic Food Market obtains its products from the same suppliers and
20 wholesalers as traditional vendors, and experiences the same price fluctuations as
21 traditional vendors. **Ex. 2**, Aff. of Ms. Lively at ¶ 17.

22 22. Basic Food Market pays its employees a competitive wage. **Ex. 2**, Aff. of
23 Ms. Lively at ¶ 18. It offers them paid vacations and holidays, and medical and dental
24 insurance. *Id.*

1 23. Basic Food Market does not run the type of store that caused Congress to
2 include cost containment provisions in the WIC Reauthorization Act. **Ex. 2**, Aff. of
3 Ms. Lively at ¶ 19.

4 24. ADHS submitted several cost containment plans to the USDA's Food and
5 Nutrition Service. **Ex. 2**, Aff. of Ms. Lively at ¶ 20. These plans were denied, and
6 ultimately ADHS proposed the "March Plan" after much guidance from the Food and
7 Nutrition Service. *Id.* The March Plan separates Above-50-Percent vendors into their
8 own peer group, while regular vendors remain in peer groups segregated by location,
9 classification as independent or chain, and total gross annual sales. **Ex. 2**, Aff. of Ms.
10 Lively at ¶ 21.

11 25. To determine the maximum amount that Above-50-Percent vendors could
12 be reimbursed, ADHS used the previous month's statewide average price for all regular
13 vendors by food instrument type. **Ex. 2**, Aff. of Ms. Lively at ¶ 22. Regular vendors
14 would be reimbursed at the average for their peer group plus a percentage variance. *Id.*
15 For example, the State would compile the redemption amount of all food instruments
16 numbered 000311AA, excluding those redeemed at Above-50-Percent vendors, and
17 then determine the average redemption amount for food instrument 000311AA. *Id.*
18 Above-50-Percent vendors would then be reimbursed only up to that amount for food
19 instrument 000311AA, but every other peer group had a higher reimbursement amount
20 because each is allotted an additional percentage variance from the average. *Id.* The
21 percentage reimbursement variance for regular grocers is between five percent (5%)
22 and seventy percent (70%), but averages forty percent (40%). This results in regular
23 vendors being able to charge up to 140% of their peer group average. *Id.*

24 26. In her letter of October 13, 2006, Susan Gerard, Director of ADHS,
25 informed Basic Food Market through its counsel that this is the only approach FNS
26 would approve. **Ex. 2**, Aff. of Ms. Lively at ¶ 23. However, this plan was obviously

1 going to be disastrous for Above-50-Percent vendors that would not be entitled to the
2 percentage variance that major retailers would receive. *Id.*

3 27. ADHS proposed a way to avoid this disparate result by determining the
4 average cost of each individual food item authorized under the WIC program, and then
5 evaluating Above-50-Percent vendors to ensure that their prices were consistent with
6 the statewide average price for those items. **Ex. 2**, Aff. of Ms. Lively at ¶ 24.
7 However, FNS rejected these methodologies stating that they could not be implemented
8 by the required certification date, and reminded ADHS that future changes would have
9 to go through the same certification process. *Id.*

10 28. ADHS' March Plan went into effect on June 1, 2006. **Ex. 2**, Aff. of Ms.
11 Lively at ¶ 25.

12 29. The March Plan purely reflects one of two federal approach to cost
13 containment. **Ex. 2**, Aff. of Ms. Lively at ¶ 26. This approach taken in the March Plan
14 creates an impossible dilemma for the Above-50-Percent vendors because it fails to
15 calculate the statewide average price of individual food items. *Id.* By relying only on
16 the value of the voucher types, the system fails to take into consideration that
17 participants often only partially redeem vouchers at traditional grocery stores, so the
18 grocery store average does not reflect the maximum value of that particular voucher
19 type because not all the items were "purchased." *Id.*

20 30. Because the Arizona policy does not calculate or track the statewide
21 average price of individual food items, it also does not account for times when large
22 retail grocers put an item on sale as a loss leader to attract customers, thereby charging
23 a reduced price that a smaller vendor could never match. **Ex. 2**, Aff. of Ms. Lively at ¶
24 When this occurs, the loss sale causes the statewide average price for every voucher
25 containing that item to be depressed. *Id.* Therefore, although an Above-50-Percent
26 vendor may have been charging a fair and competitive price for that item, vouchers

1 including that item will have redemption values lower than the true market price
2 because of the sale at one retail chain. *Id.*

3 31. Once the March Plan took effect, these problems immediately caused
4 Basic Food Market to suffer severe economic losses. **Ex. 2**, Aff. of Ms. Lively at ¶ 28.

5 32. During June 2006, the first month of the plan, Basic Food Market had
6 11,839 vouchers returned because the voucher amount was higher than the statewide
7 average. **Ex. 2**, Aff. of Ms. Lively at ¶ 29. The state withdrew \$382,228.95 from Basic
8 Food Market's bank account, of which \$356,957.26 was later returned. *Id.* In the
9 interim, Basic Food Market was left scrambling to avoid bouncing checks it had written
10 to suppliers and creditors. *Id.*

11 33. Because ADHS does not calculate the average prices for items it is
12 impossible for WIC vendors to determine which item is causing a voucher to be higher
13 than the statewide average. **Ex. 2**, Aff. of Ms. Lively at ¶ 30. Basic Food Market had
14 to comb through each returned voucher to determine if any item is showing up more
15 consistently than any other, which may mean that item's price is too high, causing the
16 voucher amount to be higher than the statewide average. *Id.* This is a time and labor
17 intensive inquiry that has to be repeated each month, and that yields uncertain results.
18 *Id.* Basic Food Market has reduced prices on almost every item it stocks by at least
19 seven percent in a blind attempt to guess at what items might have been a few cents
20 higher than the unpublished state voucher average for that month. *Id.*

21 34. Basic Food Markets continued to still receive returned vouchers in this
22 manner through December 2006. **Ex. 2**, Aff. of Ms. Lively at ¶ 31. Currently, ADHS
23 provides the statewide average prices for the previous month just in time for Basic Food
24 Market to adjust its prices for the upcoming month. *Id.* Although this addresses the
25 problem of returned vouchers, it does nothing to alleviate the disastrous effect that the
26 March Plan has had on pricing. *Id.*

1 35. In addition to the significant withdrawals from its bank account, Basic
2 Food Market is charged a flat fee of five dollars by its bank for each returned voucher.
3 To date, this has amounted to nearly \$100,000 in returned check fees. **Ex. 2**, Aff. of
4 Ms. Lively at ¶ 32.

5 36. Basic Food Market is still compared against all participating vendors
6 statewide, including mammoth superstores like Wal-Mart, Super Target, and military
7 commissaries. **Ex. 2**, Aff. of Ms. Lively at ¶ 33. These same superstores are
8 reimbursed at up to 140% of the average price charged by vendors in that peer group.
9 **Ex. 2**, Aff. of Ms. Lively at ¶ 34.

10 37. Other small independent grocers do not have to compete against the
11 prices charged across the state by vendors like Wal-Mart, but only against other small
12 independent grocers in their area that have similar total gross annual sales. **Ex. 2**, Aff.
13 of Ms. Lively at ¶ 35. However, Above-50-Percent vendors, even small ones, have to
14 compete against the prices charged by everyone else in the state, including superstores.
15 *Id.* This effectively requires Basic Food Market stores to charge prices that are lower
16 than every other traditional vendor in the state. **Ex. 2**, Aff. of Ms. Lively at ¶ 36.

17 38. Cost containment has had a dramatic effect on Basic Food Market. **Ex. 2**,
18 Aff. of Ms. Lively at ¶ 37. Basic Food Market has had to completely restructure the
19 way it does business. *Id.* In the years prior to cost containment, Basic Food Market
20 had always maintained a competitive profit margin. *Id.* However, since ADHS' cost
21 containment plan was implemented in late May 2006, Basic Food Market has not made
22 a profit. *Id.* Basic Food Market's initial response was to cut costs and expenses. *Id.* It
23 has renegotiated its contracts with all of its vendors and with its bank. *Id.* It
24 immediately lost almost an 8% gross margin. *Id.* It also had over \$60,000 in WIC
25 returned checks fees in addition to the fees it incurred for each weekly WIC deposit. *Id.*
26

1 39. To reduce its returned check fees, Basic Food Market had to hire
2 temporary administrative personnel, and had to reassign duties to evaluate the WIC
3 returned checks. **Ex. 2**, Aff. of Ms. Lively at ¶ 38. It also had to reduce its annual pay
4 rate increases, bonuses, and employee incentives. *Id.* It is now closing one of its stores
5 to offset some of these losses. As a result of this store closing, it will lose customers,
6 employees, and some of its buying power. *Id.* In addition, Basic Food Market has been
7 unable to carry some of the specialty formulas it has traditionally carried. **Ex. 2**, Aff. of
8 Ms. Lively at ¶ 39.

9 **RESPECTFULLY SUBMITTED** June 18, 2007.

10 **BERRY & ASSOCIATES, PLLC**

11 By /s/ Christopher J. Berry
12 Christopher J. Berry
13 101 North First Avenue, Suite 1800
14 Phoenix, Arizona 85003
15 Attorney for **Plaintiff**

BERRY & ASSOCIATES

ATTORNEYS AT LAW

1 CERTIFICATE OF SERVICE

2 I hereby certify that on June 18, 2007, I electronically transmitted the attached
3 document to the Clerk's Office using the CM/ECF System for filing and transmittal of a
4 Notice of Electronic Filing to the following CM/ECF registrants:

5 James D. Todd, Jr.
6 Senior Counsel
7 20 Massachusetts Ave., N.W.
8 Washington, D.C. 20001

9 By: /s/ Christopher J. Berry
10 CHRISTOPHER J. BERRY

11 **ORIGINAL** of the foregoing e-filed and mailed
12 June 18, 2007, with:

13 **COURT OF THE CLERK**
14 **UNITED STATES DISTRICT COURT**
15 **FOR THE DISTRICT OF ARIZONA**
16 Sandra Day O'Connor United States Courthouse
17 401 W. Washington Street, Suite 130
18 Phoenix, AZ 85003

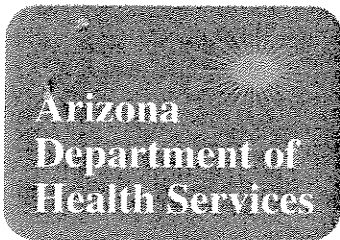
19 **COPY** of the foregoing e-mailed and mailed
20 June 18, 2007 to:

21 James D. Todd, Jr.
22 Senior Counsel
23 **U.S. Department of Justice**
24 **Civil Division**
25 20 Massachusetts Ave., N.W.
26 Washington, D.C. 20001

By/s/ Christopher J. Berry

Exhibit 1

Basic Food Market's Controverting
and Supplemental Statement of Facts



Office of the Director

150 N. 18th Avenue Suite 500
Phoenix, Arizona 85007-3247
(602) 542-1025
(602) 542-1062 FAX

JANET NAPOLITANO, GOVERNOR
SUSAN GERARD, DIRECTOR

RECEIVED

OCT 16 2006

OCT 13 2006

By Facsimile (602) 462-1151 and U.S. Mail

Christopher J. Berry, Esquire
Whitten Berry, PLLC
101 North First Avenue, Suite 1800
Phoenix, Arizona 85003

Subject: Basic Food Market and the Federal Cost Containment Regulations

Dear Mr. Berry:

Thank you for your letters of concern regarding the impact that the Federal cost containment regulations are having on your client's (Basic Food Market's) operations. The Arizona Department of Health Services (ADHS), Office of Chronic Disease Prevention and Nutrition Services, which administers the Arizona WIC Program, understands your client's current issues. The ADHS is also aware of the plight of other Above-50-Percent Vendors (A-50 Vendors) and that of regular vendors throughout the State as they attempt to comply with the Federal cost containment regulations. Please note that the United States Department of Agriculture (USDA) will continue to accept comments from concerned WIC vendors until November 29, 2006. If, however, your client chooses to file a lawsuit in federal district court as indicted in your letter, will you please provide the ADHS, through the Arizona WIC Program, either a copy of the complaint or the cause number.

This response is an attempt to clarify some misunderstandings that your client may have regarding the Federal cost containment regulations, the impact that the regulations have on your client, or the Arizona WIC Program's mandatory compliance with the regulations. It should be noted that based upon the November 29, 2005 Federal Register (Vol. 70, No. 228), the Code of Federal Regulations (7 C.F.R. §246.12), and the Amended Vendor Contract that your client signed on April 21, 2006, the Arizona WIC Program had a choice to either: a) terminate all existing Above-50-Percent Vendors from participation in the Arizona WIC Program; or b) allow all existing A-50 Vendors to participate in the Arizona WIC Program pursuant to the Federal cost containment regulations. The Arizona WIC Program chose to allow existing A-50 Vendors to participate pursuant to the Federal cost containment regulations.

Christopher J. Berry, Esquire
Page 2

After the choice was made to allowing existing A-50 Vendors to participate in the Arizona WIC Program pursuant to the Federal cost containment regulations, the state had two options as indicated in your letter: 1) establish a separate peer group for A-50 Vendors (first Federal approach); or 2) establish distinct price selection and reimbursement criteria for A-50 Vendors within a peer group that includes traditional vendors (second Federal approach). Your letter indicates that Arizona's current approach to cost containment is the second approach; this is not correct.

On October 28, 2005, the Arizona WIC Program submitted its original vendor cost containment certification request to the USDA describing Arizona's plan to ensure that competitive price criteria and allowable reimbursement levels do not result in higher average payments per voucher to A-50 Vendors than to other comparable vendors. Arizona's October 28, 2005 plan (original plan) was to implement the second Federal approach which established distinct price selection and reimbursement criteria for A-50 Vendors within a peer group that includes traditional vendors. Further, Arizona's original plan included methodology that took individual food item prices into consideration when determining the "not to exceed" (NTE) by peer group. This is exactly the preferred methodology that Basic Food Market suggests that the State of Arizona follow on page four of your letter. However, the USDA did not approve Arizona's original plan.

After numerous exchanges between the USDA and the Arizona WIC Program, on March 22, 2006, the Arizona WIC Program submitted a revised plan to the USDA based upon considerable Federal direction. The March 22, 2006 plan involved further revisions based upon additional Federal direction. The current Arizona plan was finally approved and certified by the USDA on September 14, 2006. The current Arizona plan utilizes the first Federal approach which establishes a separate peer group for A-50 Vendors. For that separate peer group, the State agency limits reimbursement to A-50 Vendors to the mean (statewide average of all regular vendors by Food Instrument Type-FI Type) of all regular vendors. The Arizona WIC Program agrees that using the statewide average price per Food Instrument Type can be problematic. However, this is the only option that the USDA has approved for the Arizona WIC Program.

Arizona was required to implement its current plan by October 1, 2006, in order to avoid paying significant monetary penalties per month to the Federal government. After the implementation of Arizona's current plan, the State must continue to ensure that A-50 Vendors participate pursuant to the Federal cost containment regulations. Pursuant to 7 C.F.R. §246.12 (g)(4): "If FNS determines that a State agency has failed to ensure that above-50-percent vendors do not result in higher costs to the program than if participants transact their food instruments at regular vendors, FNS will establish a claim against the State agency to recover excess food funds expended and will require remedial action."


Christopher J. Berry, Esquire
Page 3

Page three of your letter describes the monetary loss that Basic Food Market endured in June and July of 2006 due to the implementation of the Federal cost containment regulations. The State has been working diligently to minimize the loss that your client has endured. As indicated in an August 1, 2006, letter from Karen Sell to Eddie Bryant of Basic Food Market, Basic Food Market may want to consider negotiating another banking agreement that lowers or eliminates rejected check charges. Ms. Sell's August 1, 2006, letter also instructed Basic Food Market to utilize the WIC ACH Bank Statement by store to determine the maximum amount that can be paid per Food Instrument Type. Furthermore, in the beginning of August 2006, the Arizona WIC Program expended a significant amount of money to revise the WIC ACH Bank Statements so that the statements would be easily comprehensible for the A-50 Vendors to determine the NTE for a specific FI Type.

In order to aid all vendors in their attempts to comply with the Federal cost containment regulations, the Arizona WIC Program believes that implementing a pin number access based Internet website in which the maximum NTE by FI Type will be available to the vendors. Initially, the internet access will be available only to A-50 Vendors. Subsequently, the Internet access will be available to all regular vendors as well. The Internet site will not be available for at least a few months. Ultimately, the Internet site will contain five days advance notice prior to implementation of the new NTE. However, the five day advance notice prior to implementation of the new NTE will require USDA approval. Federal approval may take additional time.

The Arizona WIC Program recognizes Basic Food Market's commitment to the WIC participants of Arizona and hopes that the Internet site will aid Basic Food Market in its compliance with the Federal cost containment regulations. We look forward to your patience and continued cooperation.

Sincerely,



Susan Gerard
Director

SG:KIS:kk

c: Allison Kern, Esquire, Assistant Attorney General
Karen I. Sell, RD, Nutrition Programs Manager

Exhibit 2

Basic Food Market's Controverting
and Supplemental Statement of Facts

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5 Telephone: (602) 462-1141
6 Facsimile: (602) 462-1151

7 Attorneys for Plaintiff

8 **IN THE UNITED STATES DISTRICT COURT**
9 **FOR THE DISTRICT OF ARIZONA**

10 BASIC FOOD MARKET, L.L.C.;
11 BASIC FOOD MARKET II, L.L.C.,

12 Plaintiffs,

13 v.

14 UNITED STATES DEPARTMENT OF
15 AGRICULTURE FOOD AND NUTRITION
16 SERVICE,

17 Defendants.

No.

**AFFIDAVIT OF DONNA J.
LIVELY IN OPPOSITION TO
MOTION FOR SUMMARY
JUDGMENT**

18 STATE OF TEXAS)
19 County of El Paso) ss.

20 1. I, Donna J. Lively, upon my oath, give the following Affidavit. I am over
21 eighteen years of age, and the matters set forth in this Affidavit are based upon my
22 personal knowledge.

23 2. I am one of the managers of Basic Food Market, L.L.C., an Arizona
24 limited liability company. Basic Food Market, L.L.C. operates seven stores in
25 Maricopa County, Arizona.

26 3. I am also one of the managers of Plaintiff Basic Food Market II, L.L.C.,
an Arizona limited liability company that operates one store in Pima County, Arizona.

4. Although Basic Food Market and Basic Food Market II are separate
limited liability companies, they are owned and managed by the same individuals,

1 including myself. In this Affidavit, the companies and their retail outlets are
2 collectively referred to as "Basic Food Market."

3 5. Basic Food Market provides basic food, nutritional, and related products
4 to parents in Arizona who participate in the Women Infant and Children ("WIC")
5 program.

6 6. Basic Food Market has operated in Arizona since 1996.

7 7. Basic Food Market employs approximately fifty-one (51) people in
8 Arizona, many of them former participants in the WIC program.

9 8. In Arizona, the WIC program serves approximately 152,000 participants
10 each year.

11 9. In an average month, Basic Food Market serves about 11,000 participants.

12 10. Under the Arizona WIC program, participating women and children
13 receive vouchers from the Arizona Department of Health Services ("ADHS"). These
14 vouchers are then exchanged for supplemental food packages that are customized to fit
15 the participant's needs.

16 11. Participants can redeem their vouchers at any authorized retailer. These
17 include both traditional grocery stores and stores that specialize in selling WIC
18 products. Such stores are referred to as predominately WIC stores (PWICs), WIC-only
19 stores, or Above-50-Percent vendors. Basic Food Market is an Above-50-Percent
20 vendor. Stated simply, we provide WIC products to WIC participants as our main form
21 of business.

22 12. Basic Food Market goes to great lengths to insure that our customers
23 receive every product listed on their voucher.

24 13. As Above-50-Percent vendors, we provide WIC participants with a more
25 respectable shopping experience than they tend to encounter in traditional grocery
26 stores where they can be subjected to embarrassment or discomfort at being identified

1 as a WIC recipient, or at being unable to purchase a certain item because it is not part of
2 their approved food package.

3 14. WIC transactions can be very complicated and pose problems for many
4 cashiers who do not experience the transaction often in comparison to regular sales
5 transactions. Because we deal predominantly with WIC items, our stores have the
6 knowledge and day-to-day experience to know how to handle WIC transactions. Many
7 of our staff members are former WIC participants, so they are knowledgeable about the
8 program's rules, and they relate well to our customers. In short, we provide a non-
9 threatening and dignified shopping experience.

10 15. Basic Food Market collectively operates eight stores in Arizona.
11 However, one store will soon be closing due to the problems set forth in this lawsuit.
12 We have been operating in Arizona and providing an important service for eleven
13 years. Many of our stores carry specialty baby formulas that no other grocer in the state
14 stocks. Many customers, some of whom are not WIC participants, can only obtain their
15 baby's formula at Basic Food Market.

16 16. Since our inception, Basic Food Market has charged fair and reasonable
17 prices for all products. We are an honorable, responsible, authorized WIC retailer, and
18 we take pride in the valuable role we serve in assisting the WIC participants. Basic
19 Food Market enjoys a good reputation in the community and, prior to cost containment,
20 a positive working relationship with ADHS.

21 17. Basic Food Market obtains our products from the same suppliers and
22 wholesalers as traditional vendors, and experiences the same price fluctuations as
23 traditional vendors.

24 18. Basic Food Market pays our employees a competitive wage. We offer
25 them paid vacations and holidays, and medical and dental insurance.
26

1 19. Basic Food Market does not run the type of store that caused Congress to
2 include cost containment provisions in the WIC Reauthorization Act.

3 20. ADHS submitted several cost containment plans to the USDA's Food and
4 Nutrition Service. These plans were denied, and ultimately ADHS proposed the
5 "March Plan" after much guidance from the Food and Nutrition Service.

6 21. The March Plan separates Above-50-Percent vendors into their own peer
7 group, while regular vendors remain in peer groups segregated by location,
8 classification as independent or chain, and total gross annual sales.

9 22. To determine the maximum amount that Above-50-Percent vendors could
10 be reimbursed, ADHS used the previous month's statewide average price for all regular
11 vendors by food instrument type. Regular vendors would be reimbursed at the average
12 for their peer group plus a percentage variance. For example, the State would compile
13 the redemption amount of all food instruments numbered 000311AA, excluding those
14 redeemed at Above-50-Percent vendors, and then determine the average redemption
15 amount for food instrument 000311AA. Above-50-Percent vendors would then be
16 reimbursed only up to that amount for food instrument 000311AA, but every other peer
17 group had a higher reimbursement amount because each is allotted an additional
18 percentage variance from the average. The percentage reimbursement variance for
19 regular grocers is between five percent (5%) and seventy percent (70%), but averages
20 forty percent (40%). This results in regular vendors being able to charge up to 140% of
21 their peer group average.

22 23. In a letter of October 13, 2006, Susan Gerard, Director of ADHS, states
23 that this is the only approach FNS would approve. However, this plan was obviously
24 going to be disastrous for Above-50-Percent vendors that would not be entitled to the
25 percentage variance that major retailers would receive.

1 24. ADHS proposed a way to avoid this disparate result by determining the
2 average cost of each individual food item authorized under the WIC program, and then
3 evaluating Above-50-Percent vendors to ensure that their prices were consistent with
4 the statewide average price for those items. However, FNS rejected these
5 methodologies stating that they could not be implemented by the required certification
6 date, and reminded ADHS that future changes would have to go through the same
7 certification process.

8 25. ADHS' March Plan went into effect on June 1, 2006.

9 26. The March Plan purely reflects one of two federal approach to cost
10 containment. This approach taken in the March Plan creates an impossible dilemma for
11 the Above-50-Percent vendors because it fails to calculate the statewide average price
12 of individual food items. By relying only on the value of the voucher types, the system
13 fails to take into consideration that participants often only partially redeem vouchers at
14 traditional grocery stores, so the grocery store average does not reflect the maximum
15 value of that particular voucher type because not all the items were "purchased."

16 27. Because the Arizona policy does not calculate or track the statewide
17 average price of individual food items, it also does not account for times when large
18 retailer grocers put an item on sale as a loss leader to attract customers, thereby
19 charging a reduced price that a smaller vendor could never match. When this occurs,
20 the loss sale causes the statewide average price for every voucher containing that item
21 to be depressed. Therefore, although an Above-50-Percent vendor may have been
22 charging a fair and competitive price for that item, vouchers including that item will
23 have redemption value lower than the true market price because of the sale at one retail
24 chain.

25 28. Once the March Plan took effect, these problems immediately caused
26 Basic Food Market to suffer severe economic losses.

1 29. During June 2006, the first month of the plan, Basic Food Market had
2 11,839 vouchers returned because the voucher amount was higher than the statewide
3 average. The state withdrew \$382,228.95 from Basic Food Market's bank account, of
4 which \$356,957.26 was later returned. In the interim, Basic Food Market was left
5 scrambling to avoid bouncing checks it had written to suppliers and creditors.

6 30. Because ADHS does not calculate the average prices for items it is
7 impossible for WIC vendors to determine which item is causing a voucher to be higher
8 than the statewide average. Basic Food Market has to comb through each returned
9 voucher to determine if any item is showing up more consistently than any other, which
10 may mean that item's price is too high, causing the voucher amount to be higher than
11 the statewide average. This is a time and labor intensive inquiry that has to be repeated
12 each month, and that yielded uncertain results. Basic Food Market has reduced prices
13 on almost every item it stocks by at least seven percent in a blind attempt to guess at
14 what items might have been a few cents higher than the unpublished state voucher
15 average for that month.

16 31. Basic Food Markets continued to still receive returned vouchers in this
17 manner through December 2006. Currently, ADHS has agreed to provide the statewide
18 average prices for the previous month in time for Basic Food Market to adjust its prices
19 for the upcoming month. Although this addresses the problem of returned vouchers, it
20 does nothing to alleviate the disastrous effect that the March Plan has had on pricing

21 32. In addition to the significant withdrawals from its bank account, Basic
22 Food Market is charged a flat fee of five dollars by its bank for each returned voucher.
23 To date, this has amounted to nearly \$100,000 in returned check fees.

24 33. Basic Food Market is compared against all participating vendors
25 statewide, including mammoth superstores like Wal-Mart, Super Target, and military
26 commissaries.

1 34. These same superstores are reimbursed at up to 140% of the average price
2 charged by vendors in that peer group.

3 35. Other small independent grocers do not have to compete against the
4 prices charged across the state by vendors like Wal-Mart, but only against other small
5 independent grocers in their area that have similar total gross annual sales. However,
6 Above-50-Percent vendors, even small ones, have to compete against the prices
7 charged by everyone else in the state, including superstores.

8 36. This effectively requires Basic Food Market stores to charge prices that
9 are lower than every other traditional vendor in the state.

10 37. Cost containment has had a dramatic effect on Basic Food Market. We
11 have had to completely restructure the way we do business. In the years prior to cost
12 containment, Basic Food Market had always maintained a competitive profit margin.
13 However, cost containment has completely changed that. Since ADHS' cost
14 containment plan was implemented in late May 2006, Basic Food Market has not made
15 a profit. Our initial response was to cut costs and expenses. We renegotiated our
16 contracts with all of our vendors and with our bank. They complied and cut fees and
17 costs as much as they could. Yet we still lost almost an 8% gross margin. Although,
18 the bank cut its fees, we still had over \$60,000 in WIC returned checks fees in addition
19 to the fees we incur for each weekly WIC deposit.

20 38. To reduce our returned check fees, we had to hire temporary
21 administrative personnel, and had to reassign duties to evaluate the WIC returned
22 checks. We have reduced our average annual pay rate increases, bonuses, and
23 employee incentives. We are now closing one of our stores to offset some of our
24 losses. As a result of this store closing, we will lose customers, employees, and some
25 of our buying power.

