

Statement by;

ROBERT MORGAN  
Attorney General of North Carolina

N. C. Milk Commission  
Raleigh, N. C.  
June 7, 1972

ON RESCINDING FAIR TRADE ORDER #11

Mr. Chairman, ladies and gentlemen of the Commission, I thank you for allowing me to appear before you to express my views in support of my recommendation that you rescind Fair Trade Practice Order #11, or in the alternative, to suspend it for a substantial period of time (a minimum period of 90 days).

This is your third meeting in about six weeks. You have heard lengthy statements and many recommendations from milk industry members as to what action should be taken to prohibit certain practices currently prevailing in the dairy industry in North Carolina.

I understand that it was the unanimous opinion of those who appeared before you in two prior meetings that Fair Trade Practice Order #11 was ineffective in providing the degree of price stability in the marketing of milk desired by some industry officials.

I understand also that the overwhelming majority of those who appeared were divided about equally between two views as to what action the Commission should take.

Those in the first group recommended that Fair Trade Order #11 be rescinded or suspended and that we allow processors to freely compete in an open market. This would let milk prices to the consumer find their own level through the unrestrained workings of competition in the market place. This recommendation leaves intact the present protections guaranteed to the milk producer by your milk marketing order #2. This is also the recommendation by my office.

Those in the second group recommended that Fair Trade Order #11 be rescinded and in place thereof, the Commission should immediately set the price to be paid for milk at all levels of distribution in the State, including the price to be paid by the consumer.

I realize that two industry members asked the Commission to leave Fair Trade Order #11 in effect and they said, thereby, restore the conditions in effect immediately prior to April 17, 1972. In my opinion , the two members misunderstood the result which would follow from their request. In effect, however, they were asking you to set the price of milk at the wholesale level to be charged by the processors.

Because the Commission had not called for a hearing to set prices at either the wholesale or retail level, in our opinion, you cannot legally, at this time or in the immediate future (because of a lack of substantial and reliable cost data), set milk prices at the wholesale level which were in effect prior to April 17, 1972. For the same reasons, you cannot set the prices of milk at the wholesale and retail level.

Since you cannot do what those latter industry members desire, a close examination of all remaining recommendations of the industry members reveals a solution which is simple, clear cut, and easy to implement. This solution is for the Commission to rescind or suspend for a substantial period, all of the provisions of Fair Trade Order #11 and let those in the market compete on the same terms as all other competitors do, subject only to the specific prohibitions against unfair methods of competition contained in the antitrust laws which apply equally to all competitors in the market.

I think it is particularly significant that after two lengthy hearings, the only request and recommendation made to you from those in the market which you are presently able to implement, was "remove the barriers to competition".

Some of the comments were, "Let us freely compete". "Rescind Fair Trade Order #11." "Suspend Fair Trade Order #11." "Fair Trade Order #11 is not obeyed and that places those who do obey it at a disadvantage ... either enforce it or rescind it." and, "The enforcement of Fair Trade Order #11 by the Commission is what brought on the current conditions."

Larger chain food retailers advised my office as late as last week that the prices they charge are regulated and determined by the Milk Commission. Frankly, I was surprised to hear them make this statement. When asked to identify the Commission's rule which does so, they identified Fair Trade Order #11.

When they were told that Fair Trade Order #11 does not establish the prices, they manifested complete disbelief and said they had been in the business too long and had too much experience with the Commission to believe otherwise.

For example, one high company official said that he had even given milk to charity rather than lower the price to the consumer. He then asked how, if the Commission doesn't set prices, you could explain the fact that the Commission called him to complain about one of his stores selling milk at 99¢ per gallon, which was not below cost. He felt it

necessary to assure the caller from the Commission that such was unauthorized and that corrective action would be taken. "Corrective action" was taken and the price of milk went back up at the particular store.

Other store managers have told us of phone calls from the Commission staff reminding them of law suits brought by the Commission against retailers for dropping prices. Fair Trade Orders were cited by the callers. These store managers manifested concern over injury to their store's public image through law suits brought by the Commission. If such threats were made, whether expressed or implied, their concern was warranted. And I think you should be concerned also.

Thus, it follows with certainty that as long as Fair Trade Order #11 or any vestiges thereof remain, including the proposed revision, the processor who obeys your rules is placed in an impossible position. If he obeys your Fair Trade Order, he loses his customers and if he violates your Fair Trade Order, he loses the small margin of profit.

The large chain retailer, while maintaining high prices, realizes large margins of profit on milk sales, and they have been placed in fear of law suits if they reduce their milk prices and profit margin.

Some of the big processors seem to be doing all in their power to confuse the issue and to muddy the water by advancing the argument that, "[T]his is a complex business and we had better do nothing rather than take precipitous action."

Now, the milk business may very well be complex and those of us who are not in the business may not fully understand it. But, that argument fails entirely in the face of the recommendations of those who are in the milk business itself.

While we may not understand all of its facets, certainly those in the business do, and they say, "Fair Trade Order #11 is not working - rescind it and do it now." And no one is asking for "precipitous" action because Fair Trade Orders have received long and intensive study, both by the Commission and by my offices.

I agree with those who say it should be rescinded or suspended and it should be done now. My reasons are not based upon the recommendations of those in the industry, however. My recommendations flow from an extensive investigation undertaken by my office which commenced in April, 1969, and has continued to this time.

My reluctant conclusion is that if price fixing or resale price maintenance is a disease, then the milk industry is one of the most infected industries in this State. The result of this infection is unreasonably high prices for milk to the consumer, marginal profits to the honest processor, and exorbitant profits from milk by the large chain retail stores.

Whether we like to admit it or not, the former Milk Commission was used as the carrier of the resale price maintenance disease in the marketing of milk in this State through the use of "Fair Trade Practice Orders". The proposed revision before you today has the same "carrier" characteristics. While this may be a harsh indictment, it is nonetheless true.

Let me use some actual examples to illustrate the last point. Under the provisions of the Fair Trade Orders, including the proposed revision, all sales prices must be filed in advance and cannot be changed on less than 10 days advance notice to the Commission and to all competitors (except to meet a competitor's lower filed price).

The wholesale prices filed prior to April 17, were generally \$1.22 per gallon. Under regulations of this

Commission, the following practices actually prevail in this State.

	Chain Retail Stores with Own Processing Plant	Chain Retail with Private Label	Chain w/ F Cert.	Small store w/o disc.
Retail Price	1.31	1.31	1.31	1.31
Approx. Cost	.90	.96	1.05	1.22
Mark-Up	<u>.41</u>	<u>.35</u>	<u>.26</u>	<u>.09</u>
Mark-Up %	45%	36%	25%	7 1/2%

These conditions continue to prevail today in most of North Carolina and where they don't, you are being asked to recreate and restore those conditions.

My investigation further reveals that normal pricing practices of retailers follows a rough pattern as follows:

The longer an item stays in the store, the larger the mark-up by the retailer. The range from profitable items is from 7% (cigarettes) on items which remain in the store about a week, to 40% for the slower moving items.

Milk generally stays in the store no longer than three days. It is one of the fastest turnover items in the store.



This usually calls for a lower mark-up. When we compare the mark-up by the small retailer, we see that the mark-up on milk is about the same as on cigarettes. The small retailer who receives no rebates follows the normal pattern of pricing fast-turnover items in setting his retail milk prices. Every other large food retailer departs from this practice, however, on milk.

In addition, when it comes to milk, the chain retailers disguise the fact that they have such a large mark-up on milk by establishing the retail price at about an 8% mark-up on the invoice cost which is not the actual cost, if you consider rebates.

Another example which illustrates price setting at the retail level because of Commission action, whether intended or not, is found in those stores which have a variety of "store brand" or "house brand" products together with "outside" or "nationally advertised" brands.

The officials in these stores stated as a fact that the profit margin on the store brand and nationally advertised brands was substantially the same, and the lower retail prices on the store brands merely reflected the lower costs of the "store brand" to the retailer. These savings in cost were passed along to the consumer in lower retail prices.

The one notable exception to this practice is milk. The retail price of milk to the consumer is substantially identical on both the "store" brand and the "outside" brand, even though as illustrated above, the "store" brand actually costs the retailer less than the "outside" brand, just as is the case on all other products. Here again, the reason for the departure from normal pricing practices was laid to the Milk Commission and specifically the Fair Trade Orders issued by it.

When we finally broke through the surface appearances of a small mark-up percentage and established the real mark-up, the pricing managers unanimously said that the prices they set were based upon Milk Commission's established prices.

One manager candidly admitted that if milk were sold in free and open competition, the price to the consumer would be lower. An economist who has been consulting with us indicates the savings to the consumer flowing from competition could be several million dollars annually. This estimate contemplates the continued enforcement of your established prices to the producer in Milk Market Order #2.

Faced with these facts, I have had to ask myself and my staff members what possible justification there is for the Commission to continue its Fair Trade Order provisions.

I can't justify it to myself and none of my staff, including those consulting with us, have been able to justify its continuation in any form.

I have concluded that the only real reason to enter such an order is to prevent the use of price as a competitive tool in the dairy industry. This, I believe, is conceded by those most familiar with the Order. Their rationale seems to be that by removing price as a competitive tool, you reduce competition between sellers in the market and you thus get "stability" and afford some "protection" for those smaller processors.

This is illusory at best and plainly injurious to both the small businessman and the general public at worst.

There are many sellers and buyers in the milk marketplace in North Carolina. Competition and rivalry in such a situation should be intense. Considering this fact, this Commission cannot, and we say should not, remove or impair the ability to compete between sellers so long as they do so on a fair, lawful basis.

We should all be aware that when you remove price as an element of competition, you merely intensify other types of non-price competition. Usually these are the most expensive kind of competitive tools and are largely unwanted by the

buyers; for example, increased rebates to favored customers. This cost must be recouped by the seller by raising his prices to the non-favored customer. Another example of increased non-price competition is increased advertising. This expense adds to costs which are recouped by increased prices.

I could go on and on with examples of increased non-price competitive behavior which are employed when the ability to use price is removed or substantially impaired by government or other action. The result is always increased costs which ultimately must be borne by the consumer.

Mr. Chairman, I was impressed by your opening remarks at the last meeting of the Commission when you gave your interpretation of the duty of the Commission. You said that you do not conceive it your duty to protect some particular segment of the industry from competition but rather to protect the public's interest in reasonable prices. I concur 100 percent in those remarks.

I believe you can achieve this goal best by increasing the number of available competitive tools to those in business, not by removing them, and not by erecting artificial barriers to the legitimate use of price as one of those competitive tools. Price is the least expensive competitive tool available to any businessman in the free world today. And, if we believe

in free enterprise, then we must agree that its legitimate use should be encouraged, not discouraged.

Now I have emphasized the use of the word legitimate use of price as a competitive weapon.

By advocating and requesting the rescission of Fair Trade Order #11 and objecting to the adoption of the proposed revision of that Order, I have not suggested that we open the door to, nor legalize, predatory pricing behavior by any processor or distributor doing business in this State. To me this is the most salient fact which recommends the elimination of Fair Trade Orders by the Commission.

This Commission was created to detect and prevent predatory conduct by those engaged in the processing and marketing of milk in North Carolina. The 1971 General Assembly gave you broad, extensive, and specific power to stop predatory practices when found to exist, and to punish those parties who engage in them. You even have power to take away their right to continue to do business in this State.

This power was designed to be invoked in specific instances of proven predatory pricing practices by specific parties. I fully concur with the law and its intent. In effect, you have been given the authority to administer the antitrust or antimonopoly laws of this State over a single segment of industry, the milk industry.

Nothing the General Assembly has said can reasonably be construed to mean that it is the public policy of this State to eliminate competition in the marketing of milk in this State. Indeed, the public policy is just the opposite.

The public policy declared in establishing the Milk Commission was to prevent the elimination of competition in the marketing and distribution of milk in North Carolina. This policy was stated by our Supreme Court in MILK COMMISSION v NATIONAL FOOD STORES, 270 NC 323, 154 SE 2d 548 (1967).

Thus it is crucial to you in making your decision on Fair Trade Orders in general and those before you now, in particular, to recognize the initial distinction made by the Supreme Court and the General Assembly in enacting the milk laws. I repeat - the policy is to prevent the elimination of competition, not to prevent competition.

The present law itself prohibits the following specific practices:

- (1) Sale of milk below cost for the purpose of injuring, harassing or destroying competition, and
- (2) Sale of milk below cost by a retailer as a "loss leader".

Except for those two prohibitions, those involved in the sale of milk are to be free to use price as a competitive tool. This is not just the position of the Attorney General of North Carolina or the Consumer Protection Division of my office. This is the public policy of this State as stated by both the General Assembly of North Carolina and our Supreme Court. Promotion of competition then should be the polar star to guide your judgment.

I submit there has been no factual or legal showing made to this Commission indicating it should exercise general powers over the entire milk industry by Fair Trade Orders when the results have been shown to inhibit legitimate competitive behavior in the market and foster such unfair results as we have discovered and shown to you here today.

Mr. Chairman, ladies and gentlemen, I suggest you consider carefully why you are being asked to continue Fair Trade Orders and the extensive regulations contained therein. Ask yourself who is advocating them and for what purpose. Isn't it a fact that those who support price filings with the Commission admit the direct result of such filing is to inhibit price competition?

Do you conceive the proper role of the Commission to be that of a clearinghouse for the exchange of selling prices

to be charged 10 days hence between competitors? If this is not its proper role, and I submit it is not, then why do those who advocate Fair Trade Orders insist so vehemently that this be done?

I suggest that if you permit yourself to be persuaded by those who advocate price fixing by use of the illusory star of "stability", then you will permit yourselves to be used by industry as a vehicle to fix prices and maintain the status quo between large processors and large chain stores. These existing arrangements, together with the price filing requirements existing and proposed, as a practical matter, foreclose other processors from a substantial portion of the retail milk market. Thus, you achieve the opposite result from the declared public policy.

You will have been persuaded to do indirectly what is unlawful if done by you directly. You will have eliminated some competition which would otherwise exist and which would otherwise be lawful. Such a result is untenable.

No Fair Trade Order is needed to find those who violate our laws. No Fair Trade Order is needed to produce proof of those violators, and no Fair Trade Order is needed to impose appropriate sanctions on those who do, in fact, violate our laws.



Thus, if no Fair Trade Order is needed for carrying out any of the legitimate duties of this Commission, then it follows that no policy should be continued under the guise of "Fair Trade Practice Orders" or by any other means which inhibit lawful activity, eliminates lawful competition, and injures the consuming public of North Carolina.

\* \* \* \* \*