

Rotarians of District 769
District 769 Annual Conference

SPEECH BY ROBERT MORGAN
WINSTON-SALEM, N. C.

MARCH 30, 1973

I certainly appreciate your inviting me to come to Winston-Salem to speak to you today. I have a lot of good friends up here and it's always a pleasure to come back.

You have asked me to talk to you about current events in the Attorney General's Office. I think your program committee must be familiar with the way our Office operates and the fact that we usually have a pretty good fight going with somebody all the time. I really don't know whether this is by accident or design but it does make for a interesting time.

I suppose the most controversial thing we now have going is the debate concerning Senate Bill 302 which proposes a number of changes in the laws related to the State Milk Commission.

Our concern about milk prices in this State and the manner in which the milk industry is regulated is not new found. The battle is now in its fourth year and the current controversy is merely the latest round.

I had contended for a long while that the price of milk in North Carolina has been maintained at an artificially high level and that the device for doing this has been the

the State Milk Commission and the use of "fair trade practice orders." No vestage of open competition or free enterprise today exists in the milk industry. The State Milk Commission has made this so and our current efforts are directed towards securing passage of Senate Bill 302, introduced by Senator Barker (D-Wake) which would allow competition among retailers of milk.

Lets look for just a moment at what this new legislation which we support would do.

One: The power of the State Milk Commission to make administrative orders which control the processor, distributor, and retailer would be eliminated. This change, if adopted, would prevent the Commission from promulgating the rules and regulations commonly called "Fair Trade Practice Orders" which have been the subject of great public controversy.

Two: The Bill would prevent the Commission from entering orders requiring distributors to give competitors notice of prices on products sold. Instead, price filings would be received by the Commission on a confidential basis.

I believe that if the Commission in fact needs to have the sales prices of milk on file, they have a right to them; but it is imperative that these reports be submitted to the Commission for the use of Commission staff only. I do not believe that the Milk Commission should be used by the processors as a clearinghouse to exchange pricing information

on milk in North Carolina. Awareness of the situation in the marketplace should be sufficient to enable merchants to compete without this aid from a State agency.

Three: The power of the Commission to fix the sales price of milk at wholesale and retail would be eliminated.

Four: Under another proposed change, distributors and processors would be prevented from making marketing agreements with producers. This change would not affect the ability of producers to make marketing agreements among themselves in order to establish a stronger position in the market.

The milk laws passed in 1953 recognized the fact that milk is a food product vital to the health and well-being of our citizens. Thus the General Assembly instituted a regulatory system whose goal was to insure that our citizens will have available to them at all times an adequate supply of milk at prices which are fair and reasonable to the consuming public and at the same time provide a reasonable profit for the producer. The Preamble to the rewrite to the law in 1971 re-asserts this goal.

The Milk Commission, of course, is the agency charged with administering this law. That agency has determined that the goals established by the General Assembly can be attained by assuring a continuous home-produced supply of milk for our citizens and that the keystone of milk regulation

is providing marketing stability for the dairy farmer.

I recognize the concerns that the dairy farmer in our State is faced with in order to survive. He produces the most perishable of all food commodities; he must make a continuing and usually a greater investment in his farm, herd and equipment than is required of his neighbors engaged in other farm activities; he must meet strict sanitary regulations administered by a variety of government bodies; and he must be efficient because the nature of herds requires constant attention to insure production of milk when the demands are existant.

All of these factors make the milk producer extremely susceptible to unfair and damaging purchasing practices by processors and distributors. This is the very reason for the existence of what is referred to as Milk Marketing Order #2. This is the regulation that guarantees the dairy farmer a fair price for his product.

If the Commission did not choose to use this regulation to protect producers, I doubt very seriously that they could survive the pressure that could be brought to bear to obtain their perishable raw milk at a lower price.

Let me emphasize that I have stated on many occasions that I support the Commission's efforts to protect the producer by using Milk Marketing Order #2. I still do.

I stated a moment ago that our first milk laws were passed in 1953. Since 1953, when the Commission was authorized by the General Assembly, the life style, including the buying habits, of the citizens of North Carolina has changed and changed drastically. If any one trend is evident to me, it is that most of our citizens are price conscious and shop for the best price on goods and services but usually without forsaking quality. To get the consumer dollar, sellers today have to compete and we all know that competition in the marketplace today is generally keen.

It is then reasonable to ask why there is no price competition in the selling of milk at retail. There is, of course, a simple answer to this question, but the answer the consumer receives today is unacceptable and I believe indefensible. As I said a few moments ago, the State Milk Commission has systematically destroyed any vestige of competition.

Let me explain to you if I can how the milk producer in North Carolina is paid for the milk he produces. In milk marketing lingo there are two kinds of milk - class one milk and class two milk. These terms have nothing to do with the quality of the milk and do not mean that either class is inferior to the other.

What these two terms are used by the dairy industry and our Milk Commission is to place a designation on the ultimate utilization of fluid milk by the consuming public in North Carolina. Class one milk means that milk which is processed, sold and consumed as fluid milk by the ultimate consumer. Class two milk is that milk which is used to manufacture milk by-products such as cheese, ice-cream, condensed milk, powdered milk and so forth.

Accepting, for the time being, that it is essential to a regulatory program of milk production by a government agency, then it is necessary to classify milk according to the utilization made of it by the public. Thus Class one and Class two milk is as good a terminology as any other so long as the regulators realize we are talking about ultimate use of milk by the consumer and not the inherent quality of the milk.

Let's look at North Carolina's "utilization formula" for a moment. The manner in which milk is marketed in North Carolina requires that a "utilization formula" be applied by each processing plant and that producers be paid according to the sales experience of the particular plant. For example, let's assume for a moment that a milk distributor's sales of milk and milk products is divided in the following manner: 90% of the plant's production is milk sold at retail as Class one while 10% of the plant's output is Class two usage or use in the production of milk by-products such as

cheeses and ice-cream. The producer then receives payment on a 90-10 ratio or what many persons refer to as the "blend price." In other words, the more liquid milk the processor sells, the more the dairy farmer receives for the milk he produces.

What happens if we pursue this example another step. In cases where the purchasing practices of consumers change and the distributor loses Class one milk sales, his loss in revenue affects directly the size of the producer's paycheck. The use of the utilization formula in this way subjects the dairy farmer to pressures that are exerted at retail marketing level. Why should this occur"

The purpose of the milk law is to protect the producers and I believe should be altered to give him greater protection from the pressures now caused by price fluctuations at the retail level. Under the present system, the producer obviously does have some direct interest in the conditions of the milk market at wholesale and retail and allows the processors and distributors and retailers to throw up their customary smoke screen when pressed about high milk prices and contend that the regulations which cause inflated prices are necessary for the sake of the producer.

The Commission has always possessed the power to fix prices at any level upon a finding of fact that the situation in the market threatened to demoralize or disrupt

the milk industry. This power was magnified when the law was changed in 1971. Since 1969, the Commission has held public hearings on several occasions to hear evidence to determine if the Commission's power should be exercised. In all of these cases, the evidence showed that one-gallon jugs of milk were being sold at lower than the established prices, but the Commission could not satisfy itself that the discounted sales price was for the purpose of injuring, harassing or destroying competition. Two particular instances where the Commission went to court in order to stabilize milk prices are especially interesting.

In North Carolina Milk Commission v Dagenhardt, 281 (1964), the Commission filed a complaint against the defendant, a retail grocery, in an attempt to prevent the sale of milk below cost. At that time the statute provided that evidence of the sale of milk below cost is prima facie evidence of a scheme to injure, harass, or destroy competition and the defendant had the burden of rebutting the prima facie case. After reviewing and weighing the evidence, the appellate court found the defendants had successfully rebutted the evidence.

In another case, North Carolina Milk Commission v National Food Stores, Inc. 270 N. C. 323 (1967), the defendants contended, and successfully so, that they were using milk as a "loss leader" to attract customers, not to injure, harass or destroy competition. The Commission lost again.

You can see from the above actions of the Milk Commission that attempts have been made to discourage retailers from using price as a competitive tool in the marketing of milk, but it has been unsuccessful in these official attempts. I believe that the energy and resources of the Commission should be directed toward insuring the producer a fair and just price for his product and that on the other hand the Commission should restrict its efforts to control the price of milk at wholesale and retail.

Our legislatures in the past have decided that it is the State's obligation to insure the producer security by providing him with a fair price for his product. This price should allow him to capture a return on the capital investment necessary to carry on the expense of a dairy herd.

In January 1973, the Commission recognized that the producer was in an economic pinch and acted promptly to aid him by ordering an increase in prices paid to producers. I dare say that no other body, State or federal, has acted so swiftly to protect the interest of its producers. I approved of this action.

And I dare say no one has ever moved faster than the processors, distributors and retailers in passing this increase on to the consumers along with an additional increase in price above and beyond the extra few cents granted to the producers by the Commission.

The Commission publicly expressed its dismay. Frankly, I was shocked that the processors and distributors and retailers would be so brazen and I was awfully disturbed by the newspaper ads which the North Carolina Dairy Products Association ran throughout the State implying that the increase was for the sole benefit of the dairy producer. Nothing could have been further from the truth.

There are some facts about producers that we all must understand. Milk is sold in North Carolina by cooperative organizations and proprietary type plants. The proprietary-type operation normally does not own herds that are sufficient to produce the milk needs of its customers. Therefore it buys from producers and the main thrust of this type of operation is directed toward the processing and distributing of milk and milk products to its wholesale and retail customers.

The Cooperative is different in that the dairy farmer has an interest in all marketing levels. The milk producers who are members of a dairy cooperative, which includes a processing and distribution system, have the opportunity to share in the earnings of the plant, or in the reverse, to help absorb losses that may occur as a result of the operation at the wholesale or retail levels.

I point out to you again that the power of the State is used to guarantee prices to all producers in the State without regard to the type of marketing structure used and this is where the State's obligation stops. Those producers who have a direct interest in the wholesale and retail marketing level have no right to expect the State through the Milk Commission to insure a profit at these marketing levels, also, because they have chosen the cooperative plan of marketing.

What are the issues and concerns that are before us today. The real issue is the price of milk at retail; the high price of milk in chain stores and at the corner grocery store.

How can these stores purchase milk? Some chain stores in recent years have built their own processing plants, so they have substantially less invested in the milk and milk products that they sell.

Retailers also have the option of buying from milk processors and distributors on a full service basis. This is the marketing procedure that is generally used throughout North Carolina.

Next, we must ask ourselves how consumers purchase milk and milk products. They have the option of buying from the local retailer, or the housewife may choose to buy from a milk distributor who delivers the product to the home. This type of buying by the consumer, in my estimation, should be the most expensive because of the cost of delivery factor. However, the home-delivery price is little more than the price of milk at the store.

There are several observations one should make about home delivery. First, home delivery cuts out the middle-man - the retailer - and therefore gives the distributor an

an additional margin of profit with which to absorb the cost of the delivery service.

Second, home delivery based on a route basis is a fairly stable method of marketing, for when one delivers the milk to the door, he does not have to worry about whether the housewife will choose his brand or that displayed next to it.

Third, because of the stability of the home delivery market and the added profit margin, the distributor does not want prices at the supermarket to be significantly lower than the home delivery price. Otherwise the housewife might forsake convenience and head to the corner grocery for the lower price. This often happens when milk prices are slashed by retailers and consequently the home delivery market is disrupted. The distributor thus has a great interest in protecting the home delivery market and preventing fluctuations in the store price.

Fourth, the distributor is willing to offer a home delivery price which is comparable to the high supermarket price since he knows that the Milk Commission's Fair Trade orders will prevent competition among retail stores and their process will remain fairly constant. All he has to do is stay close enough to the store price so that convenience overshadows the small price differential and his home delivery market is secure.

You can see, therefore, why distributors become concerned when "milk wars" spring up. Their marketing plans are temporarily disrupted and they are inconvenienced. How much are retailers paying for their milk and what is their margin of profit? What is the purchase price shown on the invoices to the retailers by the milk distributor?

Since the latest price adjustment granted to the producers, some distributors in the State are billing a gallon of milk to retailers at \$1.36 per gallon. Some are billing gallons at \$1.32, while others show \$1.29 on the invoice. The retailers who have low volume milk sales may get no rebates and the prices that I have given you are actually their net purchase prices. Another merchant in the same area, whose volume of milk sales may entitle him to substantial volume rebates, is able to lower his purchase cost to an amount around \$1.03.

COMPARISON OF RETAILERS'
PERCENTAGE MARKUP ON MILK

	CHAIN RETAILER OWNING PROCESSING PLANT	CHAIN RETAILER RECEIVING REBATE	SMALL RETAILER NOT RECEIVING REBATE
RETAIL PRICE PER GALLON	\$1.35	\$1.35	\$1.45
APPROXIMATE COST	<u>.96</u>	<u>1.03</u>	<u>1.36</u>
MARKUP	.39	.32	.09
% MARKUP	41%	31%	7%

If we look closely at the administrative orders governing the sale of milk at wholesale, we find that rebates are a device designed to pass savings on to the customers of the distributors. These savings, however, are not passed on to the consumers and the big retailers reap the profits.

It appears to me that the practice in North Carolina used by large retailers in the pricing of milk is contrary to the normal pricing policies on other fast turnover items. My inquiry shows that normal pricing practices of retailers follow a rough pattern as follows:

The longer an item stays in the store, the larger the markup 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 markup. When we compare the markup by the small retailer, we see that the markup 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 markup on milk by establishing the retail price at about an 8% markup on the invoice cost which is not the actual cost, if you consider rebates.

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

In June of 1972, I made a presentation to the Milk Commission concerning their Fair Trade Practice Orders. I reported at that time that large chain food retailers had advised members of my staff that the day-to-day prices they charged for milk were regulated and determined by the Milk Commission. I was surprised to hear them make this statement. When asked to identify the Commission's rule which does so, they identified Fair Trade Orders.

When they were told that their prices were not set by the Commission at that time, 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, if the Commission doesn't set prices, how can you 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 the price he was selling per gallon 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.

As I told you earlier, the Milk Commission cannot set the retail price of milk without a prior specific finding of facts concerning marketing conditions so I am at a loss to understand why retailers believe that they must charge a price for their product that is comparable to the price that the housewife pays for home delivery.

In essence, I believe that the real thrust and effect of Senate Bill 302, which we are supporting, is to allow the merchants in North Carolina the option of using price as a competitive tool in the marketing of milk. Most of them want this right. We know that savings can be passed on to the retail buyers and when these retailers receive price advantages, why shouldn't they have the right to pass

these savings on to the consumers in North Carolina without the intervention of the Milk Commission?

The current structure used in North Carolina to market milk attempts to prevent shifts in the retail market. In my opinion, there is no way that the State can devise or should even try to devise rules and regulations that dictate the buying habits for any product, including milk.

Even now, under the current system we hear of "milk wars", that is, milk being sold as a traffic builder in a store. Some prices I hear are 89¢ per gallon, 99¢ and \$1.09. Usually these prices are temporary and are advertised as specials of the store. I am confident that the retailer has made a sound business judgment by making this offer to his customers and he should be free to do so without harassment from the State. In addition, I do not believe that the producer should feel the pressure caused by the marketing decisions of an independent businessman which he now does because of the "utilization formula" which links the producer's fortune to the retail market situation.

I would like to relate to you a situation that we encountered in the Spring of 1971. The case concerned discriminatory pricing practices by milk distributors in the Cabarrus, Rowan and Stanley County areas. From reviewing

the facts in that situation, I believed that the pricing practices were directed toward placing a small, home-town dairy at a distinct competitive disadvantage. My office applied to the court for an order preventing the named defendants from continuing their pricing techniques. On the date of the hearing, the evidence given to the court indicated the unfair pricing practices had ceased.

My office pursued this matter under the State Anti-Trust laws and was successful in preventing large milk distributors from using pricing discrimination against this local processing plant.

I understand that subsequent to our action, the Commission may have taken action against some milk distributors for giving rebates that exceeded the amounts set by the Commission.Commission.

The Commission has the power to make any rules and regulations to insure the producer his price, and I suggest that if the Milk Commission believes that present orders are not sufficient to accomplish this goal, they should ask for the relief necessary to protect this primary level of production.

It also seems imperative that the Commission consider an alternative to the utilization formula used by the milk

plants to pay its producers. This may be an important first step toward segregating the problems of the various elements of the industry and therefore solving them.

There are other factors that must be considered, such as milk bases and incentives for efficient producers that will prove to be paramount if the decision is made to allow the milk industry in North Carolina to compete at the wholesale and retail levels.

Those persons who permit themselves to be persuaded by those who advocate price fixing by use of the illusory star of "stability" permit themselves to be used by the 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 existing price filing requirements, as a practical matter, foreclose other processors from a substantial portion of the retail milk market. Thus, the end result is opposite from the declared public policy.