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UNITED STATES OF AMERICA  
FEDERAL TRADE COMMISSION  
NEW YORK REGIONAL OFFICE

V890022

**COMMISSION AUTHORIZED**

February 17, 1989

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Dear Professor Masson:

The staff of the Federal Trade Commission is pleased to respond to your letter of December 23, 1988 to Daniel Oliver, Chairman of the Federal Trade Commission, requesting comments<sup>1</sup> relating to the Dairy Trade Practices Act ("the Act").<sup>2</sup> We understand that the Act is scheduled to expire on April 1, 1989, and that the Advisory Council on the Regulation of Dairy Practices ("the Council") has been charged by the New York Legislature with the task of reviewing the need for legislation to replace it. We also understand that the Council's mandate is not limited to reviewing the Act, but includes analyzing the relationships between the Act and both New York and federal antitrust statutes. We believe that New York consumers are likely to be best served if the Act is allowed to expire and is not replaced by regulatory legislation.

Interest and Experience of the  
Federal Trade Commission Staff

The Federal Trade Commission ("the Commission") is charged by Congress to prevent unfair methods of competition and unfair and deceptive acts and practices. In furtherance of its mandate, the Commission or its staff frequently submits comments, upon request, to regulatory agencies, legislatures, and other

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<sup>1</sup> These comments represent the views of the staff of the New York Regional Office and the Bureau of Competition of the Federal Trade Commission. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner.

<sup>2</sup> N.Y. Agric. & Mkts. Law §§ 258-s - 258-z (McKinney 1988).

government bodies concerning the consumer benefits of unfettered competition.

The staff of the Federal Trade Commission submitted comments to the State of New York in 1987 analyzing the potential benefits of New York Assembly Bill No. 3643, which was designed to remove barriers to entry created by prior milk legislation. In 1986, in a letter to Governor Cuomo, Commission Chairman Daniel Oliver opposed New York milk licensing laws and regulations that had the effect of preventing entry into the milk distribution business, especially since a New Jersey business had already demonstrated that it could successfully distribute milk in Staten Island at a lower price than was then being charged.<sup>3</sup>

In Section I of this submission, we set forth our understanding of the Dairy Trade Practices Act. In Section II, we describe possible justifications for economic regulation of markets, including the milk market. Section III explains why we believe economic regulation of the milk distribution industry is not needed. We also point out that existing federal and state antitrust laws generally are sufficient to protect consumers (Section IV).

#### I. THE DAIRY TRADE PRACTICES ACT

The Dairy Trade Practices Act consists of Sections 258-s through 258-z of the New York Agriculture and Markets Law.<sup>4</sup> Section 258-s declares that the New York State milk industry is affected with the public interest, and that it is the public policy of New York State to assure a plentiful supply of milk to its inhabitants, maintain the economic well-being of the dairy industry, preserve competition, encourage improved technology, and protect the consuming public. The basic operative sections of the Act concern market conduct. They forbid certain types of price discrimination, pricing below cost, and unfair methods of competition in the distribution of fluid milk and fluid milk products. Indirect efforts by a seller to engage in these forbidden tactics are also prohibited by Section 258-w, which bars the use of rebates, commissions, brokerage, discounts and gifts between a buyer and seller of fluid milk or fluid milk

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<sup>3</sup> The comments of staff and Chairman Oliver focused on statutory barriers to entry into the milk business. Statutory barriers have been reduced by recent court decisions and legislation. See Farmland Dairies v. Gerace, 650 F. Supp. 939 (E.D.N.Y. 1987) and the subsequent amendments to the New York laws concerning licensing of milk dealers, N.Y. Agric. & Mkts. Law, § 258-c. (McKinney 1988).

<sup>4</sup> N.Y. Agric. & Mkts. Law (McKinney 1988).

products to accomplish the ends prohibited by Sections 258t through 258v, except to meet competition. Knowing inducement or receipt of a price, service, facility or benefit prohibited by Sections 258t, u or w, is forbidden by Section 258-x. The Commissioner of Agriculture and Markets is authorized by Section 258-y to issue regulations further defining acts deemed to be prohibited under the above sections. Section 258-z permits private lawsuits as well as suits by the Commissioner of Agriculture and Markets to enforce the Act and exempts sales of raw milk by producers to dealers from the prior sections. These laws were added in 1973 to the preexisting, complex New York milk control law which dates back to 1934. In 1987, the entire Act was repealed, effective April 1, 1989.

## II. POSSIBLE LEGITIMATE JUSTIFICATIONS FOR ECONOMIC REGULATION OF MILK INDUSTRY

In a competitive market, supply and demand are determined by consumers voting with their dollars.<sup>5</sup> To maximize profit in this competitive system, a producer must satisfy consumer preferences for products, packages, and methods of distribution in the most efficient manner. Less efficient producers are driven from the market, thus freeing up scarce resources for uses that consumers value most highly. In this way "[v]igorous and healthy competition engenders economic efficiency which redounds to the benefit of consumers."<sup>6</sup> Consumer welfare normally is maximized not by government regulation, but by allowing markets to operate freely.

Government regulation of markets may be justified in the case of market failure. Market failures may arise when consumers are unable to evaluate the safety and quality of certain goods and services. In rare cases, producers may not have the incentive to provide such information to consumers. Market failures also may arise if a market participant can affect price

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<sup>5</sup> "The heart of our national economic policy long has been faith in the value of competition." Standard Oil Co. v. FTC, 340 U.S. 231, 248, (1951), as quoted in National Society of Professional Engineers v. U.S., 435 U.S. 679, 695, (1978). Economist Paul Samuelson has explained that a competitive system is "an elaborate mechanism for unconscious coordination through a system of prices and markets, a communication device for pooling the knowledge and actions of millions of diverse individuals." P. Samuelson, ECONOMICS 42 (12th ed., 1985).

<sup>6</sup> International Tel. & Tel. Corp., 104 F.T.C. 280, 402 (1984).

by reducing output.<sup>7</sup> The exercise of market power, however, requires not only the existence of a large market share but also conditions that prevent other firms from entering the market to compete with the dominant firm.

When markets fail, government regulation may be able to correct the market failure and thus increase the general public welfare. Even when regulation is proposed to cure a market failure, however, it promotes public well-being only when the costs imposed on all by that regulation are less than the costs that would be incurred because of market failure. A regulation designed to serve the interests of a special group may not produce a net benefit for society as a whole.

### III. SPECIAL REGULATION OF THIS INDUSTRY DOES NOT APPEAR NECESSARY

The milk distribution industry does not appear to exhibit any significant failures. Producers can receive adequate and accurate information about consumer preferences in the milk market, where consumers can easily express their desires through frequent purchases. The proliferation of different types of milk products sold in a variety of sizes and types of containers may be some indication of the amount of information being transmitted from purchasers to producers in this industry.

The availability of accurate information about the quality and safety of milk is a potential market information failure that has been addressed by laws requiring various disclosures on milk containers, e.g., disclosure of milkfat content, the identity of the processor, and "freshness" dates.<sup>8</sup> The Dairy Trade Practices

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<sup>7</sup> Output restrictions can lead to lower prices when the buyer has market power and to higher prices when the seller has market power. Cf. General Foods Corp., 103 F.T.C. 204, 345 n.30 (1984).

Market failures could derive from "externalities." An externality--environmental pollution, for example--is said to exist when a cost associated with the production or consumption of a product is not reflected in the price system. Hence, the externality is overproduced because the price system does not constrain its production.

<sup>8</sup> Reasonable health and safety regulation, i.e., where the drafters have fully taken into account the regulation's costs as well as its benefits, can benefit consumers. As discussed above, such regulation can appropriately compel producers to take steps to kill harmful bacteria in raw milk and prevent contamination of the milk product. Various disclosure  
(continued...)

Act does not address these health and safety issues but is a purely economic regulation that cannot be justified unless the markets for the production and distribution of milk are affected by a market failure that leads to anticompetitive conduct.

In the milk distribution industry, a single distributor or retailer does not appear able to exercise market power to raise prices.<sup>9</sup> Improved milk processing and distribution technologies have made it possible for both raw and processed milk to be transported considerable distances, greatly increasing the geographic area of competition.<sup>10</sup> Any attempt by an individual firm to reap greater-than-competitive profits or to provide less-than-competitive service is likely to be thwarted by a competitive response from other firms in the market or potential entrants. Indeed, incumbent firms are unlikely to attempt to exploit market power when they know that any short-term profit gained by overcharging or underserving customers may be more than offset by the loss of those customers and associated normal profits for the foreseeable future.<sup>11</sup>

Concerns, such as those expressed in Section 258-s that specific "dominant" purchasers of milk may exploit market power in a manner injurious to sellers, similarly appear unwarranted. Numerous prospective purchasers from a multi-state area offer

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<sup>8</sup>(...continued)  
regulations can also benefit milk consumers. However, since these existing health and safety regulations are not found in the Dairy Trade Practices Act, but in other laws not facing repeal, we do not address their merits in this comment.

<sup>9</sup> We recognize that price levels for raw milk are largely determined by Federal and state milk marketing Orders. The State Commissioner of Agriculture and Markets can and has established minimum wholesale prices for raw milk. N.Y. Agric. & Mkts. Law, § 258-m (McKinney 1988). This comment does not express an opinion as to the appropriateness of raw milk price supports. We believe that competition in the distribution of processed milk products will assure consumers an adequate supply of such products at the lowest mark-up above the prevailing raw milk price, whether that raw milk price be determined by Orders or by market forces.

<sup>10</sup> The New York legislature has recognized that the present-day pool of potential marketers of milk in New York State extends throughout the greater part of the state, well into New Jersey and Connecticut, and even into other New England states. See Declaration of Policy, N.Y. Agric. & Mkts. Law § 258-p (McKinney 1988).

<sup>11</sup> Cf. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 106 S. Ct. 1348, 1357-58 (1986).



alternatives to any seller subjected to lower-than-competitive offers from a locally "dominant" firm. Further, New York dairy farmers lawfully may join together in cooperative associations to sell their output, thus enabling them to negotiate from a position of significant strength.<sup>12</sup> In addition, if actually faced by a purchaser able to exert significant power, sellers operating through cooperative associations might enter the distributor's market (i.e., integrate forward) in order to bypass that purchaser.

Therefore, a significant market failure in the State's milk distribution industry appears unlikely. However, should the Council, with its specialized knowledge of this industry, conclude that the threat of market failure is so great as to warrant a prophylactic response, regulation would be appropriate only to remedy the specific likely failures identified, and then only if the benefits of the regulation exceeded its costs.

IV. EXISTING FEDERAL AND STATE LAWS ARE SUFFICIENT TO PROTECT CONSUMERS FROM ECONOMICALLY HARMFUL PRACTICES

A competitive milk market can be expected to satisfy efficiently the dairy needs of New York consumers, while at the same time affording to New York State's dairy-related businesses equal opportunity to succeed (or fail) based upon their ingenuity, skill and effort. Effective competition in New York State's milk markets does not appear to be impaired by significant market failure; nevertheless, these markets, like any markets, must be protected from anticompetitive acts of their participants.<sup>13</sup> This protection is afforded by federal and state antitrust statutes. The Sherman Act broadly proscribes concerted action in restraint of trade and attempted and actual monopolization.<sup>14</sup> The Federal Trade Commission Act proscribes "unfair methods of competition."<sup>15</sup> New York State's Donnelly Act contains a Sherman Act-like proscription of concerted action in

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<sup>12</sup> N.Y. Gen. Bus. Law § 340.3 (McKinney 1988) and 7 U.S.C. §§291-293 (West 1983) (Capper-Volstead Act).

<sup>13</sup> As noted above, in addition to the Dairy Trade Practices Act, many Federal and state laws and regulations govern this industry and prevent it from operating as an unfettered market. Nevertheless, we believe that the expiration of the Act will increase competition.

<sup>14</sup> 15 U.S.C. §§ 1-7 (West 1983).

<sup>15</sup> 15 U.S.C. § 45 (West 1983).

restraint of trade.<sup>16</sup> The Clayton Act proscribes specific practices such as exclusive dealing and tying arrangements<sup>17</sup> and price discrimination<sup>18</sup> to the extent that, in any particular instance, they are likely to impair competition and provides for private, treble damage actions to enforce both the Sherman and Clayton Acts.<sup>19</sup>

These statutes generally have been interpreted by the courts in a manner that distinguishes between vigorously competitive conduct, including aggressive pricing practices, and competition-injuring conduct.<sup>20</sup> In contrast, the Dairy Practices Act may sweep too broadly, condemning aggressive pricing that does not injure competition, thereby depriving consumers of the benefit of competition. For example, whereas courts interpreting the Sherman Act have avoided erroneous condemnation of vigorously competitive pricing, the Dairy Practices Act condemns pricing below cost if even a single competitor is thereby eliminated, irrespective of whether the pricing practice injures or promotes the competitive process.<sup>21</sup>

#### V. CONCLUSION

We believe that the interests of New York consumers and businesses are best served through the fostering of free and competitive markets. In a free market, competition will encourage the milk industry to satisfy consumer preferences in

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16 N.Y. Gen. Bus. Law § 340.1 (McKinney 1988). The Council may wish to suggest that the Legislature consider limiting the scope of the exemption from the Donnelly Act of Section 340.3 of the General Business Law. The New York Court of Appeals, in State v. Glen & Mohawk Milk Ass'n, 61 N.Y.2d 705, 460 N.E.2d 1091, 472 N.Y.S.2d 606 (1984), determined that Section 340.3 permits agricultural cooperatives to engage in, among other things, collective refusals to purchase. See State v. Glen & Mohawk Milk Ass'n, 93 A.D.2d 975, 461 N.Y.S.2d 648 (4th Dep't 1983). Section 340.3 should not "provide blanket immunity for all monopolistic and anti-competitive practices of these cooperatives." (Doerr, J, dissenting.) In general, exemptions from antitrust law should be disfavored.

17 15 U.S.C. § 14 (West 1983).

18 15 U.S.C. § 13 (West 1983) (Robinson-Patman Act).

19 15 U.S.C. § 15 (West 1983).

20 E.g., Matsushita Elec. Indus. Co. v. Zenith Radio, 475 U.S. 574, 106 S. Ct. 1348, 1357-8 (1986).

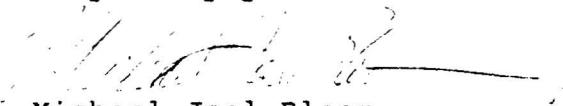
21 N.Y. Agric. & Mkts. Law, § 258-u (McKinney 1988).

the most efficient manner, maximizing consumer choice while ensuring that consumers pay the lowest competitive price. The New York milk industry does not appear prone to any market failure requiring regulatory intervention. Indeed, the Dairy Trade Practices Act in some respects may facilitate, rather than cure, market failure by preventing aggressive competition and so denying the benefits of competition to the consumers and businesses of the State.

For these reasons, we believe that New York consumers will benefit if the Dairy Trade Practices Act is allowed to expire and is not replaced by further special regulation of the New York State milk industry.

We appreciate the opportunity to comment.

Very truly yours,



Michael Joel Bloom  
Director  
New York Regional Office