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**Federal Trade Commission**

Office of the Regional Director

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COMMISSION AUTHORIZED

May 19, 1987

Michael J. Bragman, Chairman
Committee on Agriculture
Assembly of the State of New York
State Assembly Building
Albany, New York 12248

Dear Chairman Bragman:

By letter of March 20, a copy of which is attached, the staff of the Federal Trade Commission commented on Assembly Bill No. 3643 ("A. 3643"), a bill to reform New York State's milk distribution licensing system. We since have reviewed other Assembly bills that would modify this system and are pleased to accept your invitation to comment on them as well.¹ Although these bills tend to support competition in the milk marketplace, no bill or combination of bills -- apart from A. 3643 -- adequately addresses the several anticompetitive aspects of the current regulatory scheme.

ASSEMBLY BILL NO. 3643

In our previous letter, we wrote that Section 258 of the Agriculture and Markets Law limits competition in New York State's milk markets and thereby suppresses innovation, encourages the adoption of wasteful cost-inflating practices, and misallocates resources. As a result, New York consumers incur vast overcharges for milk. In contrast, A. 3643 would permit increased competition by eliminating significant barriers to vigorous competition by

¹ This letter presents the comments of the New York Regional Office and the Bureaus of Competition, Economics, and Consumer Protection of the Federal Trade Commission. The views expressed are not necessarily those of the Commission or of any individual Commissioner, although the Commission has voted to authorize the presentation of these comments to you.

current and potential dealers. These barriers include county-by-county licensing and regulation of non-predatory pricing,² and perhaps most importantly, application of the "destructive competition" and "public interest" standards. These standards permit the Commissioner of Agriculture ("Commissioner") to deny a license to distribute milk on finding that entry will "tend to a destructive competition in a market already adequately served" or is "not in the public interest."³ We concluded that passage of A. 3643, by eliminating these barriers, would result in widespread availability of milk at reduced prices.

Having previously addressed A. 3643 and its public benefits in detail, we now discuss those bills that might usefully supplement A. 3643. Then we consider those bills that are intended as alternatives to it.⁴

USEFUL SUPPLEMENTS TO A. 3643

Several of the bills introduced might be useful supplements to A. 3643. Standing alone, however, they would not be adequate substitutes.

A. 3158 would require the Commissioner to consider the competitive consequences of any proposed denial, suspension, or revocation of a license to distribute milk. Adoption of A. 3158 might help ensure that the benefits of competition fostered by other reforms -- such as elimination of the "destructive competition" standard -- are fully realized.

² Section 258-u of the current law prohibits, but does not define, below cost pricing. Section 15 of A. 3643 would define "below cost" to mean below average variable cost. Even as so defined, however, the prohibition of below cost pricing could stifle honest competition. Accordingly, we suggested that the Assembly repeal rather than revise Section 258-u.

³ N.Y. Agric. & Mkts. Law § 258-c (McKinney Supp. 1986). Section 9 of A. 3643 would eliminate this discretion.

⁴ We discuss Assembly Bills Nos. 3157 through 3159 and 3161 through 3164 ("A. 3157" through "A. 3159" and "A. 3161" through "A. 3164").

A. 3159 states that the public policy of the State of New York is to promote "the availability of milk to consumers at reasonable prices by promoting competition" This bill thus could provide a helpful interpretive guide to the Commissioner and the courts.

Passage of A. 3158 and A. 3159 would promote consumer interests in the implementation of New York State's milk distribution laws. Enacting either or both of them, however, without also eliminating county-by-county licensure, repealing below cost pricing regulation, and, most importantly, eliminating the "destructive competition" and "public interest" barriers to entry, might permit continued exclusion of efficient would-be competitors, to the detriment of the consuming public.

A third bill, A. 3162, raises slightly different concerns. This bill provides that the Commissioner must determine within 120 days of application whether to grant a license. Upon a finding that a determination within this period cannot be made, the Commissioner may extend the period by not more than an additional 120 days.⁵ A. 3162 is intended to prevent extremely lengthy licensing proceedings that can substantially delay or even prevent competitive entry into the state's milk markets. In the event the Assembly retains the "destructive competition" and "public interest" standards of the current law, passage of A. 3162 might prove somewhat helpful because, as we stated in our earlier letter, the current license application process itself increases entry costs and serves as a deterrent to potential competitors. The process enables firms already in the market to delay the entry of competitors and to preserve their own market positions.⁶ However, if the "destructive competition" and "public interest" standards are eliminated and statewide licensure is put in place, as we suggest, even one 120-day period would seem excessive. We therefore urge the Assembly to adopt a substantially shorter period in conjunction with the other reforms that we have discussed.

⁵ A. 3162 also would increase various license fees. These increases do not appear to have competitive significance.

⁶ The Legislative Commission on Expenditure and Review, in April 1985 Audit, State Milk Dealer Licensure and Regulation, noted that "competing milk dealers almost always oppose granting [a] license."

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ALTERNATIVES TO A. 3643 ARE LESS ADEQUATE

The bills introduced as alternatives to A. 3643 do not, in our view, address some of the major competitive concerns raised by the current law. As a consequence, these bills would not provide New York consumers the benefits that competition could be expected to bring.

A. 3161 provides that sellers and buyers of milk may deal with whomever and under whatever terms they choose, "[e]xcept where expressly provided otherwise." However, because this bill would not alter the current system of county-by-county licensing -- which is otherwise "expressly provided" for -- it would facilitate the continuation of collusive and other customer allocation arrangements. In contrast, by requiring statewide licensure, A. 3643 would ease entry barriers associated with

⁷ The five largest processors in New York City (who account for over 80% of milk sales in that market) have been recidivist antitrust violators. In 1956, 1966, and again in 1982, these five processors were found to have conspiratorially fixed prices and allocated markets. People v. Milk Handlers & Processors Ass'n, Civ. No. 40077/57 (N.Y. Sup. Ct. Aug. 13, 1958); State v. Milk Handlers & Processors Ass'n, Civ. No. 41396/1966 (N.Y. Sup. Ct. Sept. 11, 1975); and People v. Elmhurst Milk and Cream Co., Inc., 116 Misc. 2d 140, 455 N.Y.S.2d 473 (Sup. Ct. Kings Co. 1982); People v. Dairylea Coop. Inc., 114 Misc. 2d 421, 452 N.Y.S.2d 282 (Sup. Ct. Bronx Co. 1982); People v. Queensboro Farm Products, Inc., 1982-83 Trade Cas. (CCH) ¶65,071 (Sup. Ct. Queens Co. 1982); State of New York v. Dairylea Coop. Inc., 81 Civ. 1891 (S.D.N.Y. 1982). Additionally, the record in the recently concluded Farmland Dairies hearing is replete with evidence that once the ordinary milk retailer selects its first supplier, he becomes the property of that supplier. In the Matter of the Application of Fair Lawn Dairies, Inc. For an Extension of Its Milk Dealer's License, Before Lyle Newcomb, Hearing Officer, June 23, 1986 at 1454-59, 1873-77, 1920-29, 1943, 1955, 1969-70, and 1985-86.

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geographic market extension by firms already serving a part of the state, thereby making anticompetitive collusion less practicable.⁸

Two other bills, A. 3163 and A. 3164, appear to eliminate county-by-county licensure (although A. 3163 would permit the Commissioner to continue to designate marketing areas as small as a county). Unlike A. 3643, however, these bills opt for a regional approach.⁹ We are concerned that adoption of regional licensure may not reduce entry barriers enough to stimulate entry and thereby drive milk prices down to competitive levels.¹⁰

All three of the above bills fail to advance consumer interests as effectively as A. 3643 for an additional reason. The current law restricts competition by permitting the Commissioner to classify licenses to authorize "milk dealers to carry on a certain kind of business only" We understand that this classification provision permits the Commissioner to limit a licensee functionally, i.e., to the processing of milk, or to its wholesale distribution, or to its sale at retail. Continuation of the Commissioner's authority to issue limited licenses may

⁸ To the extent that A. 3161 is intended to condemn collusive customer allocation arrangements, it is unnecessary because federal and state antitrust laws clearly proscribe such arrangements.

⁹ A. 3163 would provide that "market" means "a territory designated by the commissioner as a natural marketing area." A. 3164 would provide that "market" means a "contiguous territory designated by the commissioner as a natural marketing area which either (a) contains a population of one million or more as determined by the last available federal census, or (b) includes fifteen or more counties."

¹⁰ Although statewide licensure is preferable to regional licensure, licensure requirements invariably are barriers to entry. Therefore, licensing schemes ought not to be adopted (or continued) unless two conditions are satisfied. The first condition is that the benefits of licensure must exceed its costs, including those costs attributable to reduced competition. The second is that licensure must be the least restrictive means of achieving a substantial public purpose, e.g., protecting the health and safety of consumers. We have not undertaken an analysis of whether licensure of milk sellers satisfies either of these conditions.

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discourage or prevent firms from assuming additional functions in the milk distribution system in order to achieve cost-savings. For example, supermarkets may be denied the opportunity to integrate backward into milk processing. As a consequence, savings that could result in price reductions to consumers may be forestalled. A. 3643 alone expressly limits the classification of licenses and thereby facilitates efficient vertical integration and resultant consumer savings.¹¹

The final bill, A. 3157, like A. 3643, would eliminate the Commissioner's discretion to deny a license on finding that issuance of the license would "tend to a destructive competition" or would not be "in the public interest." In this respect, A. 3157 would permit increased competition and related consumer gains. However, it too fails to address several important competitive issues that are addressed by A. 3643, such as reform of below cost pricing regulation and statewide licensure. Therefore, A. 3157 alone would not increase consumer welfare to as great an extent as A. 3643.

CONCLUSION

We believe that effective reform of New York State milk regulation depends upon the elimination of barriers to vigorous competition by current and potential dealers. As we noted in our March 20 letter, A. 3643, particularly as we would modify it, addresses the most significant barriers. Passage of A. 3643 might well be enhanced by other measures that reinforce competition in the milk marketplace, as discussed in this letter. To the extent that another bill or combination of bills that fails to address these entry barriers is enacted, however, competition may not be sufficiently stimulated to produce reduced prices and other consumer benefits.

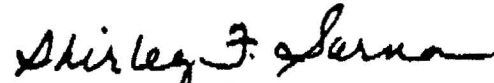
¹¹ Under A. 3643 the Commissioner could classify licenses only "for the purpose of establishing the rate of license fees and otherwise carrying out the duties of the commissioner under this chapter" A. 3643 § 5.

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We hope that these remarks are helpful to the Assembly. Please do not hesitate to contact me if you have any questions.

Very truly yours,



Shirley F. Sarna
Acting Regional Director



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FOR YOUR INFORMATION.....May 20, 1987

The Federal Trade Commission Staff has told the New York State Assembly that it should not adopt several bills that have recently been proposed to change the state's milk licensing law. Instead it should pass a pending bill (Assembly Bill 3643) that the FTC endorsed in a March 20 letter. The staff said the additional bills "fall short of A. 3643 in addressing the major competitive concerns of the present system," although several contain provisions that would be useful supplements to that bill.

In its earlier letter, the staff had said that present N.Y. regulations are anticompetitive and should be changed. At that time it endorsed A. 3643, saying it would "eliminate vast overcharges for milk" sold to N.Y. consumers. The staff said the bill would permit increased competition by eliminating several significant barriers to vigorous competition by current and potential dealers. These barriers include county-by-county licensing, regulation of non-predatory pricing, and a provision that empowers the Commissioner of Agriculture to deny a license on the grounds that entry by a new dealer would "tend to a destructive competition."

The staff said that passage of appropriate legislation "would result in widespread availability of milk at reduced prices."

The letter represents the views of the FTC's New York Regional Office and the Bureaus of Competition, Consumer Protection, and Economics, and does not necessarily reflect the views of the Commission or of any individual Commissioner.

Copies of the letter are available from the FTC's New York Regional Office, 2243-EB Federal Building, 26 Federal Plaza, New York, N.Y. 10278; 212-264-1207; and from the FTC's Public Reference Branch, Room 130, 6th St. and Pennsylvania Ave. N.W., Washington, D.C. 20580; 202-326-2222; TTY 202-326-2502.

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