

**Responses to some questions raised at the March 14, 2003
meeting on dairy pricing and fair pricing milk**

by

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Bob Wellington raised three excellent questions concerning the fair pricing law for the State of Connecticut. Here I restate each and provide as best an answer as I can. The first question that Bob raised was “can the law deal with cross subsidizing payments that processors might make in order to subvert the law?” What Bob was driving at was the following example: supermarkets may pay more to processors in order to comply with the law, however, this increased payment for milk might not be paid back to farmers. Rather processors might simply give retailers a discount on some other product they sell, such as orange juice or half and half. The end result of this is the retailer pays no more for milk than the paid before the law.

Answer: This type of behavior would generate bogus compliance for the retailer, however, the processor would not be able to do this activity without increasing premiums paid back to farmers. This activity does increase the wholesale price of milk, which means that the processor that is otherwise in compliance with the law would move up to a wholesale price that’s in excess of 140% of the farm price. The processor would still have to comply with the wholesale part of the law by raising prices to farmers until the wholesale price was only 140% of the farm or the raw milk price. The requirement that the processor do this effectively quashes the ability of the processor to rebate back to the retailer in some other product area the increased amount of money the retailer paid for wholesale milk.

The second question that Bob raised was basically a fear that this law would disadvantage state of Connecticut processors such as Guida because out of state processors would not have to comply with a law. Consequently out of state processors could offer lower prices to Connecticut supermarkets and capture business from in state processors. I will call this the Midland Farm strategy because as I understand it Midland Farms recently did make a bid on the Big Y private label contract that underbid Guida. At the time Big Y did not switch out of loyalty to Guida.

Answer: Under the proposed fair pricing law if an out of state processor comes in with a low ball offer to a Connecticut retailer this could trigger the retail 140% rule. In fact that would be the case because we are only analyzing the situation where the farm prices are so low that these rules are binding. What this means is that the retailer is faced with a choice of either cutting the retail price or elevating the wholesale price to comply with the law. As pointed out in my February 26th testimony the clear incentive and the most profitable move is to elevate wholesale price rather than cut retail price. Thus the law actually discourages retailers from accepting low ball offers from out of state processors. That is the case because under the proportional price collar the retailer makes a higher dollar profit margin at a higher wholesale price.

The third question that Bob raised was how exactly will the increase in over-order premiums be paid back to farmers? This indeed is a potential sticking point for the law. According to Wellington the individual state cannot dictate that farmers from several states be paid these

premiums in a milk shed wide pool. An individual state has no authority to construct or demand that such a pool be constructed. Here we will have to rely upon the bargaining ability and these incentives of the cooperatives that supply milk to Connecticut handlers and handlers in other states that have in fact passed this law. At this time we have effectively two cooperative organizations: Agri-Mark and Dairy Marketing Services. Those two cooperatives separately or in concert under the Capper Volstead Antitrust exemption must devise a way to pool and pay back premiums to farmers. Farmers that sell milk for very small specialty brands may well be processed in distant parts of the country. That milk may simply not participate in any cooperative pooling that happens for the majority of the milk that comes through this system. Those processors would be allowed to pay such premiums to farmers as they see fit. Certainly we need more insight from the cooperatives on this part of the plan.

A fourth strategy that could be used to circumvent the law in a fashion that would damage “in area” processors is as follows:

The issue as to whether the law will be applicable to a processor outside of the State of Connecticut. The Attorney General has said, yes, providing the transaction takes place within the State boundaries. Stop and Shop and Garelick can get around this issue by creating a point of sale in the State of Massachusetts at the Garelick processing plant. In this case, Stop and Shop would pick up the product instead of Garelick delivering the product. Because Garelick never steps foot in the State of Connecticut, they would never be bound by the State law. The “sale” price from Garelick would still need to be high for Stop and Shop to maintain a high markup. However, there is nothing stopping Garelick from giving discounts on Half-and-Half, Orange Juice, etc. This is a reasonable work around for Stop and Shop who has stores in both CT and MA. A warehouse is not needed, as Stop and Shop could haul the milk directly into CT from the MA plant. In this case, the Garelick plant in MA does not obey the 140% law, so farmers receive no over-order premium for milk supplied to that plant. Guida, being in the State of Connecticut, would lose supermarket business to out of state plants because it does have to pay farmers higher prices and obey a CT 140% law.