***Supermarket News***, Feb 10, 2003 p37

## SPILL IT; AN OUTPOURING OF SUPPORT FOR MILK-PRICE CEILINGS FROM CONSUMERS AND LAWMAKERS HAS RETAILERS ON THE DEFENSIVE.

*by Robert Vosburgh*



This is part one of a two-part SN report

The topic of milk prices is leaving a sour taste in the mouths of retailers.

Massachusetts, New Hampshire and Connecticut lawmakers are considering legislation that would cap retail milk prices to prevent gouging; Chicago consumers are participating in a class-action lawsuit alleging the city's top retailers of milk-price fixing; and Vermont has re-established a commission to determine the pricing structure used in milk.

In Pennsylvania and Maine, consumer advocates and dairy activists are collecting prices to speak out against the disparity between what farmers are paid and what processors and retailers get.

As primary purveyors of fluid dairy, supermarkets are squarely in the middle of this intense debate, and the legal pressure coming to bear threatens to expose pricing formulas and business strategies retailers traditionally guard as their most important secrets. But with legislators holding the power of the law and states equipped with agencies such as the attorney general's office, there may be little hope of hanging onto those prices for much longer.

One fact not in dispute is that the prices dairy farmers are being paid today for their milk have fallen to a 25-year low. What's under scrutiny are the prices consumers are paying at stores -- which have largely remained unchanged, according to critics.

"There is no justification out there for the high retail prices of milk," said Professor Ronald Cotterill, director of the Food Marketing Policy Center at the University of Connecticut. "The spread between the farm and the retail prices are way beyond what any of us have seen in any kind of estimate for the cost of processing and the cost of retailing."

Cotterill, an outspoken critic of the current situation, has been conducting studies that have sought to document the price spread. More recently, he was involved in a Massachusetts state probe that offered a glimpse into the byzantine practices that go into pricing milk.

In the past, most states' regulations regarding milk prices focused on preventing large operators from undercutting smaller competitors by selling milk on the cheap, at below cost. Cotterill said this law was turned on its head when Massachusetts launched an investigation of a small retailer called Midland Farms in North Easton. The three-month series of hearings was convened after H.P. Hood, an independent processor, and convenience-store chain Cumberland Farms filed a complaint about Midland's low prices.

An analysis of the chain's price structure found Midland was offering most grades of milk at about $1.79 a gallon; only 1% sold for $1.49. By comparison, the average prices for whole milk sold from competitors -- mostly larger chain stores -- in the market area were in the neighborhood of $2.99.

During the hearings, Midland defended the prices noting it operates its own dairy, which erased several layers of costs. But multiple analyses by state investigators concluded the limited-assortment chain of three stores was still selling milk at below cost -- a technical violation of the law.

A compromise ended the investigation, whereby Midland raised its prices slightly, though they would still be below what other retailers were charging. Responding to a question as to why the state was investigating a small retailer's pricing -- when the law was designed to protect them from predatory actions by large retailers -- a spokeswoman for the Massachusetts Department of Food and Agriculture replied that the agency was obligated to act on a complaint, adding, "We don't have the authority to decide whether the law is worthwhile or not."

That may soon change, as virtually every New England state caught up in the milk price debate considers adding laws that place a cap on retail prices. Some are even considering rolling money back into the industry as financial support for farms, a source of funding that used to come from the Northeast Dairy Compact before it expired in September 2002.

In Connecticut, Attorney General Richard Blumenthal announced just after the new year legislation designed to remedy the pattern of consistently high prices. The bill would penalize any retailer determined to be selling milk at a "unconsciously excessive" price, or roughly 140% of what the retailer or processor paid.

"Something is desperately wrong with the milk market picture. Milk consumers are paying vastly more. Yet dairy farmers are receiving significantly less," he said. "Retailers and processors are reaping unconscionable profits that exploit both consumers and dairy farmers."

At the same time, authorities throughout the region, including Blumenthal, are gauging the impact of a proposed merger between H.P. Hood -- one of the complainants in the Midland Farms case -- and National Dairy Holdings. Officials fear the consolidation of the two processors will further compress the market and make it more prone to domination.

The retail-processor connection can be a strong one. Just three years ago, Blumenthal and fellow attorneys general from Maine, Massachusetts, Vermont, New Hampshire and Rhode Island launched an antitrust investigation into a deal between Suiza Foods Corp., Dallas, and Stop & Shop Cos., Quincy, Mass., New England's No. 1 supermarket chain. Under the agreement, Suiza, already the largest dairy processor in the country, was to supply the chain with private-label dairy products; the retailer also would have been prevented from selling certain brands in the dairy case. In return, Stop & Shop was going to sell its own processing plant in Readville, Mass., to Suiza.

The year-long probe resulted in a brokered compromise whereby Suiza pledged to reserve 30 million gallons of its New England processing capacity for competitors for a period of five years; Stop & Shop agreed to sell the Readville facility to an entity other than Suiza. By the time the agreement was announced, Suiza was finishing out a heavy acquisition phase that had earned it a 60% share of the New England market, according to officials' estimates.

Government limitations involving control of natural business forces like consolidation are resulting in a concentration of market power that has regulators seeking remedy on the retail end of the supply chain. One state in the Northeast region -- New York -- mandates milk retailers of any size and venue offer at least one brand of fluid milk at prices within a 200% increase of the farm price.

"They could carry any and all other brands as premium brands, and those can be over the threshold," said Jessica Chittenden, spokeswoman for the New York State Department of Agriculture and Markets. "But as long as there is one brand within the threshold, they're in compliance with the law."

Like other states, New York conducts weekly surveys at random across the state to make sure that stores have at least one brand that is selling within the threshold price. However, Chittenden noted that the law is not an absolute; it acts more as a guide.

"Certainly, down in metro New York, it's going to be more difficult to keep it within a 200% range because of overhead costs like packaging and transportation vs. a store that's in Syracuse," she told SN. "So, there is some flexibility but basically it ensures us that we are keeping the price of milk on the retail level in balance with what's being paid on the farm."

Indeed, a comparative survey conducted in November 2002 by Cotterill and his staff at the University of Connecticut documented what he found to be a wide price gap between milk prices in New England and in New York. The researchers visited 40 stores all over New York, looking for the cheapest brand available. In almost all cases, they were private label.

"Price ceilings for the same brand level -- private label -- were $2.57 a gallon on Long Island and in the metro New York area. The Hudson River Valley region up north averaged $2.41. Of the 40 stores, 25 had prices below the [state-set price] ceiling, 13 were at the ceiling, and two were above it," Cotterill said.

New England's prices were more in the neighborhood of $2.99, or 50 cents higher than those found in New York.

Even Cotterill concedes the New York law isn't a panacea for controlling retail milk prices, and there are instances, such as the two in the November study, where the price is going to be above the cap. However, the larger, overall effect is better management of prices -- and that should be the goal of New England and elsewhere where prices are high.

"This law, which should be more binding now with the low farm prices, isn't that binding but it does have a bite. Not everybody in New York is at the ceiling," Cotterill said. "It leads us to conclude that prices in New England, which are about 50 cents a gallon higher than the average prices in New York, are indeed in excess of cost. It certainly doesn't cost that much more to process and sell milk in New England than it does in New York or on Long Island."

Retailers have argued that consumption of fluid milk has fallen, and therefore, has compelled them to raise prices. Statistics from the U.S. Department of Agriculture show that in 1950, per-capita consumption of milk was about 40 gallons. In 2000, that figure fell by nearly half, to 22.6 gallons. By comparison, the consumption of soft drinks swelled from 10 gallons to nearly 50 gallons for the same period. Cotterill said retailers could play a bigger role in reversing that trend based on models he's reviewed.

"If they cut the price, the per-capita consumption of fluid milk could easily go up 10% to 15%. It's a classic industrial organization restriction of supply to elevate price," he said.

Consolidation and a coinciding decrease in the amount of milk purchased are only two factors of a multi-faced formula, however. Category management of the dairy case has taken hold. This business practice shows that retailers have realized they could make more money by charging a good price for it, Cotterill said. The days of using milk as a loss leader are long over.

"[Supermarkets] used to have a whole cooler just for milk. They might be 40 feet long, with 80% filled with gallons, half gallons and quarts of milk. Another 20% was specialty items," he said. "Over the past five or six years, that's changed to where about half of the cooler is fluid milk, and the other is high-value specialty items, which are slower-moving but very high margin. They're managing the cooler for higher margins."

In a courtroom in Chicago, attorneys representing customers of the city's two biggest retailers are trying to shed light on just how high those margins are -- and whether they're unfair to customers.

The class-action lawsuit, which began last week, alleges Jewel and Dominick's conspired to fix prices of milk between 1996 and 2000, resulting in customer overcharges of between $51 million and $125 million over four years.

In their opening arguments, attorneys for the retailers said that while shelf prices for the chains may have appeared to be near identical, the front-end price actually paid by customers often differed because of promotions and the like.

In March 2000, for example, promotions caused price differences at Dominick's and Jewel 25 days during that month, one attorney for Dominick's said.

Both retailers also acknowledged each company sends associates into stores to check prices on a regular basis, but that does not constitute price-fixing or collusion.

They also said that when wholesale prices declined dramatically in 1999, retail prices remained at the same level, despite a drop in retailer costs. That was simply a decision made as part of a larger business strategy, and had nothing to do with fixing prices, they argued. The trial is expected to last a month.

Coming in March:

Retailers react