

RECOMMENDATIONS FOR LEGISLATION

Pertaining to

THE CALIFORNIA MILK MARKETING LAW

Submitted to

THE CALIFORNIA STATE SENATE

By

THE CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE

C. BRUNEL CHRISTENSEN, DIRECTOR

November 30, 1974

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TABLE OF CONTENTS

	Page
SUMMARY OF RECOMMENDATIONS.....	ii
INTRODUCTION.....	1
RECOMMENDATION.....	2
MINIMUM PRODUCER PRICING.....	3
RECOMMENDATIONS.....	4
MINIMUM WHOLESALE PRICING.....	6
RECOMMENDATIONS.....	11
MINIMUM RETAIL PRICING.....	13
RECOMMENDATIONS.....	17
UNFAIR PRACTICE PROVISIONS.....	18
RECOMMENDATIONS.....	18
THE MILK POOLING PROGRAM.....	21
RECOMMENDATIONS.....	23
MISCELLANEOUS RECOMMENDATIONS.....	24

## SUMMARY OF RECOMMENDATIONS

### INTRODUCTION

1. The Department recommends that the Milk Law be viewed as five separate programs.

### MINIMUM PRODUCER PRICING

1. The Department strongly recommends the minimum producer pricing program be retained in the Milk Law.
2. The Department recommends the mandatory provisions under Section 62212 requiring the use of manufacturing milk production costs as a basic pricing standard be amended to state explicitly the cost of producing market milk.
3. The Department recommends the law be amended to provide for a more definitive supply standard that can be interpreted uniformly by all concerned parties.
4. The Department recommends the law be restructured to require petitions or requests for hearings to contain specific proposals for hearing consideration.
5. The Department recommends the law be amended to give the Director specific authority to examine books and records of producers to determine production costs through impartial cost surveys.

#### MINIMUM WHOLESALE PRICING

1. The Department recommends that the existing minimum wholesale pricing authority be repealed and replaced by the processing plant platform price concept.
2. If the legislature determines that there should not be mandated minimum wholesale pricing authority, the Department recommends that standby wholesale pricing authority be provided for in the law. It is further recommended that the standby authority be stated in general terms to permit the Director maximum flexibility to use whatever system might be appropriate to achieve stability. The intent of the law should be reversed so wholesale pricing will not be mandated.

#### MINIMUM RETAIL PRICING

1. The Department recommends that some form of minimum retail price regulation be maintained in the Milk Law to assure stability.
2. The Department recommends that the minimum retail pricing standard be changed from "reasonably efficient" to "the average cost of the larger stores having 60% to 70% of milk sales".
3. If the legislature determines that retail pricing authority is to be repealed:
  - (a) The Department then recommends that provision be made for slow, orderly withdrawal that will not unnecessarily disrupt the industry. This may be done by establishing a date by which all minimum retail prices are to be withdrawn.
  - (b) The Department further recommends that the legislature provide standby retail pricing authority that could be implemented on an exception basis, similar to the standby wholesale pricing authority recommendation.

## UNFAIR PRACTICE PROVISIONS

1. The Department strongly recommends the Unfair Practice Provisions of the Milk Law be retained and strengthened.
2. The Department recommends the Unfair Practice Provisions and definitions be amended to make them applicable to transactions with any customer.
3. The Department recommends that Section 61382 (the discrimination standard) and Section 61384 (the sales below cost standard) be amended to state explicitly that each entity handling milk shall maintain current cost records in support of his selling prices for each dairy item offered for sale and that such cost records shall be readily and immediately available upon demand for inspection and review by the Director. It is further recommended that such individual cost records not be required when the handler is meeting competitive prices or conditions as provided in Section 61372.
4. The Department recommends that Section 61412 be amended to require that each handler's price schedule filed with the Director shall not become effective until the tenth day after filing and that no new prices may be made effective until and unless the handler has complied with the recommended changes in Sections 61382 and 61384.
5. The Department recommends that Sections 61571 and 61572 be amended to increase the civil penalty provisions to a range of \$100 to \$5000 per violation.

6. The Department recommends that Section 62003 be amended to provide that the minimum bond requirement be raised to \$10,000 with the authorization for the Director to require additional bond coverage in cases deemed necessary to protect the producer from threatened loss.
7. The Department recommends that the civil penalty provision in Section 62642 be increased to a range of \$100 to \$5000 per violation.

#### MILK POOLING PROGRAM

1. The Department strongly recommends the Pooling Program be retained.
2. The Department recommends that the law be amended to provide a formalized procedure for achieving equalization within a specific time period. It is further recommended that quota so allocated must remain in the possession of the receiving production entity for at least two years before it is eligible for transfer.
3. The Department recommends that the law be amended so all transfers will be at equalization.
4. The Department recommends that the law be amended so 10 percent of any base and quota transferred is withdrawn.

#### MISCELLANEOUS RECOMMENDATIONS

1. The Department recommends that the fluid milk assessment fee structure and maximum rates be amended.
2. The Department recommends that Articles 17 and 18 of Division 21, Part 3, Chapter 2 of the Agricultural Code be repealed.

RECOMMENDATIONS FOR LEGISLATION  
Pertaining to the  
THE CALIFORNIA MILK MARKETING LAW

A Report To The  
CALIFORNIA STATE SENATE

INTRODUCTION

This report presents to the legislature, the Department of Food and Agriculture's conceptual recommendations for restructuring Division 21, Part 3, Chapters 1, 2, and 3 of the Food and Agricultural Code relating to the marketing of milk and dairy products. Although submitted with the Findings and Conclusions relating to the public hearing requested in Senate Resolution No. 114, this report is not and does not purport to be a summary of recommendations made at that public hearing.

It is apparent the legislature has recognized that it takes a complete industry to supply milk to consumers. The statute provides a system of price regulation from producer to consumer with each part carefully interwoven with the others.

Even though the parts are tied together, it should be emphatically pointed out there are actually five separate programs embodied in the Milk Law. With appropriate legislative changes, it would be possible to operate each of the five programs independently.



These five programs are:

1. Minimum Producer Pricing.
2. Minimum Wholesale Pricing.
3. Minimum Retail Pricing.
4. Unfair Practice Provisions
5. The Milk Pooling Program.

The Department realizes that any modification to the law will require conforming changes to numerous sections which would be very time consuming to identify. Since concepts are more important than detail for the planning function, recommendations in this report are so expressed according to each of the programs listed above. The Department, as always, stands ready to provide assistance to the legislature with its restructuring task.

#### RECOMMENDATION

1. The Department recommends that the Milk Law be viewed as five separate programs. This will help avoid the pitfalls of severely modifying or eliminating beneficial programs while trying to resolve a problem within one area.

## MINIMUM PRODUCER PRICING

The chaotic marketing conditions and destructive trade practices that led the State to intervene and establish a stabilization and marketing program including minimum pricing for dairymen are well documented. Many of the same factors contributing to the instability leading to the passage of the Milk Law are still with us today and could easily erupt absent the program. In spite of this, growing dissatisfaction has been expressed with respect to the proper price level to producers as well as to the pricing standards and procedures used by the Department.

### ALTERNATIVES

There appear to be four alternatives open to the legislature. These are:

1. Make no change in the legislation or existing system of regulation (i.e., maintain the status quo).
2. Consider complete abrogation of the State's producer pricing program.
3. Consider substitution of Federal regulation for State regulation.
4. Consider improvements to the legislation and the prevailing system of regulation.

Available evidence suggests that all affected parties would be well advised to work toward maintaining and improving the current system of minimum price regulation at the producer level. This system has worked well and can be improved by appropriate changes in the basic legislation and regulatory system. Neither the abrogation by the State of its stabilization and marketing program, nor the adoption of Federal regulation could assure all or even most of the benefits and advantages which are now being achieved.

The scale, complexity, and importance of this industry have imbued it with considerations of public interest which cannot be ignored or dismissed. Abolition would not result in a reestablishment of the law of supply and demand nor would it permit free market forces to operate in effecting prompt and amicable resolution

of conflicting interests.

The scale, size, and continuous nature of its production and marketing processes; the quality and sanitary standards; and the regularity and reliability which are necessary in the production and marketing of this important food product obviate any reliance on price making processes being done automatically. It is doubtful that satisfactory production and marketing systems would be maintained without some public supervision in pricing procedures or intervention in reconciliation of differences for the protection of the public interest.

Abandonment of public regulation would impel the various industry sectors to make decisions through the process of negotiation. The negotiations would be conducted in secrecy and not exposed for public review and the facts surrounding them would be almost impossible to ascertain.

As the second largest milk producing State, California is unique in that, with few exceptions, the production, processing, packaging and distribution of fluid milk are conducted within its boundaries and, therefore, can be almost completely subject to jurisdiction by the State.

Finally, it is axiomatic that regulation of fluid milk prices at the producer level will be maintained in California by either State or Federal jurisdiction. If State regulations were withdrawn, Federal regulations would be instituted as rapidly as possible. California's producer pricing program which relates price to cost of production appears to serve the public interest better than the Federal producer program which is not cost oriented.

#### RECOMMENDATIONS

1. The Department strongly recommends the minimum producer pricing program be retained in the Milk Law.

2. The Department recommends the mandatory provisions under Section 62212 requiring the use of manufacturing milk production costs as a basic pricing standard be amended to state explicitly the cost of producing market milk.
3. The Department recommends the law be amended to provide for a more definitive supply standard that can be interpreted uniformly by all concerned parties.
4. The Department recommends the law be restructured to require petitions or requests for hearings to contain specific proposals for hearing consideration.
5. The Department recommends the law be amended to give the Director specific authority to examine books and records of producers to determine production costs through impartial cost surveys.

## MINIMUM WHOLESALE PRICING

The Desmond Act enacted in 1937, mandated the Director of Food and Agriculture to establish minimum wholesale prices that reflected processing and delivery costs in each marketing area. This pattern of wholesale prices proved to be very effective for distributors and retail stores for many years because distributors' costs, though different, did not vary substantially. Store costs likewise were quite uniform. This simplified wholesale price structure met the needs of the industry and guaranteed the public a supply of milk at reasonable prices.

Vertically integrated operations (where the retail store and the milk processing plant are under the same ownership) were in existence at the time the law was passed. Very little pressure was placed on the law from this direction because the volume moving through these outlets was a small part of the total market.

As time progressed, the vertically integrated operations became larger, their retail stores became larger, the number of stores increased, and their milk operations increased correspondingly. To remain competitive, other chain stores expanded their outlets and vertically integrated to include a milk processing plant.

With this change came the concept of the "white milk" plant. Theretofore, plants had tended to be full-line plants that processed milk and most dairy products. The "white milk" plant processed only high volume items, quart, 1/2 gallon, and gallon containers. This innovation was exceptionally well suited to the vertically integrated operations for they could make large deliveries to their high volume stores.

During the same period, some conventional distributors and some independent retail stores also increased in size and efficiency. This gradually led to ever widening cost differences between the large and the small and began to place extreme pressure on the wholesale pricing structure. It was also demonstrated that stores buying larger volumes of milk per single delivery were absorbing a disproportionate share of the cost of handling milk once the truck stopped at the store. These

factors led to the conclusion that a single wholesale price was not realistic economically speaking.

To correct this situation, the Milk Law was amended to provide for wholesale discounts. This authorized the Director to establish a minimum wholesale list price with discounts reflecting delivery cost differences for increasing volumes per single delivery. The resulting minimum wholesale price schedules responded to the need of industry. They proved to be quite effective for a number of years and operated in the public interest.

As the number of stores and their respective volumes continued to expand, the efficiency of the "white milk" plants increased. This further magnified cost differences between the small and large operators and regenerated severe pressure on the wholesale pricing structure. This did not create any problems for the vertically integrated firms because the minimum wholesale price was not applicable when no sale occurred and they were operationally exempt. Large independent stores expressed increasing interest in acquiring a milk processing plant. This placed conventional distributors in a serious dilemma. If their best customers, the large independent stores, acquired a milk processing plant, the conventional distributor would suffer loss of business, increased average unit costs, and possible financial disaster. If they were going to retain these stores as customers, some consideration had to be given to them to partially offset the inherent advantages of vertical integration.

It was in this climate that the Joint Venture concept was developed. In a Joint Venture, a conventional distributor and a group of retail stores own and operate a white milk plant. While the retail store could not completely capture a separate profit center like a vertically integrated operation, it would receive a pro rata portion of the profit through the payment of dividends. These dividends, in effect, enabled stores belonging to a Joint Venture to purchase milk below the

minimum wholesale prices established by the Director. The Joint Venture concept was challenged but the court ruled it legal under existing law.

The Joint Venture did two things - first, it increased the amount of milk that was for all practical purposes exempt from minimum wholesale prices. Second, it made it possible for a retail store to enjoy many of the benefits of vertical integration with a very limited capital outlay.

This second point provided a tremendous incentive for stores to join a Joint Venture and placed the conventional distributor who did not or could not develop one, at a tremendous competitive disadvantage. Since the conventional distributor was required to sell at the minimum wholesale price and since the larger stores could purchase milk below this price via the Joint Venture dividend, the conventional distributor had the option of violating the established prices through "informal" discounts or requesting their suspension.

After being declared legal by the court, the Joint Venture concept spread to the Sacramento area. Due to its inherent instability to the wholesale market, a public hearing to consider possible suspension of minimum wholesale prices was held. On November 18, 1973, minimum wholesale prices on the quart, 1/2 gallon and gallon containers were suspended in the North Central Valley Marketing Area (Sacramento) to give conventional distributors an opportunity to compete with Joint Ventures. This was the first suspension of wholesale prices under the law.

As the Joint Venture moved into the San Joaquin Valley, public hearings were called and minimum wholesale prices on quart, 1/2 gallon and gallon containers were suspended on April 14, 1974 in the Central Valley, Kings - Tulare, and Kern County Marketing Areas.

The insurmountable problems with current wholesale pricing were brought into sharp focus as the Department analyzed and evaluated the record of the public hearing held in the Central Coast Counties Marketing Area (San Francisco Bay Area)

on August 28 and September 4, 1974. Distributors requested a 3.3 cent per half gallon increase in the wholesale price to offset increasing labor costs and carton costs. In reviewing this request, along with the Department's own cost studies, the Department concluded that a wholesale price increase could be justified on a cost basis. However, it was also noted that increasing the wholesale price level was not consistent with a price that would lawfully permit conventional distributors to compete with Joint Ventures.

Either the Department would have to grant an exceptionally large discount for the larger stores or conventional distributors serving these stores would be placed in the position of offering "informal" discounts below the minimum to remain competitive and retain their customers. In either case, the out of store price would have had to be increased which would have increased the gross margin of the larger stores to unacceptable levels and consumers would be paying more for milk unnecessarily. Therefore, the Department concluded that establishing cost related wholesale prices in this marketing area would create more instability than stability and that neither the intent and purposes of the Act nor the public interest would be served by increasing the wholesale price structure. Accordingly, all minimum wholesale prices in the Central Coast Counties Marketing Area were suspended effective October 19, 1974.

It is the Department's observation that these same pressures exist in other heavily populated areas and has led to the conclusion that meaningful wholesale prices under the authority in existence today cannot be effectively administered within the intent and purposes of the law.

On Thursday, November 7, 1974, the Department announced public hearings in San Luis Obispo, Southern Metropolitan, San Diego-Imperial and Redwood Marketing Areas to consider possible amendments to or suspension of wholesale and retail pricing. These hearings are scheduled for November 19, 25, December 4 and 6 respectively. The Notice of Hearing stated that it was the Director's proposal to suspend all minimum wholesale prices in these areas.



The philosophy of current wholesale pricing in the Act is to establish a minimum wholesale list price and then establish discounts as delivery costs are transferred to stores. For example, it is much more costly for a distributor to deliver to stores taking a few cases of milk per delivery than one taking several hundred dollars worth of milk. In the first instance, the truck is loaded by hand, the driver checks the storage and display area, verifies the order and faces up and stocks the refrigerated display case. In the second, there is a preorder that is stacked on pallets, loaded into a large van by forklift, unloaded at the store's dock by forklift, and the store assumes all responsibility for handling the milk from that point on. The established wholesale list price has to be high enough to cover the costs of the smaller deliveries and is then gradually reduced by discounts for the larger and larger deliveries. This has been referred to by some as the "striptease".

#### ALTERNATIVES

Current conditions suggest three alternatives. The second and third alternatives approach the problem from the opposite direction to the present system. They suggest a single minimum wholesale price at a low level and require the distributor to establish charges necessary to cover any additional services provided.

1. Total Repeal.

Repeal all wholesale pricing authority and strengthen the Unfair Practices Provisions in the predatory pricing (sales below cost) area.

2. True Minimum Wholesale Pricing.

There is no precise definition of true minimum wholesale pricing. The common ingredient is a minimum price below which some efficient distributors cannot sell economically to large stores.

A true minimum wholesale price below the costs of all distributors or one that only covers the cost of the integrated and Joint Venture operations places severe pressure on conventional distributors to sell below cost in

order to maintain their large customers. No firm can sell below cost and remain in business very long. Such a true minimum would prevent drastic price wars but would legalize predatory pricing. The trend toward vertical integration and Joint Ventures would be accelerated and the number of conventional distributors would decline. In this way, this concept could foster conditions favorable to the further development of monopoly.

### 3. Processing Plant Platform Price.

This concept would authorize the establishment of minimum wholesale prices to be applicable at the platform of the processing plants in each marketing area. The distributor would determine the charge for services he renders to any customer beyond the platform.

This minimum processing plant platform price concept has the problem of determining what level or standard to use. This would not be insurmountable because it has the advantage over the current method of being only involved with processing costs. This point is important because differences in processing costs between conventional and vertically integrated firms are quite small. These differences become accentuated when delivery costs are considered. Minimums for delivery costs would not be established under this concept.

## RECOMMENDATIONS

1. The Department recommends that the existing minimum wholesale pricing authority be repealed and replaced by the processing plant platform price concept.

The minimum processing plant platform price concept is different and the Department believes it will overcome the shortcomings of the existing wholesale pricing authority. The Department also believes this concept can be

feasibly administered and will provide a basis for establishing minimum wholesale and retail prices that will better serve the public interest.

2. If the legislature determines that there would not be mandated minimum wholesale pricing authority, the Department recommends that standby wholesale pricing authority be provided for in the law. It is further recommended that the standby authority be stated in general terms to permit the Director maximum flexibility to use whatever system might be appropriate to achieve stability. The intent of the law should be reversed so wholesale pricing will not be mandated.

Everyone is cognizant that minimum wholesale pricing authority has been in effect for 37 years. It is doubtful that anyone can accurately forecast what would happen if it is fully removed. The adjustments will no doubt be traumatic and could have serious repercussions that might be injurious to the public interest. Because of this, the Department believes it would be prudent to have standby authority in the event unexpected conditions arise as the distribution portion of the industry withdraws from mandatory wholesale price regulations.

## MINIMUM RETAIL PRICING

The establishment of minimum retail prices like wholesale prices, is mandatory on the Director. Unlike existing wholesale pricing, the Department believes that the establishment of minimum retail prices is economically necessary for stability in the market and is feasible and meaningful from an administrative standpoint.

The minimum retail pricing program has received the most criticism of any of the milk programs. This is partially because the retail price is the final pricing level in the regulated series. It is partially because the increase in the retail price of milk has come in substantial jumps over the past two years as feed costs have skyrocketed to dairymen. It is partially because many think the established price is too high. It is also partially due to its being a target of frustration over inflation that has eroded the purchasing power of the dollar and has tended to reduce the accustomed standard of living.

### ALTERNATIVES

There are several legislative options relating to retail pricing. One has to look at these options conditionally, that is, whether or not there is to be some kind of wholesale pricing authority.

#### 1. Repeal Retail Pricing Authority.

One obvious alternative is to repeal retail pricing authority. If this alternative were selected, the Department suggests that the necessary restructuring to accomplish this should not adversely affect other desirable portions of the milk law.

The major attraction for repealing retail pricing is to permit stores to "special" milk at a price below the store's handling costs. A few people connected with retail stores have testified before legislative hearings that they would special milk at prices that would give them a gross margin of 2 to 3 percent, which is substantially below their store costs. They inferred that they

would expect to move much more milk on these "specials" than they do now on a normal weekend and make up their lost margin by increasing the prices on other products in the store.

If stores did "special" milk in this manner, severe stress would be placed on the dairy industry. Even though most people do their grocery shopping and purchase milk on Thursday, Friday and Saturday, a substantial amount of milk is still purchased on other days. The "weekend special" would concentrate milk purchases on these three days and would severely distort an already uneven flow of milk to the market. Since milk cannot be stockpiled because of its perishability and because it requires refrigeration, abnormally large amounts of milk would be needed by the bottling plants in a very few days, perhaps taxing their capacities to meet this unnatural demand. This could very well require manufacturing plants to close completely or partially on these days so bottling plants could have the necessary supply. During the remaining days, milk would have to be diverted from the bottling plants to manufacturing plants. It is doubtful that existing manufacturing facilities could handle these extreme fluctuations and could require additional manufacturing plants to accommodate the excess milk.

It is entirely unrealistic to believe that bottling plants can operate as efficiently on fewer days than they do now. This could only increase their costs which must be eventually borne by consumers. Manufacturing plants must also operate on a continual basis if maximum efficiency is to be attained. It is unrealistic to expect them to operate in a "wet", "dry" cycle to insure sufficient milk to a bottling plant to satisfy this unnatural demand. This means that efficiency would be lost or more milk would have to be produced to supply these market needs. The latter would aggravate an already critical situation, especially during the periods of normal peak production. In either case, costs would increase and be passed on to consumers. In the end, the

"specials" for alleged consumer benefit could result in a greater expenditure for the same amount of milk and dairy products and an increase in the price of other items in the store to make up the store loss.

2. Retain Retail Pricing.

Another obvious alternative is to retain retail pricing authority. Yet, one should take into consideration its manifested shortcomings.

3. Change the "reasonably efficient" Standard to "most efficient".

If retail pricing authority is maintained, one alternative is to change the standard from "reasonably efficient" stores to "most efficient" stores. A more precise definition of either term would be most beneficial to the Department and the public. This might be accomplished by stating the standard is the average cost of larger stores, including integrated and Joint Ventures, handling a specific percentage of milk sales in stores such as 60% to 70%.

One problem would be the possible adverse effect on smaller stores as the standard was lowered to more efficient levels. However, one should be aware that most of the smaller stores today are upcharging over the existing minimum price.

A change in the standard to "most efficient" could lead to lower minimum retail prices, provided no other cost relationships changed.

4. Repeal the Overall Cost of Doing Business Standard.

Consumer advocates have been very critical over the Department using the optional standard of the overall cost of doing business to determine retail prices. One alternative to satisfy these criticisms is to repeal this optional standard.

If this alternative were selected, the repeal of the optional standard should not be made effective until the Department has an operational method for determining the store cost of handling milk. The Department has developed such

a procedure and is in the process of testing it to determine its workability.

Consumer advocates have stated the cost of handling milk standard will result in lower out-of-store prices. Our highly preliminary investigations tend to support this position, though perhaps not to the extent some might think desirable.

#### 5. True Minimum Retail Prices.

Another alternative is true minimum retail pricing. As with true minimum wholesale pricing, this can mean different things to different people. The basic concept, as it exists in at least one State, results in a minimum retail price so low that not even the integrated firms can sell at that level economically.

A true minimum retail price that is below the cost of all stores or one that covers the most efficient store, places extreme pressure on substantial portions of the trade to sell below cost. Such a concept is not economically sound. While it might prevent dramatic price wars, it legalizes predatory pricing in that some efficient stores would have to sell below cost to meet the lawful price of a legitimate competitor. This certainly encourages conditions leading to monopoly which is in opposition to the intent of the existing law.

#### 6. A Specific Minimum Store Margin.

Another alternative is restructuring the law to provide for a specific minimum store margin. This concept would establish in the law the gross margin to which the Director would have to adhere in establishing the minimum retail price.

In all probability, such a specific minimum store margin would not have any relationship to costs. It also runs the risk of becoming a type of true minimum with all its deficiencies. However, it is a very direct way to regulate a store's gross margin.

## RECOMMENDATIONS

1. The Department recommends that some form of minimum retail price regulation be maintained in the Milk Law to assure stability.

It should be emphatically pointed out that to be realistic, minimum retail pricing authority must have some connecting link with the raw product or producer price. Otherwise, it floats without any reference point. In the past, this was one of the functions provided by the minimum wholesale price. If wholesale pricing authority is retained in the Act, it would continue to provide this connector.

If it is withdrawn from the Act, then some kind of basing point is needed to bridge the gap. If this latter situation were the case, the Department further recommends that the processing plant platform cost concept be used to provide the connector without being implemented as a minimum wholesale price per se.

2. The Department recommends that the minimum retail pricing standard be changed from "reasonably efficient" to "the average cost of the larger stores having 60% to 70% of milk sales".
3. If the legislature determines that retail pricing authority is to be repealed:
  - (a) The Department then recommends that provision be made for slow, orderly withdrawal that will not unnecessarily disrupt the industry. This may be done by establishing a date by which all minimum retail prices are to be withdrawn.
  - (b) The Department further recommends that the legislature provide standby retail pricing authority that could be implemented on an exception basis, similar to the standby wholesale pricing authority recommendation.



## UNFAIR PRACTICE PROVISIONS

The Milk Stabilization Act has always contained a comprehensive group of public interest laws commonly known as the Unfair Practice Provisions. These statutes prohibit bulk fluid milk transactions that would circumvent the minimum price to be paid to producers. In addition, there are licensing, bonding and contractual requirements designed to foster orderly production and marketing of bulk fluid milk at the producer level.

There are also similar Unfair Practice Provisions pertaining to transactions involving the marketing of packaged fluid milk and dairy products. They are designed to eliminate or reduce monopolistic conditions by prohibiting price discrimination between customers, sales below costs including loss leaders, and unreasonable pricing differentials between commodities which could injure or exclude lawful competition. They are also designed to curb destructive trade practices that would unnecessarily increase the cost of producing and marketing fluid milk and dairy products to consumers.

The Department believes the Unfair Practice Provisions are essential to protect the public interest.

### RECOMMENDATIONS

1. The Department strongly recommends the Unfair Practice Provisions of the Milk Law be retained and strengthened.
2. The Department recommends the Unfair Practice Provisions and definitions be amended to make them applicable to transactions with any customer.

Present language is applicable to wholesale customers and consumers, but has no specific application to modern day operations such as jobbers, contract services, or other specialty type operations which do not make direct sales to consumers. The Department believes all such

operations should be covered.

3. The Department recommends that Section 61382 (the discrimination standard) and Section 61384 (the sales below cost standard) be amended to state explicitly that each entity handling milk shall maintain current cost records in support of his selling prices for each dairy item offered for sale and that such cost records shall be readily and immediately available upon demand for inspection and review by the Director. It is further recommended that such individual cost records not be required when the handler is meeting competitive prices or conditions as provided in Section 61372.

These changes are necessary to provide for timely and meaningful enforcement by the Director.

4. The Department recommends that Section 61412 be amended to require that each handler's price schedule filed with the Director shall not become effective until the tenth day after filing and that no new prices may be made effective until and unless the handler has complied with the recommended changes in Sections 61382 and 61384.

Recommendations 3 and 4 will tie the price filing and cost justification requirements together so new prices must comply with both before they can be made effective. This places the burden upon the handler to prove before the fact that his intended prices will be in conformity with the Code. This will prevent a handler from disrupting the market and engaging in predatory pricing during the time it would take the Department to complete a cost study to determine if a handler's prices are below his costs.

5. The Department recommends that Sections 61571 and 61572 be amended to increase the civil penalty provisions to a range of \$100 to \$5000 per violation.

The present civil penalty provisions range from \$50 to \$500 per violation. The increased amounts will give the Director the flexibility to initiate punitive actions in a more meaningful relationship to the magnitude and seriousness of the transaction violated.

6. The Department recommends that Section 62003 be amended to provide that the minimum bond requirement be raised to \$10,000 with the authorization for the Director to require additional bond coverage in cases deemed necessary to protect the producer from threatened loss.

The present requirements for bonds by processing distributors to insure payment to producers range from \$1000 to \$5000. This amount is no longer adequate to serve its intended purpose.

7. The Department recommends that the civil penalty provision in Section 62642 be increased to a range of \$100 to \$5000 per violation.

This change will conform the civil penalty provision of Section 62642 with those recommended for Sections 62571 and 62572.

## MILK POOLING PROGRAM

The Gonsalves Milk Pooling Act was passed in 1967 to correct instability that developed under the operations of the Young Act and was the enabling authority to establish the Milk Pooling Program. This Act gave each eligible market milk producer a production base and pool quota representing his historical production and share of the Class 1 market. Rather than directly receiving the minimum classified producer prices established by the Director, dairy farmers are paid according to their production base and pool quota. This base and quota belongs to producers and is freely transferable.

One of the inherent purposes of the Gonsalves Milk Pooling Act is to equalize gradually the distribution of Class 1 usage among market milk producers of the State. This was to be accomplished through the issuance of new quota resulting from increases in Class 1 sales. In a short time, all dairymen were to have reached their equalization point, where a producer's pool quota is equal to 95% of his production base.

The Pooling statute was formulated during a period that had been marked by consistent growth in Class 1 sales. Unfortunately, these sales did not continue at the rate anticipated when the Act was adopted and the Pooling Plan formulated. This has seriously restricted the movement toward equalization. Because of this, quota has become a prized possession and carries a high value when transferred from one producer to another.

These issues, lack of equalization and high quota values, are the two principal problems facing the Pooling Program today.

### ALTERNATIVES

There have been several suggestions made to resolve these problems. These include:

1. Failing to approve transfers.

The Director is currently required to approve all transfers of base and quota before they can become effective. One alternative is to amend the law

so transfers in excess of some predetermined price could not be approved. While this would superficially regulate quota values, it would also provide strong incentives for producers to make "informal" transfers.

2. Requiring transfers be made to the State.

The law could be amended to require all sales of base and quota be made to the State who would resell it to interested producers at a fixed price according to some priority system. This places the State in the position of a Broker which the Department believes is undesirable. Producers would be tempted to transfer their quota "informally" to other producers creating an almost impossible enforcement problem.

3. Equalizing through a planned program.

The law could provide a specific plan independent of Class 1 sales to equalize producers gradually within a given time period. It appears that such a planned program is necessary if equalization is to be achieved in the foreseeable future. If this were done, some control over the quota allocated under the amended program should be included so it could not be sold immediately. If a dairyman did sell, this newly allocated quota would revert to the pool.

4. Forfeiting production base on transfers.

One of the purposes of the law was to provide producers with production base and pool quota to supply milk for the market. Production base is also an important factor in receiving growth through allocations of new quota. When a dairyman decides he no longer wants to supply milk for the market, there is little justification for allowing his growth factor to be transferred to another producer. The amount of production base allowed to be sold could be adjusted so all transfers would be at the equalization point. Any production base in excess of this amount would be lost. This would tend to reduce quota

values and make progress toward equalization.

5. Removing base and quota on transfers.

For the reasons mentioned above, the amount of base and quota sold by a producer could be reduced by some fixed percentage. This would tend to reduce quota values and help the program move toward equalization.

RECOMMENDATIONS

1. The Department strongly recommends the Pooling Program be retained.
2. The Department recommends that the law be amended to provide a formalized procedure for achieving equalization within a specific time period. It is further recommended that quota so allocated must remain in the possession of the receiving production entity for at least two years before it is eligible for transfer.
3. The Department recommends that the law be amended so all transfers will be at equalization.
4. The Department recommends that the law be amended so 10 percent of the base and quota transferred is withdrawn.

## MISCELLANEOUS RECOMMENDATIONS

### Administrative Fees

1. The Department recommends that the fluid milk assessment fee structure and maximum rates be amended.

A change is necessary to continue to fund the program. It has been the policy of the Department to establish the level of assessment to meet the anticipated program expenditures. The maximum rates have only been invoked when necessary.

2. The Department recommends that the assessment fees be changed from a fat basis to a fat and solids-not-fat basis and that the maximum rate for each producer and distributor be set at \$0.002 per pound fat and \$0.002 per pound solids-not-fat used for Class 1 purposes and \$0.001 per pound fat and \$0.001 per pound solids-not-fat used for Class 2 and 3 purposes.

This recommendation is made assuming the Department's primary recommendations for each program are adopted. If these recommendations are not adopted, the maximum rate should be set at a rate commensurate with the program.

Code Update

1. The Department recommends that Article 17, Sections 62301-62323, entitled "Sales Stimulation and Consumer Educational Programs" and Article 18, Sections 62351-62357, entitled "Amendment and Extension of Sales Stimulation and Consumer Educational Programs", Food and Agricultural Code, Division 21, Part 3, Chap. 2, be repealed.

The provisions of these two Articles have not been used for several years.





## DEPARTMENT OF FOOD AND AGRICULTURE



1220 N Street  
Sacramento  
95814

November 30, 1974

Honorable James R. Mills  
President Pro Tempore  
State Senate  
State Capitol, Room 5100  
Sacramento, California 95814

Dear Senator Mills

The California Department of Food and Agriculture transmits herewith a report entitled "Recommendations for Legislation Pertaining to the California Milk Marketing Law."

These recommendations are presented for your consideration and in conjunction with the report requested in Senate Resolution No. 114.

Respectfully submitted

  
C. B. Christensen  
Director