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After the Nebbia Case: The Administration of Price Regulation

Frank Edward Horack Jr.
Indiana University School of Law - Bloomington

Julius Cohen
West Virginia University College of Law

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Long prior to the stock market fiasco of 1929, the “embattled farmers” had by successive volleys directed nation-wide attention to their economic difficulties. Mortgages assumed on the basis of two dollar wheat and dollar corn had to be paid from crops commanding less than half their former prices. In an endeavor to meet these obligations and the steadily increasing tax rate, farmers turned to marginal activities. Poultry and dairy products became the chief source of revenue for many farmers. Naturally, these marginal activities were soon over-developed. Price deflation followed, leaving farm populations devoid of buying power. Demonstrations of the dairy farmers of New York, Wisconsin, and Iowa during the summers of 1932 and 1933 again emphasized that all was not quiet on the farm frontier. A host of experimental legislation was rushed through sympathetic legislatures. Most of this legislation was
patently unconstitutional. Some were ready to declare that that was unimportant.

During the tide of this legislation activity a milk control bill was enacted by the state of New York creating a milk control board and granting to it broad powers to regulate wholesale and retail prices. With the federal government experimenting with the control of business, it was readily assumed that a new era of control in the milk industry had arrived. Thus it was with much anticipation that lawyers and economists watched the progress of *Nebbia v. New York* from its first trial till its final appeal and consideration by the Supreme Court of the United States. Indeed, the crystallization of regulation and litigation in and around the *Nebbia* case has obscured the fact that the regulation and control of milk production is, in America, at least a century old. And so, although new manifestations have been accentuated by the demands of the depression, the problem itself is neither new or unique. The problem of milk control is not the problem of relief of economic distress, except insofar as that relief is necessary to the stability of the milk industry itself. Early milk control measures arose from the necessity of insuring the maintenance of a safe, adequate, and continuous supply of milk to the consumers at all times. While it

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1 N. Y. Laws (1933) Ch. 158.
is of course difficult to single out any particular commodity as meriting specialized treatment, the difficulty of providing fresh pure milk to a large urban population distinguishes the business from many other commodity industries. Thus, the milk industry was at first regulated for the purpose of protecting the social interest in the individual health of the people. Governmental activity to reach this goal becomes super-imposed upon the industry only at that point where self-interest fails to give adequate protection to the public. This social policy together with the protection of economic structure may be enforced by penal legislation imposing fine and imprisonment for the commission of certain prohibited acts; by injunctive relief; by administrative regulation to insure health standards, of the product, of the herds, of the distributors; and finally by the regulation of price. No matter how varied the regulation, if it bears a reasonably effective relation to the primary object of legislative policy, eventually it will receive judicial approval.

The problem of adjusting government regulation to society cannot be evaluated in terms of individual decisions, statutes, or litigation. The decision in an individual case may to some degree enhance or retard the development of a particular social policy, but for the most part judicial decision is only a poorly recorded manifestation of the policy. The true problem of social control is the determination of the vital fact or essential objective of regulation and the formulation of that

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4"Sufficient stress has never been laid on the fact that the significance of law in daily life of a people depends far more on the persons charged with its administration than on the principles according to which it is administered." Ehrlich, Freedom of Decision, 9 Mod. LEC. PHIL. SRR. 48 (1917). Cf. Holdsworth, Case Law, 50 L. Q. REV. 180 (1934).
objective according to the attitude of mind, the mode of thinking that expresses the existing mores.

A persistent and effective demand for regulation seldom arises unless there is a general belief in the need for regulation. And whatever may be the life of the statute on the books, enforcement continues only so long as regulation is adjusted to industry and industry to regulation. This administration cannot go too fast. Business cannot reform itself overnight. Nor is this desirable—for the very continuity of long established businesses attest the merit of their organization. Thus regulation, whether it be legislative, administrative, or judicial, must be a practical regulation which merits acceptance because of the results that it produces.\(^5\)

**EARLY REGULATION OF THE INDUSTRY**

Government interference or regulation affixes itself to an industry at that point where industry fails or refuses to conduct its affairs in a fashion which will protect the individual and social interests which a dominant minority of society thinks desirable. In the milk industry the first demands for government regulation were for the protection of health.\(^6\) In this country, as early as 1784, Massachusetts sought to prohibit the sale of "diseased, corrupted, and unwholesome products."\(^7\) The policy set forth in this statute was clear; but the statute was ineffective for the uncertainty of the standard of "wholesomeness" made administration and en-

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\(^5\)Green, *Judge and Jury*, (1930) pp. 77 et seq. reprinted from 28 Col. L. Rev. 1014 (1928).

\(^6\)In Europe, regulations to protect the purety of milk are of great antiquity,—as early as 1599 in Vienna, 1743 in Paris. See Erdman, *The Marketing of Whole Milk* (1921), p. 16.

\(^7\)Mass. Laws 1784, c. 50.
forecement almost impossible. Indeed, every case was a "border-line" case and this administrative barrier made the statute unworkable. As a result of this experience, legislation was directed toward the regulation of particular food industries. In dealing with the milk industry, most states having set forth the general policy of health protection, have been content either to delegate the problem of determining standards of compliance to an administrative board, or to declare by

8Green, op. cit supra note 5 at p. 95. "Duties must await the court's finding a workable method by which they can be given meaning."

9The Pennsylvania statutes are illustrative of the development of standards of milk purity. See Pa. Laws (1869) Chapter 56, which provides in general terms "that the councils of city and boroughs . . . are hereby authorized and empowered to provide for the inspection of milk, under such rules and regulations as will protect the people from adulteration and dilution of the same." Greater particularization was provided by the Acts of 1878, Chapter 183, extending regulation to all persons engaged in the sale of milk and making it a misdemeanor for anyone to sell "any impure, adulterated, or unwholesome milk." Further clarity was obtained by declaring "that the addition of water or ice to milk is hereby declared adulteration; and any milk obtained from animals fed on distillery waste or any substance in the state of putrefaction is hereby declared to be impure and unwholesome."

By the Law of 1885, Chapter 186, the test had been extended to include milk to which water or any foreign substance had been added and impure milk was described to include milk from sick or diseased cows. An exact and scientific standard was fixed by the statute. Milk which failed "to contain more than eighty-seven and fifty hundredths per centum of watery fluid and which contained less than twelve and fifty hundredths per centum of milk solids and less fat than three percent and if the specific gravity at sixty degrees fahrenheit is not between one and twenty-nine one thousandths to one and thirty-three one thousandths it shall be deemed to be adulterated."

By Act No. 236, Laws of 1895, the inclusion of certain acids was made an adulteration and by Act No. 59, the Laws of 1901, the enumeration of specific acids was increased. These later statutes seem both unnecessary and undesirable in view of the Act of 1885. Cf. Mass. Law 1859, c. 206; Va. Acts 1847-8, c. 112.

10For typical control of food purity, see Georgia Code (1926) sec. 2115, which provides that "it shall be the duty of the commissioner of Agriculture and the State Chemist to fix standards of purity for food products, where the same are not fixed by this chapter, in accordance with those promulgated by the Secretary of Agriculture, the Secretary of Treasury, and the Secretary of
statute exact standards as fast as scientific research can provide them.\textsuperscript{11} The general policy has not varied from the beginning but the standards of compliance have moved from the general to the specific.\textsuperscript{12} Not until the Babcock test was developed was the administrative problem of "What is an adulteration?" finally settled.\textsuperscript{13} Likewise, rapid developments in the science of bacteriology have provided an effective control over the purity of milk.

A more detailed inquiry into the mechanics of milk regulation is beyond the purview of this paper. It is enough to note that once assured of a reasonably clean and pure product, regulation swiftly moved toward the regulation of persons engaged in the industry,\textsuperscript{14} of production conditions,\textsuperscript{15} and of methods and conditions of storage and distribution.\textsuperscript{16} And with the development of greater technical knowledge concerning bovine di-

\textsuperscript{11} See also the statutory recognition of the science of bacteriology. Conn. Gen. Stat., Sec. 2482: "Milk containing more than one million bacteria per cubic centimeter shall be considered impure milk."

seases, legislation was generally adopted providing for the regulation and inspection of herds" and the establishment of "accredited areas" for the eradication of bovine tuberculosis.18

This cursory reference to the regulation and enforcement of health standards is meant primarily to indicate the minutia of regulation that exists in the industry; to emphasize the burden that this regulation imposes upon the industry and the attendant increase in the cost of production; and finally to suggest that the regulation—cost—price relationship has had constitutional sanction in the industry for many years.19

The history of the legislative, judicial, and administrative activity in the health regulation of the milk industry, indicates that the administrative ingenuity of boards and commissions has done more to shape the usefulness and effectiveness of the general social policy than has legislation or judicial decision. Indeed, even administration advances only as fast as science develops easy methods of compliance and effective methods of enforcement. Illustrative, is the experience of highway regulation, where the painting of a line down the center of the road (which of course was impossible prior to hardsurfacing) has done more to keep motorists on the correct side of the road than all of the penal provisions ever spread upon the statute books.

Does the history of health regulation offer a guide

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19 This regulation, except in special fields, consisted, for the most part, in regulations which effected price only indirectly. See, infra nn. 23-28; Rottschaefer, infra n. 30.
for the future of price regulation? Will the success of governmental regulation of price standards depend upon the orderly development of administrative devices for the accurate and fair determination of price relationships? These questions of course presuppose a legislative policy judgment that the general social welfare will be advanced by additional regulation of the industry. This regulation must include an adjustment of producer-distributor, distributor-consumer, and producer-consumer relation. These postulated policy-goals seek to protect the consumer against the health hazards created by the producer and the distributor; to insure the consumer continuity of supply; to protect the consumer against unfair price standards; to protect the producer against unfair cost-price burdens; to encourage organized production units; to control distributor cost standards; to insure protection against destructive distributor competition; and finally to insure to the consumer and his community certainty of supply at fair prices, and to the producer and his community certainty of market at profitable prices. Obviously, these and the many other desired results of milk-price regulation cannot be accomplished by the enunciation of a broad social policy. Nor can they be accomplished by the successive tragedies of litigation. If they can be accomplished at all they must be achieved through the slow, understanding science of administration. Administration cannot be effective until it devises certain and objective standards of enforcement. Coordinately, these standards are seldom formulated until there is a dominate need for protection which the industry is unable or unwilling to provide; which society is unable to provide for itself; and which it insists that government provide.
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RECENT DEVELOPMENTS: PRICE REGULATION

The economic complexities of our social order wherein life depends upon the consumption of goods produced by others is reflected in the ever increasing importance of price and price-relationships. It is price which for the most part draws the social lines. Thus the regulation of price becomes at least economically the most important of the social regulations. Social policy may dictate that price regulation must depend upon natural causes or it may permit limited and indirect governmental regulation, or it may sanction direct governmental price fixing. We have struggled for several decades under the assumption that our social policy gave effect to the first type of price regulation—a sort of natural law of economics whereby competition provided both remedies and safeguards to consumer and producer alike. We have overlooked the fact that governmental price regulation has always existed in some form. Taxation, the most arbitrary power of government, is a form of price regulation. Inasmuch as the tax burden may not always be "passed on" it may in some instances be a very direct type of price control. In the same fashion governmental regulations for the insurance of health standards, the establishment of trade practices, the control of unfair competition, minimum hours of

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20 The Adam Smith approach.
21 See infra nn. 23-28.
22 As in the case of carriers and utilities.
23 See infra nn. 104, 80.
25 Rottschaefer, infra n. 30.
labor, workmen's compensation, and railway rate differentials all impose a burden and a price regulation. Note, however, that the regulation in these instances does not constrain the individual choice of price except as it operates to make too low a choice economically destructive. The object of these controls is the promotion of some accepted standard of social or economic good—the protection of health and safety; the preservation of competition; the equality of purchasing and bargaining power—in general, the assumed economic stability of the social order. Likewise, these may be the ends of direct price regulation or price fixing. If these ends are not assumed then it is quite clear that the legislature has no claim to judicial support. The patience and the eyes of my readers shall be spared from a reconsideration of the historic proofs of common law authority for direct price regulation. Prior juristic comment has well established that price regulation was an established form of social control during the middle centuries of English common law development. Indeed, price regulation was accepted as the inevitable result of state authority and was welcomed

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28 Rottschaefer, infra n. 30.

29 Mansfield, The Hoch-Smith Resolution and the Consideration of Commercial Conditions in Rate-Fixing, 16 CORN. L. Q. 339 (1931); Arnold, The Lake Cargo Rate Case of February, 1928, 34 W. VA. L. Q. 272 (1928).

30 "A regulation for one kind of business may, of course, be invalid for another; since the reasonableness of every regulation is dependent upon the relevant facts ... The limitation is that set by the due process clause, which, as construed, requires that the regulation shall not be unreasonable, arbitrary or capricious; and that the means of regulation selected shall have a real or substantial relation to the object sought to be obtained." Brandeis, dissenting, New State Ice Co. v. Liebman, 285 U. S. 262, 302, 52 Sup. Ct. 371 (1932).

31 Hamilton, Affectation with a Public Interest, 39 YALE L. J. 1089 (1930); Rottschaefer, The Field of Governmental Price Control, 35 YALE L. J. 438 (1926); McAllister, Lord Hale and Business Affected with a Public Interest, 43 HARV. L. REV. 759 (1931).
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as a protection from the vicissitudes of trade. With a
general philosophical value which idealized individual
freedom and abhorred state authority, government price
regulation hibernated and was for a time forgotten to
the common law, save in the “exceptional cases of inns,
cabs and gristmills.” The long view of price regulation
—the backward view—now sees price regulation as a
problem not of competence but of emphasis. The weary
path of due process from *Munn v. Illinois* has been so
frequently trod and the reader’s eye so frequently di-
rected to the mileposts now visible only after the course
has been run it seems both unnecessary and undesirable
once again to “hit the sawdust trail.”

It must suffice to say that the early dogma of price
regulation was couched in language which made the
test of price regulation dependent upon (1) a grant of
a public franchise, (2) the exceptional character of cer-
tain occupations, or (3) a “business affected with a
public interest.” The difficult and therefore important
cases all arose under the third classification and it be-
came incumbent upon the court to determine what was
clothed with “a public interest.” The test of that qual-
ity, according to Mr. Chief Justice Taft, “was the indis-
pensable nature of the service and the exorbitant charges
and arbitrary control to which the public might be sub-
jected without regulation.”

But this test left an open
field for judicial inclusion and exclusion. And so the
litigious history of the next ten years is marked by
sharp conflicts as to what is indispensable, and indeed
if any service is so indispensable as to justify price
regulation. The judicial literature is full of discussions

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Ct. 63 (1923).
32The periodical literature is effective in illuminating the conflict. Finkelstein,
of the merits and demerits of the "affectation test." Obviously, the test is of course nothing more than a fiction. To quote from Mr. Justice Stone's dissent in the *Tyson* case:

"The phrase 'business affected with a public interest' seems to me to be too vague and illusory to carry us very far on the way to a solution. It tends in use to become only a convenient expression for describing those businesses, regulation of which has been permitted in the past. To say that only those businesses affected with a public interest may be regulated is but another way of stating that all those businesses which may be regulated are affected with a public interest. It is difficult to use the phrase free of its connotation of legal consequences and hence when used as a basis of judicial decision, to avoid begging the question to be decided."

It should not be overlooked, however, that the vagueness and emptiness of the test would have made it useful as a tool to reach the end of governmental regulation had a majority of the court wished to use it for this purpose. It is rejected now only because the restrictive interpretation originally given is no longer acceptable to a majority of the court. Thus, the *Nebbia* case now purports to adopt the test set forth by Mr. Justice Brandies in his dissent in *New State Ice Co. v. Leibman*, "that the state's power extends to every regulation of any business reasonably required and appropriated for the public protection." We have no assurance that a

*From Munn v. Illinois to Tyson v. Banton, 27 Col. L. Rev. 769 (1927); Robinson, The Public Utility Concept in American Law, 41 Harv. L. Rev. 277 (1925); Hardman, Public Utilities. I. The Quest for a Concept, 37 W. Va. L. Q. 250 (1931); See also *supra* note 30.*

*Tyson v. Banton, 273 U. S. 418, 47 Sup. Ct. 426 (1927).*

*Supra* note 2.

*285 U. S. 262, 302, 53 Sup. Ct. 37 (1931).*
more exact or useful test has been advanced. The court has at least simplified the process by removing one element of variation—that is, it may now look to the reasonableness of the regulation and does not have to filter reasonability through the judicial screens already clogged with the remains of Wolff Packing Co. v. Industrial Commission, the Adkins case, the Tyson case, and many others.

The decision in the Nebbia case is in itself narrow. It only sustains the conviction of Nebbia for violating the regulation established by the milk control board of the city of Rochester. It does not stand for the proposition that every price regulation will be supported, but rather that the policy of price regulation is not abhorrent to the Constitution. And of course it must always be remembered that the only reference made by the Constitution is that vague, and without interpretation, meaningless phrase, that no state shall "deprive any person of life, liberty, or property without due process of law."

In the field of constitutional law, and particularly in the consideration of due process problems, we have struggled with various innocuous phrases in order, as Mr. Justice Holmes says, "to beautify what is disagreeable to the sufferers." Cleared of all verbiage the court's decisions may stand only for a general belief that "so far as the requirement of due process is concerned . . . a state is free to adopt whatever economic

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36 Supra note 31.
38 Supra note 33.
40 Supra note 33 at 446.
policy may reasonably be deemed to promote public welfare and to enforce that policy by legislation adapted to its purposes. But this test is even more general than the rest. And "A theory of price control that tests its validity by reference to a social ideal runs the risk of being so vague as to be practically worthless. The conception of a social ideal is too complex to be simply stated." In the end, we must look to what courts do and not to what they say.

Will the development of price fixing regulation parallel the development of rate regulation? If the Nebbia case expresses the policy of the court, then the future will see judicial inquiry directed toward the "reasonableness of price" and not toward the initial competency to regulate. This will leave to the legislature (for the most part) the problem of policy and leave to highly trained and technically informed boards the problem of administration. The jurisdiction of the court will be for the protection of individual and social interests against abuse of arbitrary and unreasonable administration. The court has frequently limited the character of its review in this fashion. After Euclid v. Ambler Realty Co., the constitutionality of zoning was established and the only review that was necessary was a review to insure a reasonable application of the policy by administrative order. In a similar fashion, the court

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41 Nebbia v. New York, supra note 2, at 516.
42 Rottschaefer, supra note 30, at 456.
43 Green, supra note 5.
44 272 U. S. 365, 47 Sup. Ct. 114 (1926).
45 Nectow v. Cambridge, 277 U. S. 183, 48 Sup. Ct. 447 (1928); Washington ex rel. v. Roberge. With policy determined it is inevitable that its administrative application may not always be "fair and equitable." The determination of these questions will necessarily require a court (and if appealed sufficiently, the United States Supreme Court) to pass upon the constitutionality of the
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has directed its attention in the field of utilities to the reasonableness of rates—the authority to fix them already having the decisional sanction of the common law. Thus it would seem that the real point of growth, at least in price-regulation in the milk industry, will come through the development of scientific administrative techniques for the determination of price. Today, there is less judicial confidence in broad declarations of policy; greater faith in the pragmatic processes of scientific method.

The sudden growth of administrative tribunals, mirrors not only the inability of legislatures to deal with the intricate problems of business administration, but also of a judicial confidence in the trustworthiness of administrative boards. Legislatures, operating without the benefit of specialized training or experience, and under the pressure of time and political influence, are seldom able to do more than devise a fair statement of general policy. Furthermore, statutes and statutory standards lack the flexibility necessary to meet the vicissitudes of price and price determinates. And their very generality, without administrative interpretation, would seem to raise doubts concerning their constitutionality, for it was pointed out in United States v. Addyston Pipe Co., that

regulation. Powell, however, queried's "What person in his senses would think of planning a governmental scheme for a continent under which nine men at the national capitol should decide whether a zoning boundary should be extended another one hundred feet before it turns a corner?" The Supreme Court and State Police Power, 18 Va. L. Rev. 1, at 33 (1931).

The appointment of special committees, the holding of hearings, the preservation of reports tend for a particular session to overcome the paucity of scientific experience. Unfortunately, after a two year adjournment the collected material is out-moded, the legislative personnel changed, and the prior experience forgotten.

175 U. S. 211, 20 Sup. Ct. 96 (1899).
"The manifest danger in the administration of justice according to the shifting, vague, and indeterminate standard would seem to be a strong reason against adopting it."

Only administrative investigation can provide the exact standards which the court desires. The method of administrative tribunals, at once empirical and scientific, will most nearly afford an answer to the question of "fair price."

**Administrative Determination of Fair Price**

In many states, the creation of milk control boards has filled the important gap between legislative sanction and judicial approval. Statutes have empowered these boards to act, not only as passive fact-finding bodies, but also to participate actively in the declaration of regulatory standards. The administrative regulation, unlike the statute, has the advantage of flexibility and experience, so unless it goes too far beyond the "fundamental tenets of the judiciary," it will operate as law.

A majority of the problems of organization, charges, and practices in the milk industry are within the ambit of administrative authority. Most boards are authorized to prescribe minimum and maximum prices and to regulate and to control the distribution, sale, and supply of milk and milk products, and to investigate the

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48Cf. Dickison, supra note 11.

49The following statutes have authorized the creation of milk control boards: Cal. Laws 1933, c. 1029, c. 384, c. 488; Conn. Acts 1933, c. 22634; Fla., Joint Com. Substitute for Senate Bill No. 786 (1933); N. J. Laws 1933, c. 169; N. Y. Laws 1933, c. 226; Ohio, H. B. No. 671 (1933); Ore. (S. B. 44) (1933); Penna. Acts 1934, No. 37; Vt. H. B. No. 2 (1933) (H. 2); Wis. Acts 1933, No. 235.
undesirable practices of the industry. Already, studies disclose deleterious price-cutting, dumping, the destruction of milk, the threat of unsanitary production, the aggrandizement of distributor's profits, and the impoverishment of the producers. The regulation of price, together with the enforcement of health standards, may afford the machinery for adjusting the conflicting interests of producer, distributor, consumer, and society. These adjustments can be made only after long and careful researches; and once made, they can be maintained only by careful and continuous study. The administrative board is the agency best adapted to this work. Even its accomplishment will of necessity be slow. To devise satisfactory standards for the determination of fair price, the boards must consider the related problems of production cost, transportation, health regulation, competition, bargaining power and consumer demand. The study and analysis of these

50Some control boards concern themselves only with price regulation, i. e., The Vermont Milk Control Board does not attempt to dictate methods of distribution. From correspondence.
51Report of the Joint Legislative Committee to Investigate the Milk Industry, (N. Y., 1933).
52New York Times, July 28, 1933, at p. 2, col. 5; Sept. 20, 1933, at p. 15, col. 2; Milk Dealer, Jan., 1933, p. 80.
54In a recent Wisconsin study, it was found that while profits in other industries have decreased, with but few exceptions, the profits of dairy distributors over this period were maintained at former levels. The distributors which were investigated showed substantial profits during the depression years. Some Facts Regarding Profits of the Distribution of Milk, Wisconsin Department of Agriculture and Markets (1932), p. 3; see infra notes 86-88.
55Producers' taxes were reported unpaid in the New York Investigation. Supra note 53, p. 13. "The farmer is squeezed between a ridiculously low price which he gets for his milk and the high prices which are essential in farm production." Wisconsin Department of Agriculture and Markets, Some Facts Regarding Profits in the Distribution of Milk, p. 3 (1932).
economic incidents of price are essential for a workable regulation of the industry. At present many of the problems, to say nothing of their solutions, are unknown. The mere clarification of these problems would materially simplify the task of administration. Thus, this fragmentary discussion of the problem of price is intended to be merely illustrative of the extremely complicated adjustment that is necessary, if any regulation is to be successful. These problems may furnish some evidence with which to answer the question put by Green: Is the administrative factor so complicated that it is unworkable?  

1. **Production Cost**

The regulation of price depends upon the determination of a legion of economic and social relationships, not the least of which is production cost. Cost, however, is elusive. Milk production being in many cases only one aspect of a farmer's productivity, the cost of milk as a distinct unit must be considered in the light of the associated activity of the farm. Thus, when examined in its context, the cost of milk may be affected by the profits derived from associated farm products. At some periods of the year the herds may be maintained on the by-products of crops grown for other purposes, at other times they require purchased foods. Conversely, the by-products of dairying have their own economic value to the farm. Thus, the assumption that the cost of

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56 Green, *Judge and Jury* (1930), p. 77 et seq. See Mallon, infra note 80.
59 *Ibid*.
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production plus a reasonable profit should determine fair wholesale prices is misleading in that it hides the complexity of cost determination. If price is to be based upon production cost, should production cost be based upon the costs of the marginal producer or the costs of the more permanently established producer? The answer to this question, of course, involves a policy judgment concerning the desirability of centralizing production with a few large-scale producers, or producer-organizations, under strict regulation or production uncontrolled by government regulation. A solution of the production cost problem is difficult so long as the marginal producer exists, because a fair price to the marginal producer returns excessive profits to the more firmly established producers. But it is erroneous to conclude that the marginal producers' cost determines selling price.

Complications arise when one considers just who the marginal producer is and what is marginal cost. When the price of milk falls, the efficient producer may find it more profitable to divert his entire productive capital, labor, and instruments into alternative lines which appear more attractive to him. Even though he is equipped to produce milk at a profit, a certain price may be reached which will not be conducive to a continuance of this business. At any period of the season, the profit from crops and the slaughtering of cattle may offer more inducement than milk production. In this sense of the word, the most efficient producer may be considered a "marginal" guide, for the price that the market offers him may determine whether or not he will withdraw his supply from the market.

This "profit" retrogression prevents the existence of a controlled unit standard of cost-profit relationship.

A prevalent idea is that the price of milk should equal cost of production plus a reasonable profit. As an appendage it is also said that the marginal cost of production of a commodity will tend to determine the selling price. But the reverse may be true, i.e., price determining marginal cost. Suppose for example that P1, P2, and P3 are producing milk at $1.40, $1.50, and $1.60 per cwt., respectively, and that the current price of milk is $1.60. P3, the "marginal" producer is selling at bare cost. It cannot be said, however, that P3's cost determined price. Too many other factors may have entered into the situation. A decrease in demand by a variation in consumer's taste may
The "formula method" of cost determination attempts to segregate the dairy production costs from other farm costs. The dairy cow as a unit of "standardized factory" is made the basis for estimating the proportionate cost of labor, raw materials, and capital investment involved in the production of milk. The artificiality of this method is a sufficient criterion of its value.

Affecting production cost, either directly or indirectly, competitive markets, manufactured dairy products,

make P2 the marginal producer. It will give manufacturers of milk products an opportunity to produce substitutes for milk in skimmed, powdered, and condensed form. These substitutes may be stored in seasons of plenty. When prices rise, due to a curtailment of production, allowing P3 to resume activity, these substitutes may be offered at a considerable reduction, forcing down the price of fluid milk, and again eliminating P3 as the marginal producer.

By estimating the costs of labor and raw materials in a hypothetical farm situation, the cost of production is attempted to be derived. KING, THE PRICE OF MILK (1920), p. 108. See also The Chicago Milk Inquiry, 26 JOURNAL POLITICAL ECONOMY, 321 (1918).

Each market varies according to the season, weather, soil, standard of living, etc. Accordingly there is no unanimity in selling price. An increase or decrease of approximately one-half cent a quart is sufficient to draw milk into one city and out of an area that has been furnishing other communities. KING, THE PRICE OF MILK (1920), p. 102.

"The use of powdered milk will be a governor that may prevent abnormally high prices in the scarce months to farmers in whole milk regions, but it gives to farmers in other territories where milk may be cheaper, or to summer producers, a relatively wider market for milk." Ibid, p. 101. There is also as much competition between milk food products and other products. The warfare between butter as a milk product, and oleomargarine, is a pertinent example. As the price of butter rises, consumption is transferred to oleomargarine, decreasing the price of milk by increasing the available supply. The close relation between butter and fluid milk makes butter substitute competition important to the milk industry, for "The value of fluid milk being for a local or metropolitan market cannot be dissociated from its one and only anchor, which is butter-fat, as a national or world commodity." From correspondence. See also Tentative Draft for New York Area, Feb. 14, 1934, by Agricultural Adjustment Administration, p. 4.
surplus, variations in climate, season, soil, nearness to market, standards of living, and variations in bargaining power enter into the determination of fair cost-price relationships. And in the determination of fair cost of production, the effect of production cost upon retail price cannot be disregarded. The establishment of a production cost basis that will provide a “fair standard of living” for the producer may so increase the retail price of milk that it will force down the “fair standard of living” of the consumer community. Adjustment of these conflicting interests is one of the major responsibilities of milk control boards. To date their determinations have been made without definite standards. Indeed, what standards can be devised to determine fair standards of living?

Temporarily, the necessity for immediate action has

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68 Some areas through the advantage of desirable climatic conditions are able to produce milk at lower costs, because of the abundance of good hay and pasture. Likewise a relatively temperate summer climate is necessary for the production of high quality dairy products.

69 “For instance, the spring starts earlier and frosts somewhat later in the Philadelphia district than in the New York district.” King, The Price of Milk, p. 94. While one market has an abundance of supply, another market may suffer a shortage. The price in the latter market will doubtlessly be influenced by the former.

70 The clay soil of northern Ohio or the rainy Seattle region is more suited to dairying than the hills of Vermont.

71 Normally, producers must pay the transportation charges from the farm to the country milk station. The cost will of course vary with the distance to be covered. King, supra note 69, p. 175; Wisconsin Research Bulletin 113, Milwaukee Milk Market, p. 7.

72 For instance, wages for farm laborers may vary according to the community standard of living, thereby enhancing production costs.

73 Poverty-stricken producers without available cash would naturally not be in a position to bargain for low prices on implements and equipments that make up their capital structure.
caused the substitution of public hearings for more scientific computations of price. At present wholesale and retail prices have been arrived at after argument by representatives of producers, consumers, and distributors. This temporary expedient must be supplemented by independent investigation and research by the administrative board if useful standards are to be devised.

2. Transportation

Transportation (i.e., collection and distribution) is important in the determination of price. Distributors, competing for larger markets have extravagantly duplicated equipment at the expense of great capital investment. As the distributor naturally seeks a profit above his operating expenses the burden of equipment must be carried either by the producer or the consumer. Legislative attempts to regulate the number of competitors have not met with judicial approval. Indirectly, the regulation of transportation cost as a price factor may tend to reduce the number of competitors. This result will be reached, however, only if the determination of price is made upon the basis of "reasonable going con-

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74 Due to the necessity for immediate action, the technicalities of scientific price computation has given way to public hearings, in which temporary selling prices are agreed upon after argument by representatives of producers, consumers and distributors. Pa. Milk Control Board Bulletin, No. 1, Feb. 7, 1934.

75 There are not only too many distributors and intermediate holding companies, but each has more equipment than is needed in the business. It is natural that each distributor demands a profit above his operating expenses. Erdman, The Marketing of Whole Milk (1921), p. 74.

The New York study revealed that about 90 per cent of the distributor's spread, i.e., profit above selling price, is absorbed by operating costs. Supra note 8, p. 53.

cern costs” and not upon the basis of “actual going concern costs.” A business should not be able to capitalize its competitive indiscretions.

Allied to the problem of transportation is the problem of “store,” and “delivery-wagon” distribution. Early, the Nebbia case focused attention upon the question of parity between store and delivery wagon price. Some storekeepers alleged that equality of price or a small differential was injurious to their business, because of a consumer preference for delivery service. Others thought parity or even a slightly higher charge was necessary because of the necessity of maintaining a supply at all times. The chain stores, having developed methods for reducing bottling and distributing costs, have insisted upon lower rates for store sales. A differential of one cent per quart, in favor of the store sale, has been held to be equitable. In the end the determination of fair transportation costs will depend

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77The determinating factor would then be the actual need of distributive facilities, and not a reasonable profit above the facilities already existing. Would this amount to arbitrary regulation, or taking without just compensation? "But 'just compensation' in condemnation cases means such compensation as will leave the owner as well off economically as if there had been no taking and this cannot be done if it be recognized, as the Nebbia case recognizes, that there may be an evil of exorbitant exactions and that price fixing is the appropriate remedy; for when the owner is deprived of the opportunity to obtain exorbitant profits, he is clearly less well off than before. While the doctrine of the Nebbia case empowers a state to fix prices as a remedy for extortion, the fair value doctrine, if applied consistently with the premises on which it is based, inhibits the exercise of that power the moment it begins to be effective." Hale, The Constitution and the Price System, 34 Col. L. Rev. 401, 425 (1934).

78Nebbia v. New York, supra note 2. "At the present time the only opposing factor seems to be emanating from the chain store influence." From correspondence. See also Milk Control Problems. Business Week, Aug. 26, 1933, p. 45.

79Erdman, supra note 75, p. 100.

80Supra note 78; see also, Mallon, The Cow Bolts the New Deal, Today, May 5, 1934, p. 6.
upon a policy-judgment concerning the place of competition in the industry.

3. Health Regulations

The cost of compliance with health and sanitary regulations is an important item in the determination of price. Not only does the provision of refrigeration equipment and adequate testing facilities add heavily to the burden of production cost but the maintenance of inspectors and the necessity of compliance with the regulations of federal, state, local, and municipal standards add heavily to the burden. Under the present system these costs are paid initially by the distributor and are then either "routed back" to the producer by way of reduced wholesale price, or else "passed on" to the consumer in increased retail price. The function of the administrative board will be to determine a fair distribution of the burden.

4. Competition and Bargaining Power

As a price determinant, competition covers two diverse problems of control: (1) the problem of overproduction, and (2) the problem of distributor competition. Indeed, over-production and the resultant price deterioration has been the impetus that has initiated most of the current milk legislation.81

Over-production, resulting in what is technically known as "surplus"82 milk has been the depressing element in the price structure. Large distributors, with large variations in demands must carry large day-to-day

81Supra note 49.
82Supra note 67.
reserves for which they pay "fluid milk"\textsuperscript{83} prices. Smaller distributors, escaping the burden of maintaining a large reserve, consistently undersell the larger distributor. To retaliate, the large producer because of the over supply of milk can insist upon a lower wholesale price. And so the producer is made to bear the cost of the distributor's competition.

The position of the distributor in the milk industry assures him a position of dominance because of his unique bargaining strength. His position is almost identical with the position of the stockyard commission man\textsuperscript{84} and the grain elevator operator.\textsuperscript{85} The marketing of stock cannot be long postponed if top prices are to be obtained; marketing is done at stockyards miles distance from the source of production where railway car or yardage fees prevent the producer from holding his cattle for a favorable market; in short the producer must take the price offered the day his stock arrives. In the milk industry the perishable nature of the product, and distance and distribution of the consumer prevent economic power to fix the price that he will pay for the producer from resisting the prices offered by the distributor. Consequently, the distributor has the fluid milk. Overproduction induced by marginal activity has increased the security of the distributor's position,\textsuperscript{86} so that throughout the "depression" the distribu-

\textsuperscript{83}By this term is meant the wholesale prices paid to the producer for milk to be sold only for fluid consumption, as distinguished from milk going into manufactured by-products, such as butter, condensed milk, etc., which commands a lower price. Erdman, note 75, p. 194.

\textsuperscript{84}Cf. Packers and Stockyards Act (1921), 42 Stat., at L. 159; 64 U. S. C., Title 7, §181; Stafford v. Wallace, 258 U. S. 495, 42 Sup. Ct. 397 (1922); Minnesota v. Blasius, 54 Sup. Ct. 34 (1933).

\textsuperscript{85}Munn v. Illinois, 94 U. S. 113, 24 L. ed. 77 (1886).

\textsuperscript{86}See Some Facts Regarding Profits of the Distribution of Milk, Wisconsin Department of Agriculture and Markets (1932), p. 3:
tor has made substantial profits without a reduction in operating expenses or capital investment. Further, the producer has by reduced wholesale prices been required to support the industry's luxury—the holding company. Unsatisfied to place the burden of excessive capital structure upon the producer, distributors have also required that producers purchase stock in distributor organizations; and where the producers are organized the distributors have stepped in to control the

"On January 1, 1929, after the acquisition of a dairy company by the Borden interests a new goodwill item of $2,411,578.89 was entered on the books. This item represents 48 per cent of the total net worth as represented by common stock of $5,000,000. In 1930 and 1931, dividends of 12½ per cent and 10 per cent were paid on this item as actual investment. The return on actual investment was approximately double the dividend rate or between 20 per cent and 25 per cent."

In the Philadelphia milkshed there was a 4-cent per quart drop between December, 1930, and January, 1933. Of this 4 cents the farmer was forced to absorb 3.3 cents and the distributor .7 cents. Clement Harris, *Battle of the Milksheds*, Current History, Nov., 1933, p. 197.

One of the worst features connected with the history of the dairy companies during the past few years is the result of mergers and consolidations which have been taking place in the dairy industry. It was argued in 1929 and 1930 when these mergers and consolidations occurred that they would effect economies with benefits to producers and consumers. The actual facts as revealed by the department's investigations show clearly that those who really were benefited were the operators and the stockholders." Further, "it appears also that while the combined incomes of operators, officers, executives and stockholders of other industries have been declining, the combined salaries and incomes of operators, officers, executives and stockholders of the dairy distributing companies have been definitely on the increase during the years 1929, 1930, and 1931. Thus, in spite of the fact that general business conditions have been consistently getting worse and that milk prices for these years have been among the lowest on record, the dairy companies found it possible to maintain profits and receive increased incomes." Wisconsin Department of Agriculture and Markets, *supra* note 55. See also Report of the Joint Legislative Committee to Investigate the Milk Industry, New York (1933), at pp. 20-22.

In regard to the Chicago agreement which was abrogated by Secretary of Agriculture Wallace, he said: "... to our knowledge the profits of some milk companies, including subsidiaries of big holding companies, are exorbitant, to say the least. It is scarcely the function of a government depart-
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policy of producer organizations. Against these practices, the producer is relatively helpless for the deterioration of milk and the necessity for its rapid distribution leaves him in a position of disadvantage. And at least during this period of overproduction the distributor's threat of procuring milk from other production areas keeps the producer subservient, if not complacent.

The consumer, unprotected by price regulation, is unable to insist upon a fair retail price. At the present time, however, he has seldom been heard to object, having been too readily satisfied with minute reductions in the retail price made possible by the distributor's domination of production. It is not to be anticipated that any material benefit will be permanently passed on to the consumer. Although at present the consumer is profiting from the distributor's domination of the industry, if minimum price regulation is fixed at a point which will permit the large distributor to force out his smaller competitors, then without maximum price regulation the consumer is bound to suffer. Thus the distributor holds the key position in the milk industry.

CONCLUSION

A consideration of the various plans for regulation must be preceded by an inarticulate evaluation of the distributor. Is elimination or regulation his fate? Though the issue is naturally controversial, a prevailing

90 Disclosed by field study, investigation, and correspondence.

notion is that the distributor-middleman is, at the most, an unnecessary evil—that he blocks the path between producer and consumer and exacts a burdensome toll. Those who are opposed to his complete extinction have suggested that producers organize into units for control of distribution—thereby eliminating the excessive cost of the middleman’s profit. Likewise, the erection of producer-controlled plants for the manufacture of milk products has been suggested as a means of combating the “surplus” milk evil. More probable seems the absorption of the production industry by the distributors.

Granting that regulation and not elimination is the fate of the distributor, administrative boards must devise means of controlling the relations between distributor and producer. There must be experimentation with licensing and certificates of convenience and necessity. Zoning may afford protection against duplication of effort and excessive competition. The

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91 Erdman, supra note 75, p. 243.
93 Alexander Kendrick, supra note 90.

Official order No. 6, June 29, 1933, p. 2, issued by the State Board of Milk Control of New Jersey, has attempted to control production by allowing full payment to producers only as to quantities paralleling the amount prior to June, 1933. Production above this limit must be purchased at lower prices. See also, Wheeler McMillen, Milk as a Public Utility, Country Home, February, 1934, in respect to control of supply in Winnipeg, Canada.
95 Erdman, supra note 75, p. 243.
processing tax may be effective, if policy favors the maintenance of the marginal producer in seasons of oversupply. In order to stimulate productivity in winter seasons, Philadelphia using the "base-surplus" plan, has fixed the producer's "base" according to his production record in the past winter months.

Already there has been some experience with these controls in the industry. These were early attempts to establish the distribution side of the industry on a monopoly basis. Federal milk commissions have existed since 1917. Although they have not had the power to fix prices, through arbitration, they have given some stability to the industry. Now, under the Agricultural Adjustment Act, the Secretary of Agri-

Proposed by the Secretary of Agriculture under the Federal Agricultural Adjustment Act.

"To correct oversupply producers will work on a 'base' production scheme, built on the fact that cows, left to mature, give more milk in spring than in the fall. The succeeding shrinkage late in the summer and during the fall is helped by the changing diet from green pasture to dry hay. By staggering the breed, it is possible to shift the period of greatest milk production from spring to fall. The Philadelphia plan rewards farmers for making such changes. The base price equals the price paid for the total amount of milk produced during the fall period and any surplus beyond that takes a lower figure. A farmer whose herd produces 1,000 quarts a day during October, November, and December, and 4,000 during May and June, will receive the base price for 1,000 quarts and a lower figure for the surplus." Business Week, Aug. 26, 1933, p. 45.


Ibid, p. 113.

The Oregon Milk Control Statute also authorizes conformity with a view to securing a uniform system of regulation. Supra note 49.
culture is empowered to regulate the interstate aspects of the industry. The regulations by state milk commissions or control boards have generally been effective and satisfactory to the industry.\(^{102}\) Municipalization of the distribution and control of supply has already been attempted along the same lines as electricity, water, gas, etc.\(^{103}\) Regulation of price and competition has been provided in some states through boards of health refusing to inspect "foreign" milk, thus preserving the integrity of the home market.\(^{104}\) Conversely, health standards have been lowered when serious shortages exist.\(^{105}\) Whatever the source or method of control, it is desirable that there should be no conflict in administration. An initial step in this direction has been taken by California, who abides solely by the standards prescribed by the Secretary of Agriculture under the Agricultural Adjustment Act. Whenever possible, co-operation between state and federal authority will enhance the effectiveness of regulation.

The complexities of the producer-distributor-con-

\(^{102}\)Information obtained from letters from Milk Control Boards. In New York, however, an attempt to make the Milk Control Bill permanent has been made by the distributors, against the protests of the producers who complain of unfair treatment and dominance of the distributors. New York Times, March 24, 1934, at p. 8, col. 2.

\(^{103}\)Proposed for Milwaukee, 1914. See Erdman, supra note 75, p. 243. In Winnipeg, Canada, the Public Utility Board not only controls the price of milk to producers, distributors, and consumers but also controls supply. It is interesting to note that this same board controls, among other things, power, water, light, traction, and municipal finance. See Wheeler McMillan, supra note 94.

\(^{104}\)Due to the paucity of other administrative devices, Boards of Health have been cleverly used as a unit to raise the price of milk. Health authorities in some localities have bluntly refused to inspect milk from adjacent territories that are sold at lower prices. Ruth L. Cohen, A Survey of Milk Marketing Schemes and Price Policies (1933), University of Cambridge, Department of Agriculture, Report No. 20; Mallon, supra note 80.

sumer relationship may defy all attempts at systematic regulation. But if governmental control is workable at all, it can only succeed through the intelligent and scientific planning of administrative boards and commissions. This administrative regulation of the milk industry should seek to create (1) a quality product at a fair price to the consumer, and (2) a sustained and adequate purchasing power within the tri-partite relation which will support an economic structure capable of absorbing the products of the industry.\textsuperscript{106}

\textsuperscript{106}See Tugwell, in Today, April 21, 1934.