Cornell Law Review

Volume 54
Issue 1 *November 1968* Article 8

New York State Liquor Market the Rocky Road to Competition

Anthony M. Radice

NOTES

THE NEW YORK STATE LIQUOR MARKET: THE ROCKY ROAD TO COMPETITION

Five years ago, New York residents paid between fifty cents and one and one-half dollars more than residents of other states for each bottle of retail liquor.[1] The "Rockefeller Liquor Law"[2] of 1964, designed to save New Yorkers $150 million annually,[3] has not substantially reduced that differential.[4] The New York experience is an example of ineffective economic regnlation: the state sought low competitive prices, but was unwilling to remove every obstacle to that goal.

I

THE PATTERN OF PRIOR LIQUOR REGULATION

New York's Alcoholic Beverage Control (ABC) Law was designed to promote both temperance in the consumption of alcoholic beverages

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1 NEW YORK MORELAND COMM'N ON THE ALCOHOLIC BEVERAGE CONTROL LAW, REPORT NO. 3, MANDATORY RESALE PRICE MAINTENANCE 3 (1964) [hereinafter cited as MORELAND REPORT NO. 3].

2 Law of April 16, 1964, ch. 531, N.Y. Session Laws. The liquor reform legislation that resulted from the Moreland study was a modified version of the Commission's recommendations. *See* pp. 115-16 *infra*. In a declaration of policy the legislature stated that the purpose of the law was to eliminate the fundamental price discrimination against the New York consumer.

3 Governor Rockefeller introduced and strongly supported the reform law against stiff opposition in the legislature. His message to the legislature on March 25, 1964 promised that passage of his proposals "would end the $150 million tribute now levied on the people of the state for the benefit of a privileged few [the liquor industry]." N.Y. Times, Mar. 26, 1964, at 31, col. 7.

4 The most extensive price cutting occurred in New York City during the last two months of 1966. At one point almost half the retail stores in that city had reduced the price of at least some of the brands they sold, in some cases by as much as a dollar per bottle. Since that holiday season, however, significant price reductions have been the exception rather than the rule. In other areas of the state, an almost perfect record of maintaining the previous prices is occasionally marred by a temporary price war among a few retailers. *See* N.Y. Times, May 14, 1967, § 3, at 35, col. 3; *id.*, Dec. 27, 1966, at 55, col. 2; *id.*, Nov. 30, 1966, at 1, col. I.

In reference to 1966 prices, Donald S. Hostetter, Chairman of the SLA, recently stated that "[n]o data is available to indicate any additional price reduction at the retail or wholesale level." Letter from Donald S. Hostetter to Anthony M. Radice, Mar. 21, 1968, on file at the Cornell Law Library.

and respect for and obedience to law.[5] Assuming that these goals could best be achieved by restricting the number of retail outlets, the draftsmen gave the State Liquor Authority (SLA) the power to issue licenses to sell alcoholic beverages, to increase and decrease the number of licenses issued, and to control the location of the licensed premises.[6] In 1945, the SLA ruled that "public convenience and advantage are now adequately served by the number of premises licensed," and declared a moratorium on the issuance of new package store licenses.[7] The SLA also restricted the relocation of existing licenses (removals).[8]

In 1950, the legislature amended the ABC Law to require retailers to sell liquor at or above certain minimum prices.[9] The minimum prices were to be set by the distillers in monthly price schedules filed with the SLA. Apparently the legislature thought that high, stable, retail liquor prices would foster temperance.

In 1964, the New York Times reported that certain SLA officials had accepted money for their approval of applications for new licenses and for the transfer of existing licenses.[10] Governor Rockefeller responded by appointing the Moreland Commission to review the present

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5 N.Y. ALCO. BEV. CONTROL LAW § 2 (McKinney 1946). The goals of New York's law are in general the same as those of other states. *See* Levin, *Economic and Regulatory Aspects of Liquor Licensing*, 112 U. PA. L. REV. 785, 786-88 (1964). The systems and techniques of liquor regulation, however, vary considerably. Eighteen so-called "monopoly" states purchase and resell "package" liquor themselves. Six states have no state or private price controls. MORELAND REPORT No. 3, *supra* note 1, apps. A & B; DISTILLED SPIRITS INST., SUMMARY OF STATE LAWS AND REGULATIONS RELATED TO DISTILLED SPIRITS (1966). The remaining states use license systems with varying degrees of control over prices and number and types of retail outlets. The price control systems are: (*1*) Mandatory resale price maintenance (distiller-set, state-enforced consumer prices), (*2*) Minimum mandatory markups for wholesalers and retailers, and (*3*) Private resale price maintenance (fair trade). For a catalogue of self-imposed regulations of retail outlets among the states, see DISTILLED SPIRITS INST., *id.* For the philosophy of liquor control, see generally THE JOINT COMMITTEE OF THE STATES TO STUDY THE ABC LAWS, ALCOHOLIC BEVERAGE CONTROL (1960).

6 N.Y. ALCO. BEV. CONTROL LAW § 2 (McKinney 1946).

7 The moratorium was promulgated in 1948 by the Rules of the New York State Liquor Authority, Rule 17 (McKinney 1946), under the statutory authorization given by the N.Y. ALCO. BEV. CONTROL LAW § 17(2) (McKinney 1946). It was imposed in fear of liquor price wars due to an excess of retailers. It has also been claimed that the SLA instituted the moratorium to avoid the nearly impossible job of choosing a few out of many qualified applicants. NEW YORK MORELAND COMM'N ON THE ALCOHOLIC BEVERAGE CONTROL LAW, REPORT NO. 1, THE LICENSING AND REGULATION OF RETAIL PACKAGE LIQUOR STORES 8-9 (1964) [hereinafter cited as MORELAND REPORT NO. 1].

8 Rules of the N.Y. SLA, Rule 39 (McKinney 1946) (expired 1964).

9 N.Y. ALCO. BEV. CONTROL LAW § 101-c (McKinney 1946) (repealed).

10 *See, e.g.*, N.Y. Times, Apr. 19, 1963, at 1, col. 5; *id.*, May 3, 1963, at 1, col. 8; *id.*, May 24, 1963, at 1, col. 6; *id.*, Nov. 5, 1963, at 1, col. 5.

system of liquor regulations and to determine what improvements were necessary to prevent a repetition of the SLA scandal.[11]

The Commission found that SLA controls and location limits made a liquor store a profitable business regardless of the size of the store or the efficiency of its operation.[12] As the profitability of liquor stores increased, the desirability of retail liquor licenses increased,[13] and, accordingly, the number of qualified applicants soon exceeded the number of available licenses.[14] Because SLA officials had no objective criteria for choosing between equally qualified applicants, the temptation to accept bribes increased.

Moreover, the Commission found that price control systems had no discernible effect on individual consumption.[15] Although a substantial reduction in the retail price of liquor would slightly increase total state sales by increasing sales to nonresidents and to new consumers,[16] the Commission concluded that the drinking habits of individual citizens would remain unchanged.[17] The Commission, therefore, recommended that price and location requirements[18] and the one-license-per-

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11 The Moreland Commission issued the following reports in January 1964 on various aspects of the liquor control problem: MORELAND REPORT NO. 1, *supra* note 7; NEW YORK MORELAND COMM'N ON THE ALCOHOLIC BEVERAGE CONTROL LAW, REPORT NO. 2, THE FOOD REQUIREMENTS IN BARS AND GRILLS (1964) (not considered herein); MORELAND REPORT NO. 3, *supra* note 1. During 1963, the commission retained experts in liquor regulation and economics to prepare five study papers evaluating the effectiveness of the liquor regulation systems of various states.

12 MORELAND REPORT NO. 1, *supra* note 7, at 9.

13 H. LEVIN, MORELAND STUDY PAPER NO. 4, at 16-21 (1963). In the New York City area the median purchase price for transferred stores rose from $19,490 in 1950 to $39,503 in 1958. In Nassau County, an area of rapid growth during this period, the comparable prices were $19,000 in 1950 and $54,850 in 1958. *Id.* at 17. During the period from 1953 to 1962 the increase in sales per store averaged over 100% in some counties. MORELAND REPORT NO. 1, *supra* note 7, at 10-11.

14 H. LEVIN, *supra* note 13, at 27-28.

15 S. BACON, MORELAND STUDY PAPER NO. 1, at 7 (1963); A. ENTINE, MORELAND STUDY PAPER NO. 2, at 14 (1963).

16 H. WATTEL, MORELAND STUDY PAPER NO. 5, at 59 (1963). Along with a slight increase in consumption by the traditional consumers, a price decline will improve sales principally from these areas: new consumers (including people switching from beer to other alcoholic beverages), out-of-state residents, New York residents who previously bought out of state, and price anticipators who withheld normal purchasing in expectation of the price decline.

17 The controlling factors in explaining different average consumption for different areas seem to be income level and industrialization of the area. *Id.* at 40-54. The demand for liquor is inelastic. MORELAND REPORT NO. 3, *supra* note 1, at 35; Dunsford, *State Monopoly and Price Fixing in Retail Liquor Distribution*, 1962 WIS. L. REV. 454, 481.

18 MORELAND REPORT NO. 3, *supra* note 1, at 30. The repeal of fair trade was explicitly not recommended. *Id.*; MORELAND REPORT NO. 1, *supra* note 7, at 44. Package stores were

owner rule be abolished.[19] The Commission further recommended that the SLA lift its moratorium on new package store licenses and grant licenses to all qualified applicants.[20]

Although Governor Rockefeller strongly endorsed these recommendations, many legislators were reluctant to force small neighborhood liquor retailers to compete in the open market.[21] The public demand for lower liquor prices was at least partially offset by the determined opposition of the powerful liquor retailers lobby.[22] Mandatory retail price maintenance and the distance requirements between stores were repealed.[23] To satisfy the lobby, however, the legislature attempted to reduce the expected "ruinous retail competition" by prohibiting retail sales below cost[24] and advertising at a price less than cost by retailers,[25] and by shifting the burden of price reduction from retailers to wholesalers and distillers. This shift was to be accomplished by requiring distillers and wholesalers to file, with their monthly price schedules, affirmations that their prices to New York wholesalers and retailers were not higher than the lowest prices they charged anywhere else in the country during the preceding month.[26] At the same time, the SLA accepted the conclusion of the Moreland Commission and instituted a phased plan to lift the moratorium on new package store licenses.[27]

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required to be at least 700 feet apart (1500 feet in New York City). N.Y. ALCO. BEV. CONTROL LAW § 105(4) (McKinney 1946) (repealed). The distance requirements added to the restrictions on entry by denying profitable locations to retail stores and restricted "head-to-head" competition between stores by separating them.

19 MORELAND REPORT NO. 1, *supra* note 7, at 45. N.Y. ALCO. BEV. CONTROL LAW § 111 (McKinney 1946) allows only one license to a person and restricts it to the licensed premises. The regulation prohibits multiple ownership and chain stores. *See* pp. 125-27 *infra*.

20 MORELAND REPORT NO. 1, *supra* note 7, at 44.

21 The program was initially defeated by the assembly at the end of the 1964 legislative session. Governor Rockefeller immediately called for a special session to convene on April 15, 1964. At that session the legislature enacted a modified version of the program. N.Y. Times, Mar. 27, 1964, at 1, col. 8; *id.*, Apr. 15, 1964, at 1, col. 5; *id.*, Apr. 16, 1964, at 1, col. 8; *id.*, Apr. 17, 1964, at 1, col. 8.

22 During the legislative session, retailers and their representatives filled the galleries. N.Y. Times, Apr. 5, 1964, § 4, at 6, col. 1; *id.*, Apr. 17, 1964, at 1, col. 8.

23 N.Y. Session Laws ch. 798, § 1 (1967). *See* note 18 *supra*.

24 *Id.*

25 *Id.*

26 *Id.* § 2; N.Y. ALCO. BEV. CONTROL LAW § 101-b(2)(d) (McKinney Supp. 1968). Subsection (b) forbade sales without such an affirmation and subsection (h) made a false statement in the affirmation a misdemeanor.

27 SLA Bulletin No. 390 announced a four-phase program to facilitate removals and new applications. The first two phases provided for removal of existing licenses within their own counties, thus allowing the existing licensees to benefit first from the voids created by the previous "freeze" on licenses. The limitation on removals was permitted to lapse. Rules of the N.Y. SLA, Rule 39 (McKinney 1946) (expired 1964). The next two

II

Ineffectiveness of the Liquor Regulation Reforms

To date there has been no substantial, widespread reduction in the retail price of liquor in New York. Three factors are responsible at least in part, for the ineffectiveness of the liquor regulation reforms: the structure of the liquor industry, the inherent weakness of the "price affirmation" as a means of reducing retail prices, and the existence of private resale price maintenance or "fair trade" laws.

A. *Industry Structure*

The Moreland Commission assumed that without formal price controls, competition among retailers would reduce retail liquor prices. The structure of the liquor industry, however, allows distillers to maintain high retail prices by means of tacit price controls.

Four distillers dominate the industry.[28] Their products account for two thirds of the nation's total retail liquor sales. These distillers distribute their products only through wholesalers with whom they have franchise agreements. Since a wholesaler generally distributes the products of only one of these major distillers, and since a major portion of his business involves the products of that distiller, the decision to cancel a wholesaler's franchise may destroy the wholesaler's operation. A joint legislative committee created to study the ABC Law concluded that "[D]istillers (by an implied threat of franchise cancellation) are able to dictate and control the policy, both as to distribution and prices of wholesalers."[29] In many areas, distillers have set up subsidiary corporations to wholesale their products, giving them direct control over wholesale prices. Since the franchised wholesaler for his area is the retailer's only potential source of a distiller's products, control of a wholesaler's price policy gives a distiller virtual control over the price policies of those retailers who trade with it.

The SLA has already acted to reduce the distiller's influence on the price policies of retailers by ruling that products cannot be with-

stages provided for new license applications. They were to be accepted during four separate months in 1964 and 1965 and out of each group of qualified applicants 500 would be chosen for license by lottery. The system was thought to be an impartial selection and orderly expansion of the market. It provoked, however, considerable litigation by the existing licensees. N.Y. SLA Annual Report 9-11 (1964).

28 H. Wattel, *supra* note 16, at 4.

29 Report of the Joint Legislative Comm. to Study the Alcoholic Beverage Control Law, 1966 N.Y. Leg. Doc. No. 23, at 7 (1965-66). [hereinafter cited as Joint Legislative Comm. Study].

held from a retailer without good cause.[30] To insulate wholesalers from distillers' pressure, a legislative committee has proposed that franchise contracts have a minimum term of three years, that they be cancellable only for cause, and that distillers be prohibited from wholesaling their products.[31]

B. *Ineffectiveness of the "Affirmation" Law*

Because of difficulties inherent in enforcement and price calculation, and because of possible schemes for evasion, it is highly questionable whether the affirmation law can be enforced and whether, if enforced, it will reduce retail prices.[32]

It is difficult to determine what is a "price no higher than the lowest in the country." Price includes labor, transportation costs, and taxes—each factor varies from state to state and each is claimed to be very high in New York.[33] These variables must be taken into account in *pegging* New York's prices to the lowest in the land.[34] There are added problems at the wholesale level. It is naive to expect that a New York wholesaler could affirm prices of other wholesalers, with whom he has had no contact. Nor could he be expected to match every wholesale price in other states where operational costs are lower.[35] The affirmation requirement for wholesalers is thus unworkable and was repealed before it was ever put into operation.[36]

Many avenues are open to distillers who wish to avoid the impact of the affirmation law. Low prices elsewhere in the country can be disguised by hidden discounts. For example, a high list price can be set in a state market to match the New York price while a rebate or kick-

30 Rules of the N.Y. SLA Rule 16, § 65.8 (McKinney Supp. 1967). *See also* N.Y. Times, Jan. 27, 1965, at 37, col. 8; *id.*, Feb. 10, 1964, at 84, col. 1; *id.*, Apr. 16, 1965, at 31, col. 8.

31 JOINT LEGISLATIVE COMM. STUDY, *supra* note 29, at 11. Since prohibiting distillers from wholesale activity would prevent direct sale to large retailers, which is desirable as a means of reducing retail prices, this proposal should be modified to prohibit distillers only from having a financial interest in or managerial control of a wholesaler.

32 Newspaper editorials which had strongly supported Governor Rockefeller in the drive for lower consumer prices were not pleased with the outcome. The affirmation law was seen as a hollow concession to the movement to lower prices. "It is an unrealistic statute, extremely difficult to police and vulnerable to abuse." N.Y. Times (editorial), Apr. 21, 1966, at 38, col. 1.

33 *See* MORELAND REPORT NO. 3, *supra* note 1, at 6-7 & n.8.

34 N.Y. ALCO. BEV. CONTROL LAW § 101-b3(g) (McKinney Supp. 1968) allows for ". . . differences in state taxes and fees, and in the actual cost of delivery." The extent of delivery costs allowed remains unclear. It would seem, however, that operating costs are not accounted for.

35 Wholesalers claim operating costs are as much as 4% higher in New York State. *See* N.Y. Times, Nov. 22, 1966, at 63, col. 2.

36 N.Y. Session Laws ch. 798 (1964).

back from distiller to wholesaler or retailer hides the actual price. Prices in other states can actually be raised to match New York prices so as not to lose the lucrative New York profits.[37] The proof of a brand can be changed for the New York market, in effect changing the product to allow different prices to be charged,[38] or the sale of certain brands can be discontinued in New York.[39]

Even if distiller and wholesale prices are cut, there is no guarantee that the consumer will benefit, since price cuts under the old system were usually absorbed by the lower levels of the distributive chain rather than passed on the consumer.[40]

Evaluation of the effectiveness of the affirmation law had to await a determination of its constitutionality.[41] When its validity was sustained and the SLA was finally able to require the affirmed price lists, no significant price reduction was in evidence. Although some

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37 Before the affirmation law was implemented the expectation was that a sizeable number of distillers would raise prices in states where they were low so as not to have to match those low prices in New York. *See* N.Y. Times, Apr. 21, 1966, at 32, col. 1; *id.* at 38, col. 1; *id.*, June 12, 1966, at 37, col. 1. After the SLA required filing of the affirmed price schedules, there was some evidence of price increase in other states. *See* N.Y. Times, May 14, 1967, § 3, at 35, col. 3.

38 The proof or alcohol content is a main factor in differentiating brands. The SLA recognizes the problem and is searching for a solution. *See* N.Y. Times, Sept. 17, 1966, at 31, col. 8.

39 When the affirmed price lists were submitted, 110 brands were dropped from sale to avoid reducing N.Y. prices and profits on them. Four of these were among the nation's 40 largest selling brands. *See* N.Y. SLA ANNUAL REPORT 7 (1966); N.Y. Times, Sept. 17, 1966, at 31, col. 8.

40 Distiller and wholesaler price cuts and discounts have rarely been passed on to the consumer; the expectation under the new law was not optimistic in this respect. *See* JOINT LEGISLATIVE COMM. STUDY, *supra* note 29, at 8. In 1967 an amendment was passed that required wholesalers to pass on to the retailer the proportionate amount of any price reduction received from the distiller. N.Y. ALCO. BEV. CONTROL LAW § 101-b(3)(b) (McKinney Supp. 1968). This provision as well is difficult to enforce, and does not prevent the retailer from absorbing the reduction. Retail stores still claim that price reductions do not reach them. N.Y. Times, June 9, 1967, at 65, col. 2.

41 In Joseph E. Seagram & Sons, Inc. v. Hostetter, 16 N.Y.2d 47, 209 N.E.2d 701, 262 N.Y.S.2d 75 (1965), *aff'd*, 384 U.S. 35 (1966), the New York Court of Appeals and the United States Supreme Court sustained the constitutionality of the affirmation law. The Court of Appeals found it a valid and reasonable regnlation under the police powers and the Supreme Court affirmed, pointing out the 21st amendment gives the states complete power over liquor regulation within their borders. It is interesting to note that the justification of police power over liquor is to foster temperance, *i.e.*, to discourage its consumption, while the purpose of the affirmation is to lower consumer prices. The solution, of course, is that the police power is broadly defined, that concepts of public welfare change, and that the power to abolish liquor traffic (given to the states by the 21st amendment) logically includes the power to set any standards for its conduct, even unreasonable ones.

brand prices were reduced, a far greater number remained the same or increased, and a number of brands were dropped.[42]

Although the industry could claim that these unimpressive results indicate that distiller and wholesaler prices were not excessively high in the first place, it is by no means certain that the prices rest on a competitive level. In fact, one study showed New York wholesale prices higher than another market's retail prices.[43]

C. *Private Resale Price Maintenance—Fair Trade*

Observers found the Moreland Commission's recommendation to retain private, resale price maintenance inconsistent with the repeal of state, mandatory price maintenance.[44] After 1964, private fair trade contracts, permitted by the Feld-Crawford Act,[45] were used by the distillers to set retail prices at their previous levels. By means of an injunction against sale below fair traded prices, the contracts are enforceable against both contracting retailers and non-signatories. Thus, one price can be maintained in a geographic area regardless of how many retailers actually agree to the set prices. Since evidence before the Commission showed that prices are generally high in states that allow fair trade,[46] retention of fair trade seemed to be self-defeating to the reform legislation: In a market in which taste and brand loyalty are strong elements of demand, and in an industry which is concentrated on the manufacturer's level[47] and has a history of vertical price fixing, fair trade can be a very effective technique for price maintenance.[48] The

42 Affirmed price lists were filed on Sept. 12, 1966. Out of 1,341 brands, prices decreased on 549 from 1 cent to $20.30 per case (12 bottles), 701 brand prices remained constant; 91 brand prices increased from 1 cent to $4.18 per case; and 110 brands were dropped. Even the largest single price reductions in the popular categories of liquor were not impressive: Scotch—$5.00 per case, Rye straight—$5.99 per case, Blend—$2.66 per case, Gin—$2.02 per case, Bourbon bond—$4.31 per case.

43 MORELAND REPORT No. 3, *supra* note 1, chart 3, at 6.

44 It was pointed out that "In voting to abolish the old price-fixing system, most legislators failed to notice that Mr. Rockefeller had pointed out a way the distillers could really continue it." The Governor had mentioned fair trade as a method of preventing price wars, but the distillers used fair trade as a complete substitute for the old law. N.Y. Times, Feb. 6, 1966, § 4, at 6, col. 1. *See also id.*, Apr. 21, 1966, at 38, col. 1.

45 N.Y. GEN. BUS. LAW § 369 (McKinney 1968).

46 *See* MORELAND REPORT No. 3, *supra* note 7, app. D, at 40-41.

47 *See* pp. 117-18 *supra*.

48 The two principal characteristics of a price-maintained market are distinctively branded products and a degree of effective monopoly power on the manufacturer's level. Liquor is the most ideal example of a market suited for fair trade, for there ". . . is brand differentiation, extensive advertising, strong dealer organization, and often, in addition, very restrictive licensing arrangements for dealers." Bowmen, *Resale Price Maintenance—A Monopoly Problem*, 25 J. BUS. U. CHI. 141, 143 *et seq.* (1952); *reprinted in* 1 L. SCHWARTZ, FREE ENTERPRISE AND ECONOMIC ORGANIZATION 518, 521 (3d ed. 1966).

Commission, by not recommending the abolition of fair trade, left the door open for distiller enforcement of fair trade contracts in 1964 that prevented the reduction of prices.[49]

Fair trade enforcement initially proved to be almost as effective in maintaining prices as direct state enforcement,[50] since the New York courts enforced the contracts despite the attempted price reform.[51] Since 1964, however, the effectiveness of fair trade has declined. Open retail price cutting did not begin until late in 1966, but when price cutting occurred, it indicated that fair trade contracts were not maintaining the price level. When the SLA finally put the affirmation law into operation in the fall of 1966, the *distiller* price reductions were hardly impressive.[52] But the trickle of *retail* price cutting that had begun in 1964 developed noticeably during the Christmas season of 1966. It hardly fulfilled expectations, however, since it was limited to fewer than half the stores of New York City, and the price cuts themselves were not always substantial.[53] Nevertheless, their significance lies in the fact that they were not distiller price reductions caused by the affirmation law, but were reductions of retail margins in spite of fair trade contracts.

The effectiveness of fair trade contracts declined for two reasons.

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49 JOINT LEGISLATIVE COMM. STUDY, *supra* note 29. It was concluded two years after the price "reform" legislation was enacted that:

> All distillers have now entered into contracts with retailers mandating price-fixing. Since the advent of the 1964 liquor laws, distillers brought more than 200 legal proceedings to enjoin package stores from cutting prices. The New York consumer, therefore, has received little, if any, benefit from passage of the law.

Id. at 8.

50 The exception to this was R.H. Macy & Co. of New York City which attempted to openly reduce all its retail liquor prices immediately after mandatory price maintenance was repealed. Their determination brought on fair trade suits from all the major distillers and has kept them in court ever since. *E.g.*, Victor Frichel & Co. v. R.H. Macy & Co., 20 N.Y.2d 180, 229 N.E.2d 26, 282 N.Y.S.2d 234 (1967); National Distillers & Chem. Corp. v. R.H. Macy & Co., 23 App. Div. 2d 51, 258 N.Y.S.2d 298 (1st Dep't 1965).

51 *E.g.*, National Distillers & Chem. Corp. v. Seyopp Corp., 17 N.Y.2d 12, 214 N.E.2d 361, 267 N.Y.S.2d 193 (1966); National Distillers & Chem. Corp. v. R. H. Macy & Co., 23 App. Div. 2d 51, 258 N.Y.S.2d 298 (1st Dep't 1965).

52 *See* note 42 *supra*.

53 In New York City open price cutting had been attempted by Macy's and a few other large retailers in 1964-65; at the same time a small percentage of stores were giving price reductions "under the table." By the spring of 1966, 15% of New York City's stores were cutting prices to a limited extent, somewhat less than the $1.00 to $1.50 promise of 1964. By December about half the stores in that city had joined the competition but this was the farthest the development reached. The New York Times kept a close watch on developments in the liquor industry in those years, particularly prices. *See* N.Y. Times, Jan. 27, 1965, at 37, col. 8; *id.*, Apr. 16, 1965, at 31, col. 8; *id.*, Aug. 28, 1965, at 22, col. 1; *id.*, Apr. 1, 1966, at 37, col. 4; *id.*, Nov. 30, 1966, at 1, col. 1; *id.*, Dec. 27, 1966, at 55, col. 2; *id.*, May 14, 1967, § 3, at 35, col. 3.

First, the maintenance of fair trade prices requires consistent enforcement against all price cutters.[54] This is an expensive burden on any distiller even if the price cutting in the market is relatively minor. Second, a fair trade contract maintains *retail* prices which only indirectly affect distiller profits. Faced with a choice between maintaining vigilant, expensive fair trade enforcement systems, or allowing a small number of price-cutters to continue, possibly increasing the volume of distiller sales, a large number of distillers chose not to enforce fair trade.[55]

There was little price cutting after the 1966 New York City activity. A legislative committee thought that a general price reduction could be achieved only by the complete exemption of alcoholic beverages from fair trade legislation.[56] The Court of Appeals, however, acted first, and in *Victor Fischel & Co. v. R.H. Macy & Co.*,[57] it seriously discouraged the effective use of fair trade contracts in the liquor industry. Based more on legislative policy than statutory language, the decision found fair trade injunctions inconsistent *in practice* with the purpose of the 1964 reform:

> If this objective [prices pegged to the lowest in the nation] can be frustrated by Feld-Crawford injunctions, such as the one now under review, then the whole legislative process of eliminating the "exclusive price-fixing power in the hands of the distillers" . . . has been full of sound and fury, signifying nothing.[58]

The court's solution was not to construe the 1964 law as repealing the fair trade law but, rather, to attempt to apply the latter consistently with the former.

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[54] *See* General Elec. Co. v. R.H. Macy & Co., 199 Misc. 87, 103 N.Y.S.2d 440 (Sup. Ct.), *rev'd on other grounds*, 278 App. Div. 939, 105 N.Y.S.2d 1003 (1st Dep't 1951); Calvert Distillers Corp. v. Nussbaum Liquor Store, Inc., 166 Misc. 342, 2 N.Y.S.2d 320 (Sup. Ct. 1938). The reasons compelling a manufacturer to use fair trade are pressure from conservative retail outlets and avoidance of price wars during which the manufacturer usually is forced to cut *his own* prices. *See* 1 L. SCHWARTZ, FREE ENTERPRISE AND ECONOMIC ORGANIZATION 515-22 (3d ed. 1966). It is common in the liquor industry for retailers to take a distiller's product "off the shelf" (discourage its sale) to bring pressure on the distillers to enforce fair trade against price cutters. *See, e.g.*, N.Y. Times, Feb. 4, 1966, at 33, col. 8.

[55] By 1967 Seagrams was the last major distiller still attempting to enforce comprehensively its fair trade prices. Between 1964 and 1967 Seagrams instituted over 275 actions to maintain its prices. N.Y. Times, June 9, 1967, at 65, col. 2. The primary reason for the other distillers' abandoning fair trade enforcement was simply that expense exceeded benefit derived. *See* N.Y. Times, May 14, 1967, § 3, at 35, col. 3.

[56] JOINT LEGISLATIVE COMM. STUDY, *supra* note 29, at 11.

[57] 20 N.Y.2d 180, 229 N.E.2d 26, 282 N.Y.S.2d 234 (1967).

[58] *Id.* at 185, 229 N.E.2d at 28, 282 N.Y.S.2d at 237.

> Prices to be fixed by liquor injunctions under the Feld-Crawford Act cannot be *set at higher figures than those which would result in the normal course of business from the application of the price reduction provisions of that legislation.* The burden of showing whatever is necessary to be established rests upon the plaintiff in an action for a Feld-Crawford injunction.[59]

This decision reduces the effectiveness of fair trade in maintaining the previous high price level. Before a distiller can obtain court enforcement of his fair trade contract, he must show that he has complied with the 1964 affirmation law and that the retail prices which he is setting are *commensurate* with the manufacturer and wholesaler prices on the affirmed price list. In other words, a court will demand proof that price reductions at the top are carried down to the consumer.

Fischel, however, does not guarantee major price cuts. It deprives the industry of some of the benefit of and thus some of the incentive for formal distiller price-fixing, and in this way could discourage the use of fair trade contracts to externally support retail prices. The case is significant in that it adds another difficulty to the distiller's advantageous use of fair trade and, together with the factors previously mentioned, might lead to the complete elimination of fair trade contracts in the liquor industry.

The eventual abandonment of fair trade contracts due to difficulties of enforcement might have been anticipated by the Moreland Commission's failure to recommend their discontinuance.[60] Its members may have expected fair trade to be no more effective in maintaining liquor prices than in the general merchandising area where discount houses ignore the fair trade price. They could not have foreseen, however, the holding of the *Fischel* case.

The state of the market today shows that fair trade contracts are ineffective in the face of even a relatively small amount of price cutting; thus it would seem that retail prices should fall to a competitive level. This assumes, however, that retail profit margins are large

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59 *Id.* at 189, 229 N.E.2d at 31, 282 N.Y.S.2d at 241 (emphasis added). National Distillers & Chem. Corp. v. Seyopp Corp., 17 N.Y.2d 12, 214 N.E.2d 361, 267 N.Y.S.2d 193 (1966), and other cases in which fair trade injunctions were granted regardless of the 1964 reform, were distinguished on the grounds that these injunctions were granted before the affirmation law became operative—before its constitutionality was sustained, *supra* note 41, and thus while that law was stayed by the courts. 20 N.Y.2d at 185, 229 N.E.2d at 29, 282 N.Y.S.2d at 238.

60 One study paper predicted that even if all distillers immediately employed fair trade to support prices, the obstacles to competitive prices would be temporary. "Distiller policing of prices under the Feld-Crawford Act is likely to be sporadic and ineffective as compared with State policing in a market as large as New York State." H. WATTEL, *supra* note 16, at 56.

enough to absorb substantial, permanent price reduction while maintaining a reasonable return to the retailer. The structure of the retail market today does not support this assumption.

III

Obstacles to the Reduction of Retail Liquor Prices

Spokesmen at all levels of the industry claim that New York retail liquor prices cannot be further reduced. They claim low profit margins for most New York retailers and wholesalers and place the blame on New York's high operating costs.[61] The Moreland Commission demonstrated, however, that the difference between operating costs in New York and operating costs in other states does not justify a difference in retail liquor prices of $1 to $1.50 per bottle.[62] Despite high prices, high total costs yield small profit margins for New York retailers and wholesalers. A substantial portion of those costs are directly attributable to the inefficiency of their operation.

The Moreland Commission noted that the price and entry restrictions of the ABC Law encouraged operational inefficiency among wholesalers and retailers.[63] With profits guaranteed and with a neighborhood monopoly practically assured, there was little incentive to use resources more efficiently or to introduce more modern methods of distribution and sale. What competition did develop was nonprice competition—services and various forms of advertising such as gifts and tokens.[64]

In 1964, after the legislature had acted upon the Commission's recommendations, entry to the retail liquor market was unrestricted, but fair trade contracts maintained high prices. Since prices remained high, more retailers were induced to enter the market than would have entered had prices been set by market competition.[65] Accordingly, with the same sales volume spread over more stores, each store's gross sales decreased causing a decrease of gross profit on sales. Furthermore, wholesalers' costs increased because the same volume of merchandise had to be distributed to more outlets.[66] These increased costs, when passed on to the retailer, further reduced the retail profit margin.

61 *See, e.g.*, N.Y. Times, Nov. 22, 1966, at 63, col. 2; *id.*, Aug. 28, 1965, at 22, col. 1.

62 Moreland Report No. 3, *supra* note 1, at 3-7.

63 *See* p. 115 & note 12 *supra*.

64 It is a very common practice in the liquor industry for the distillers and wholesalers to distribute free gifts, prizes, tokens, etc. to retailers (both on- and off-premises consumption outlets) and consumers for advertising and good will purposes. Many of the gifts, *e.g.*, gaudy advertising clocks, are rather expensive but quite useless.

65 Levin, *supra* note 5, at 813.

66 *Id.*

Both these causes of inefficiency can be eliminated within the existing regulatory framework by the operation of competitive forces within the market. Even without legislative change, price competition will develop as the effectiveness of fair trade contracts diminishes. Some outlets will be forced out of the market. Those remaining will be stimulated to modernize their operations.

A third cause of inefficiency can only be remedied by significant legislation. Its elimination, however, offers the greatest potential reward in cost and thus price savings. This inefficiency results principally from two regulations that severely limit the type of retail outlet: the one-license-per-owner and the liquor-only rules.

Despite the Moreland Commission's finding "that temperance is not affected either by the number or the type of liquor outlets,"[67] the ABC Law forbids the issuance of more than one license to an individual[68] and restricts that license to the specific premises licensed.[69] The effect of this rule is to deny the liquor consumer the economies of scale and operational efficiency attendant to the modern chain-store method of retailing. The original justification of the rule has proved to be fallacious, but the rule survives despite the economic waste it creates.

The ABC Law provision that "No licensee . . . shall be engaged in any other business on the licensed premises,"[70] has been interpreted by the SLA to have a dual meaning. By explicitly prohibiting sales of other products on the premises, it prevents supermarkets and department stores from having liquor departments. More significantly, the SLA has extended the prohibition to exclude anyone in a general merchandising business from having a license.[71] This policy, along with the one-license-per-owner rule, has served only to protect the market from low-cost competitors. The abolition of both policies would open the market to chain liquor stores and would allow liquor sales in department stores and supermarkets.

Two considerations point to this avenue for general, permanent, and substantial price reduction. The District of Columbia permits liquor sales in drug and grocery stores, and large volume retailers have

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67 MORELAND REPORT No. 1, *supra* note 7, at 31.

68 N.Y. ALCO. BEV. CONTROL LAW § 63(5) (McKinney 1946).

69 *Id.*, §§ 63(3), 111.

70 *Id.*, § 63(4).

71 *See* MORELAND REPORT No. 1, *supra* note 7, at 37. Before this policy was adopted a few early licensees, such as Macy's, Gimbel's and Bloomingdales in New York City, were able to enter the retail liquor market despite their general merchandising business. They were and still are, however, subject to the "segregated premises" rule, N.Y. ALCO. BEV. CONTROL LAW § 105(2) (McKinney Supp. 1968), which requires that the liquor sales be conducted exclusively on a premises for that purpose with its public entrance to the street (not to another part of the building).

developed. It was formerly assumed that Washington's lack of price maintenance explained the $1.50 per bottle difference between the District of Columbia and New York prices. But now that New York has no effective price maintenance and her prices still exceed Washington's, it is clear that restrictions on the kind of retail outlet are significant.[72] And it is no coincidence that the New York retailers leading in the attempt to reduce prices are Macy's and Gimbel's department stores,[73] even though their liquor premises must be segregated from the rest of the store.[74]

The repeal of these rules would force the small retailer to streamline his business or abandon it. It is argued that the small neighborhood store with its personalized service performs a useful and beneficial role in our society. The answer to this is that since the consumer pays the price he should decide which is more beneficial to him—lower prices or personalized service. Why should he be forced to take the latter? It is also claimed that the small retailer's investment should be protected since he relied on the law. As was said against the retention of the moratorium,[75] however, the liquor traffic is at the discretion of the state, and licensees are aware when they open their business that its regulation, and in fact its continued existence, can be changed at any time. Furthermore, the retailer's dilemma is merely the age-old business decision of whether to revamp his operation to compete directly with the modern retail outlets, to remain unchanged in hope of retaining most of his customers with his "personalized" neighborhood-type store, or to abandon the business altogether. A similar dilemma faced small grocers as supermarkets developed, and many have survived. Because of the possible hardships, however, a plan liberalizing the licensing scheme in stages would be appropriate.

Another fear is that the proposal would present problems of enforcement and administrative supervision for the SLA, stemming from the many types of new licenses. No specific difficulty beyond those existing in the present system, however, has been raised. Testimony has indicated that chain stores and supermarkets would be no more diffi-

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72 The District of Columbia, Missouri, Nebraska, and Texas all have very low retail prices compared to New York. *See* MORELAND REPORT No. 3, *supra* note 1, app. D, at 40-41. The prices of these states were used by the Moreland Commission to show that low prices result when there are no price controls. The Commission failed to point out, however, that in these four areas liquor sales are not restricted to liquor stores. In these four areas and in many other states, liquor sales are permitted in drug and grocery stores, and more than one license per owner is allowed. *See generally* DISTILLED SPIRITS INST., *supra* note 5.

73 *See* note 53 *supra.*

74 *See* note 71 *supra.*

75 *See* Levin, *supra* note 5, at 823.

cult to control than present retail outlets,[76] and other states with such a distribution system seem to have no greater enforcement problems than New York.

Two other legislative restrictions hinder competitive market forces. The 1964 reform, rather than stimulating retail competition as it proposed, attempted to erect additional barriers to that goal by forbidding retail price advertising[77] and sales below cost.[78]

The ban on price advertising by retailers serves no genuine purpose. If competitive forces develop, the ban cannot stop them; it can only inconvenience them. The SLA has no sympathy for the rule, and consequently advertising gimmicks have grown up to circumvent it, *i.e.*, advertising low prices without mentioning the figures.[79] A statute that serves no purpose and is violated with impunity hardly fosters "respect for the law." And the only purpose it can serve—stifling competition—is obnoxious to the announced goal of competitive prices.

The proscription of retail sales below cost, though also enacted to stifle competition, may nonetheless serve a useful purpose. "Loss-leader" competition, and particularly its relative, "predatory pricing," might be considered undesirable in that they give an unfair competitive advantage to larger stores. Although the consumer may benefit when the large retailer, with his cost advantages, competes with the small neighborhood store, the consumer's interest is not served if the former employs an effective predatory pricing policy designed to establish a monopolistic position. Furthermore, preventing sales below cost does not hinder price competition.

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76 Data on liquor law violations in the various states are scarce and, because of other factors coutributing to liquor law violations, comparisons between the number of violations and the liquor control system used are not very useful. One conclusion from these comparisons, however, has been made: ". . . [W]here a rigorous form of control is used, one indirect problem of alcohol, violatiou of code provisions, is considerably higher than in those places where a less rigorous form of control is used." S. BACON, *supra* note 15, at 52.

77 *See* p. 116 *supra*. Another explanation for the enactment of the advertisiug ban has been proposed: "It was geuerally understood that the legislators—resentful of the pressure put on them by the Governor, whose liquor law reforms had the editorial support of most newspapers—wrote in the advertising ban to retaliate against the newspapers." N.Y. Times, Apr. 1, 1966, at 37, col. 4.

78 MORELAND REPORT No. 3, *supra* note 1, chart 3, at 6. This chart shows the relationship between wholesale cost to New York retailers and consumer prices in the District of Columbia, Miami, Chicago, and New York City.

79 More blatant ruses have been used, such as advertising "$1.00 off regular price." These have been considered legal by the SLA, thus there is little enforcement of the advertising ban. *See* JOINT LEGISLATIVE COMM. STUDY, *supra* note 29, at 9; NEW YORK SLA ANNUAL REPORT 8-9 (1966).

CONCLUSION

The announced goal of the 1964 legislation was competitive prices, but its reforms have been ineffective. The thrust of the legislation was price reduction above the retail level, although market conditions consistently pointed to the retail level as the place for the largest price reductions. The post-1964 experience has shown that even if the Moreland Commission's entire reform program had been enacted, the goal of free market prices would not have been achieved. Repeal of mandatory price maintenance did not yield low prices, and even private resale price maintenance has been substantially abandoned without widespread effect on prices. Repeal of the fair trade law in so much as it applies to the liquor industry may not be politically feasible, there being no justifiable distinction between the liquor market and other branded product markets. By reforming the structure of the market to allow it to approach and in fact combine with the supermarket-grocery store market, however, the high price effects of fair trade would disappear. Since prices cannot be consistently upheld, the incentive for fair trade will disappear and its use and enforcement will deteriorate.

Reform is needed to change the retail market structure and to regulate informal vertical control. To permit liquor sales in a wide range of retail outlets, the liquor-only and one-license-per-owner rules should be repealed. To soften the disrupting effect of new types of retail outlets on the old, the rules should be lifted in accordance with a phased plan designed to eliminate slowly inefficient operation. To insure price competition, retailers should be allowed to advertise price and thus the advertising ban should be repealed.

To regulate directly distiller control, a minimum time of three years should be set on franchise agreements, and distiller financial and managerial interest in wholesalers should be forbidden. The repeal of the fair trade law for the liquor market is not vitally necessary, but its repeal would accelerate the move towards competitive prices. Finally, since the affirmation law has proved a failure, the SLA should be relieved of its useless administration.

Anthony M. Radice