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Antitrust Modernization Commission
1120 G St. NW Suit 810
Washington, DC 20005

July 5, 2005

Dear Sir or Madam:

Enclosed is a statement for the "Comments Subcommittee" dealing with the issue of whether the antitrust immunity provided by the Capper-Volstead Act shall be continued. This may be viewed as an Executive Summary of my views on this subject.

I originally set forth my views regarding the justification for the "special treatment" accorded cooperatives by the Capper-Volstead Act in my comments as a member of the Economic Advisor Panel to the National Commission to Review the Antitrust Laws and Procedures in 1979 (see Appendix A to my current statement).

In my enclosed statement, I provide additional evidence on this subject based on research I have conducted since that time. In two extensive economic studies my colleagues and I have found that even when cooperatives market a substantial share of the products sold in a market, they lack market power because of their policies of open membership, their inability to control the supply of their individual members, and are unable to prevent free riding by non-members. I therefore recommend that the Antitrust Modernization Commission recommend no changes in the Antitrust Treatment accorded cooperatives by the Capper-Volstead Act.

Sincerely,



Willard F. Mueller
William F. Vilas Research Professor, emeritus
University of Wisconsin-Madison

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**Comments for the Antitrust Modernization Commission
Re: Recommendation for Continued Antitrust Immunity
Provided by the Capper-Volstead Act of 1922**

Willard F. Mueller, William F. Vilas Research Professor of Agricultural and Applied Economics, Department of Economics, and Law School, University of Wisconsin-Madison, emeritus, Food Systems Research Group, University of Wisconsin.*

In 1978 I was appointed a member of the Economic Advisory Panel of the National Commission to Review the Antitrust Laws and Procedures. In that capacity I prepared a report that examined the basic rationale for the special treatment accorded agricultural cooperatives by the Capper-Volstead Act of 1922.

(See Appendix A). Based on my analysis, I concluded, in part:

The basic rationale for such support is to be found in the unique structure of agriculture, the only real world example of the economist's theoretical model of perfect competition. Although the number of farms has declined and their size increased, the fundamental structural characteristics that set agriculture apart from industrial markets in the 1920's remain today. Indeed, whereas the structure of agriculture remains atomistic, the structure of much of the rest of the economy has become more concentrated and its power more deeply entrenched.¹

It was imperative to enact the Capper-Volstead Act in 1922 because the Sherman Act inadvertently imposed more severe restraints on the conduct of cooperatives than other corporations. Under some early court decisions, the mere act of forming a cooperative marketing association constituted a *per se* combination in restraint of trade. Thus, merely to exist, agricultural marketing cooperatives required immunity from Section 1 of the Sherman Act.

In my 1979 Report on the Capper-Volstead Act I explained that I supported the antitrust rule that prohibits cooperatives from engaging in practices such as coercively achieved full-supply contracts. Likewise, I agree with the prohibition against anticompetitive agreements between agricultural cooperatives and non-cooperative firms.

The Rationale for Fostering Agricultural Cooperatives

In 1965 the President Lyndon B. Johnson created a National Commission on Food Marketing to which I served as an economic adviser while serving as Chief Economist of the Federal Trade Commission. The National Food Commission concluded that cooperatives had been fostered “to negotiate with buyers, and to protect themselves against trade practices and abuses of market power to which they are otherwise vulnerable.”² The National Food Commission made no recommended changes in the Capper-Volstead Act.

In my continuing study of agricultural cooperatives, I have found that cooperatives have sought a degree of market power much more often than they have achieved it. And they often appear to have more power than they actually possess. This is true because of the almost universal practice of open-membership and freedom to leave a cooperative. Because cooperatives are unable to control industry supply—neither the supply of their members nor that of non-members—a

cooperative's market share alone is not a meaningful index of market power in contrast to that of non-cooperative firms, where high market shares typically are correlated with high entry barriers.

Since my 1979 report to the National Commission to Review the Antitrust Laws, I have engaged in two large-scale studies bearing on these issues. In 1987 I was senior author of a book that made an in-depth legal-economic analysis of the evidence in the Federal Trade Commission's challenge of Sunkist, Inc. in 1977.³ That study examined in depth the economic theory and empirical evidence of the marketing practices of Sunkist, Inc., which marketed about 70 percent of the fresh and processed Valencia oranges in California and Arizona during the 1970s.

The FTC's analysis had relied primarily on Sunkist's large market share as evidence of monopoly power. It neglected to consider Sunkist's inability to control the supply of its members and non-members. Our analysis demonstrated that Sunkist did not possess monopoly power because it lacked the ability to control the supply of its members, had it attempted to, nor the ability to prevent free riding by non-Sunkist packing houses that would have eroded any attempt to enhance prices above competitive levels.

The study examined in depth Sunkist's marketing practices and the economic theory of the conditions necessary to achieve market power. It

demonstrated the unique nature of cooperatives, especially open-ended ones, which are unable to control output and to prevent free riding by non-members.⁴

On August 15, 1980, Sunkist, Inc. and the Federal Trade Commission entered into an agreement settling the Sunkist litigation. The agreement was for settlement purposes only and did not constitute an admission by Sunkist that the law had been violated. Indeed, none of the substantive provisions of the agreement had any significant impact on Sunkist's future marketing practices. The only sanction imposed on Sunkist was that it have not more than 39 commercial packinghouses for five years. This was a meaningless prohibition since by 1980 Sunkist already had only 30 such packinghouses and five years after the agreement it had only 27 commercial packinghouses. The decline in the number of commercial packinghouses reflected increases in the economies of scale of packinghouses rather than the provisions of the settlement agreement.

The lesson of the Sunkist litigation, which involved one of the nation's largest marketing cooperatives, teaches that a cooperative achieving a large market share in an industry does not enjoy the same degree of market power as that which is typically enjoyed by non-cooperatives holding large market shares.

In 1996, my co-authors and I completed an exhaustive three-year study of the pricing practices of the National Cheese Exchange.⁵ The study was

undertaken in response to a request of the Trade Division of the Wisconsin Department of Agriculture, Trade, and Consumer protection.

The major finding of the study was that the dominant cheese trader on the National Cheese Exchange, Kraft Foods, was able to influence cheese prices to its advantage despite the existence of several large cheese marketing cooperatives that sometimes sought to countervail Kraft's power. The study concluded, in part, "there was an imbalance in market power between buyer-traders and seller-traders, with the balance of power favoring Kraft and its [two] followers. Whereas Kraft was the largest *buyer* of cheese off the National Cheese Exchange, it was the dominant *seller* of cheese on the NCE."^b The study examined considerable documentary evidence of all leading traders on the NCE and conducted an extensive econometric analysis of trading practices.

Subsequent to the completion of the Cheese Report, certain documents that Kraft had withheld during the investigation (on grounds that they included trade secrets) were subsequently released pursuant to an agreement between Kraft and the Wisconsin Department of Justice. These documents provided further evidence that Kraft enjoyed substantial market power that enhanced its profits during the period studied. These findings were published in a refereed economic journal.⁷

I believe the findings of the above-cited studies provide further credence to the conclusion that even agricultural cooperatives with large market shares have

no significant market power, and therefore should continue to enjoy the protection afforded by the Capper-Volstead Act.

Notes

* Served as Chief Economist and Director of the Bureau of Economics during 1961-1969, except for nine months when President Johnson appointed him to serve as Executive Director of the President's Cabinet Committee on Price Stability in 1968. I have frequently served as an advisor to the Senate and House Antitrust Subcommittees as well as several other Congressional Committees.

¹ Willard F. Mueller, "The Capper-Volstead Exemption," *Report to the President and the Attorney General of the National Commission for the Review of Antitrust Laws and Procedures*, Volume II, January 22, 1979, pp. 249-264.

² *Report of the National Commission on Food Marketing*, June, 1966, 110.

³ Willard F. Mueller, Peter G. Helmberger, and Thomas W. Paterson, *The Sunkist Case: A Study in Legal Economic Analysis*, Lexington Books, D. C. Heath & Company, Lexington, Massachusetts, 1987.

4. *Ibid.*, 124-125, 153ff, 160.

⁵ Willard F. Mueller, Bruce W. Marion, Maqbool H. Sial, and F. E. Geithman, *Cheese Pricing: A Study of the National Cheese Exchange*, A Report of the Food System Research Group, Department of Agricultural Economics, University of Wisconsin-Madison, prepared for the Wisconsin Department of Agriculture, Trade, and Consumer Protection Investigation into Cheese Pricing, 1966.

⁶ *Ibid.*, p. VII-23.

⁷ Willard F. Mueller and Bruce W. Marion, "Market Power in the Cheese Industry: Further Evidence," *Review of Industrial Organization*, 17, 177-191, 2000

APPENDIX A

WILLARD F. MUELLER

THE CAPPER-VOLSTEAD EXEMPTION

MEMBER OF THE
ECONOMIC ADVISORY PANEL
TO THE NATIONAL COMMISSION
FOR THE REVIEW OF
ANTITRUST LAWS AND PROCEDURES*

* November 1978. Appearing in the REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL of the NATIONAL COMMISSION FOR THE REVIEW OF ANTITRUST LAWS AND PROCEDURES, Volume II, January 22, 1979, pp.249-267

THE CAPPER-VOLSTEAD EXEMPTION

W.F. Mueller

The first American cooperatives were organized prior to the Civil War, and the various farmer movements fostered their growth in the late 19th century and the first two decades of the 20th century. Dairy bargaining associations began shortly after 1900 and many commodity associations were formed between 1910 and 1930.

It is incorrect to characterize the Capper-Volstead Act as a product of the post-World War I depression in agriculture. Rather it was made inevitable by the Sherman Act of 1890.¹ Like labor, cooperatives were early targets of private actions under the Sherman Act, targets at which sponsors of the Act certainly were not aiming in their attack on the industrial

¹The DOJ Task Force Report on *Milk Marketing*, January 1977, states that "the legislative history contains conflicting statements as to whether there had ever been prosecution of farmers or farmer cooperatives" under the Sherman Act (pp. 48-49). This statement implies doubt exists as to whether cooperatives were challenged under the antitrust laws before 1922. There is no need for speculation on this matter. Early private party cases challenged cooperatives under the Act, even when cooperatives held minuscule shares of the market. See, for example, *Reeves v. Decorah Farmers Cooperative Society*, 160 Iowa 1914, 140 N.W. 844 (1913). Moreover, the Justice Department had initiated several actions after 1914, leading the Congress to place a rider on the Department's appropriation bills for two years which prohibited it from bringing any additional actions against cooperatives. This step was taken in contemplation of the Congress enacting legislation clarifying the legal status of cooperatives. A movement to achieve this end began in 1917 and gained momentum until the law was enacted in 1922. J.G. Knapp, "History and Perspective of Cooperative Structure under the Capper-Volstead Act and the Clayton Amendment," *National Symposium on Cooperatives and the Law*, University of Wisconsin, 1974, p. 14.

trusts.² The Sherman Act inadvertently imposed more severe restraints on the conduct of cooperatives than other corporations. Under some early decisions, the mere act of forming a cooperative marketing association constituted a *per se* combination in restraint of trade. Thus, merely to exist, agricultural marketing cooperatives required immunity from Section 1 of the Sherman Act. The Congress sought to accomplish this objective by enacting Section 6 of the Clayton Act, which permitted the "existence and operation of labor, agricultural or horticultural associations" without being "construed to be illegal combinations or conspiracies in restraint of trade under the antitrust laws." The Act covered only non-stock marketing associations.

Subsequent private antitrust actions and threatened actions by the Justice Department led to the enactment of the Capper-Volstead Act of 1922. This Act gave agricultural producer associations a limited antitrust immunity by permitting them to act collectively in "processing, preparing for market, handling and marketing" their products. The Act also permits such associations to have "marketing agencies in common." Section 2 of the Act provides that the Secretary of Agriculture may proceed against any cooperative if he has reason to believe that it monopolizes or restrains trade "to such an extent that the price of any agricultural product is unduly enhanced." Should the Secretary conclude after a public hearing that the cooperative has unduly enhanced prices, he may direct the cooperative to cease and desist from such monopolization.

² Senator Sherman, who believed the Sherman Act should not cover cooperatives, proposed an amendment to the Act which provided that it should not be construed to prohibit "any arrangements, agreements, associations, or combinations among persons engaged in horticulture or agriculture *made with the view of enhancing the price of their own agricultural or horticultural products*" (emphasis added). The language was not included in the final bill as being unnecessary.

The antitrust agencies and private parties may challenge anticompetitive activity falling outside the immunity granted by the Capper-Volstead Act. Although unsettled issues remain, this much seems clear.

—Agreements between agricultural cooperatives and noncooperatives are subject to the antitrust laws, as is a cooperative's acquisition of a noncooperative business.

—If a cooperative has any nonagricultural producers as its members, it loses its antitrust immunity.

—If a cooperative monopolizes or attempts to monopolize, through the use of predatory or unfair practices, it is subject to the antitrust laws. But the acquisition of market power solely through voluntary affiliation of farmers does not constitute monopolizing.

The Rationale for Fostering Agricultural Cooperatives

There is a long history of public support for cooperatives in many capitalistic economies. The basic rationale for such support is to be found in the unique structure of agriculture, the only real world example of the economist's theoretical model of perfect competition. Although the number of farms has declined and their size increased, the fundamental structural characteristics that set agriculture apart from industrial markets in the 1920's remain today. Indeed, whereas the structure of agriculture remains atomistic, the structure of much of the rest of the economy has become more concentrated and its power more deeply entrenched.

The presence of market power is commonplace in much of the economy, and carries a high price tag.³ The food

³ Scherer, *Industrial Market Structure and Economic Performance*, p. 408.

manufacturing sector is no exception. Using three independent estimating techniques, Parker and Connor found that market power of food manufacturing firms imposed a monopoly cost of about \$12 billion in 1975.⁴ Antitrust offers little prospect of improving performance in these and other industries with entrenched power. Indeed, under existing laws antitrust is largely a holding action, preventing industrial structure from getting worse. For these reasons the performance of cooperatives should be judged within the context of an economy where varying degrees of market power are the rule, not the exception, and a public policy environment in which little has or is likely to be done about existing entrenched power.

In its final report, the Congressionally created National Commission on Food Marketing recognized the differences between agriculture and other segments of the economy.⁵

The marketing and pricing problems in agriculture differ, sometimes dramatically, from those found in food processing and distribution. Contributing to the difference are the large number of farmers, the lack of product differentiation, and frequent oversupply resulting in part from rising farm productivity, unplanned variations in yields arising from weather and other natural hazards, and the extreme perishability of many products. Farm

⁴ R.C. Parker and J.M. Connor, "Estimates of Consumer Loss Due to Monopoly in the U.S. Food Manufacturing Industries," paper presented at the Allied Social Science Association meetings, Chicago, August 30, 1978. Parker and Connor define "consumer" or "monopoly" loss as those losses due to allocative inefficiency (deadweight loss), X-inefficiency, and monopoly profits. The three measures of these costs place total monopoly loss in a range of \$11.6 billion and \$13.0 billion in 1975 which is equal to about 7 percent of sales and 20 percent of value added.

⁵ Final Report of the National Commission on Food Marketing, 1966, June 1966, p. 110.

markets lacking the firming influence of group action are volatile, often depressed, and highly sensitive to downward pressures originating further along in marketing channels. . . .

The Commission concluded:

We believe, therefore, that there is frequent need for group action by farmers to adjust sales more uniformly to market demands at reasonable prices, to improve product quality and uniformity, to negotiate with buyers, and to protect themselves against trade practices and abuses of market power to which they are otherwise vulnerable.

Simply put, cooperatives have been fostered to give farmers some market power in an imperfectly competitive economy. In my judgment, cooperatives have sought power more often than they have achieved it, and often they appear to have more power than they actually possess. This is true because of the general practice of open-membership and freedom to leave a cooperative. The unique characteristics of the cooperative corporation are relevant in evaluating the probable competitive consequences of certain practices.⁶ Because of their inability in all but rare instances to control industry supply—neither the supply of their members nor that of nonmembers—a cooperative's market share alone is a much less meaningful index of market power than is a firm's share in industrial markets, where high market shares are often correlated with high entry barriers.

Even in the absence of supply control, however, cooperatives may attain market advantages by engaging in practices

⁶ J.G. Youde, "Cooperative Membership Policies and Market Power," and P. Eisenstat and R.T. Masson, "Cooperative Horizontal Market Power and Vertical Relationships: An Overall Assessment," in *Agricultural Cooperatives and the Public Interest*, Proceedings of an NC-117 sponsored Workshop, June 6-8, 1977 (forthcoming 1978).

such as coercively achieved full-supply contracts. Such practices may give some farmers an advantage by foreclosing others from the market, and may injure other cooperative and noncooperative firms with whom they compete or whom they supply.

The most visible use of market power is when a cooperative operates in a market with a federal or state marketing order. In such an industry setting, which the cooperative (and its farmer members) may help to create, the cooperative often seeks to obtain prices above the minimum established by the order. Although this objective (or its attainment) is not itself a violation of the antitrust laws, cooperatives may in pursuing this objective use practices *vis-a-vis* competitors or customers that violate these laws. The records of various antitrust cases brought by private parties and the government document a variety of such anticompetitive practices.⁷ But these cases also demonstrate that such anticompetitive practices generally are not immunized by the Capper-Volstead Act, and have been challenged successfully under the Sherman, Clayton, and Federal Trade Commission Acts.

The Justice Department Report on *Milk Marketing* estimates that "monopolistic control of milk supply by dairy cooperatives" resulted in social losses of \$60 million.⁸ This

⁷ For a discussion and examples of alleged anticompetitive practices, see P. Eisenstat, R.T. Masson, and D. Roody, "An Economic Analysis of the Associated Milk Producers, Inc. Monopoly," prepared for the Department of Justice. For a critique of this report see Cook, Blakley, and Berry, "Review of Eisenstat, Masson and Roddy, . . ." For examples and a discussion of actual predatory or coercive practices, see Mueller, "The Economics and Law of Full Supply Contracts as Used by Agricultural Cooperatives," National Symposium on Cooperatives and the Law, University of Wisconsin, pp. 99-131.

⁸ *Milk Marketing*, a Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities, January 1977, pp. 413-14. This estimate is based on an unpublished study by Ippolito and Masson.

estimate is based on the over-order Class I premiums negotiated by dairy cooperatives in 1973 less 10 cent services rendered at 20-30 cents per hundredweight.⁹ Using these estimates would reduce DOJ's estimated losses by about one-half. Moreover, the DOJ estimate was for 1973. According to the DOJ, the size of over-order premiums declined substantially after the AMPI decree.¹⁰ If this decline was due to the decree as the DOJ report implies, then there exist today very modest over-order premiums that cannot be justified by cost considerations.

This is not to imply cooperatives have not in the past or will not in the future be able to achieve above order premiums exceeding the cost of service charges. After all, this is one reason the cooperatives were created. Manchester estimates that the total economies resulting from cooperative activities compared to a system wherein handlers assume this burden are probably 40-50 cents per hundredweight.¹¹ The manner in which these benefits are distributed between farmers and processors depends on the relative bargaining power of each. As I understand the DOJ staff's position, it believes cooperatives are not entitled to receive *any* premium beyond the cost of providing services.¹² As noted below, I believe this is an inappropriate standard to use in judging undue price enhancement.

Should cooperatives succeed in negotiating above order prices without using illegal practices, such prices are still subject to the provisions of Section 2 of the Capper-Volstead Act, the undue price enhancement section (see below).

Although the degree of antitrust immunity granted cooperatives is limited, there remain several unresolved issues:

⁹ *Milk Report*, p. 80. The DOJ "rejects the notion that some of these 'services' were in fact services."

¹⁰ *Milk Report*, p. 75.

¹¹ A.C. Manchester, *Dairy Price Policy: Setting, Problems, Alternatives*, Ag. Econ. Report No. 402, USDA, April 1978, p. 11.

¹² *Milk Report*, pp. 76-83.

Unresolved Issues

Who is a Producer?

Do agreements allocating risks between a producer and nonproducer qualify a nonproducer as a farmer if he assumes the substantial share of risks associated with farming?

I believe Mr. Justice Brennan's concurring opinion in the *National Broiler* case, narrowly defining who is a producer and hence who can be a member of an agricultural cooperative, is most consistent with the public policy rationale for fostering farmer cooperatives. This policy is designed to help individual farmers, not large processing corporations that may engage directly or indirectly in farming.

Restrictions on Members' Production

There is disagreement as to the antitrust status of restrictions on output by a cooperative.¹³ It is therefore especially appropriate to examine the economic significance of this practice.

Today few cooperatives restrict the production of their members, pursuing instead a policy of open membership and no restrictions on member output. Indeed, very few pursue policies of restricted membership, much less restricted production of members.¹⁴ Most of those practicing limited membership do so for reasons other than market power. Those few cooperatives restricting membership for purposes

¹³ The Justice Department believes the law is unclear on this point. Staff Paper on Agriculture, National Commission for the Review of the Antitrust Laws and Procedures, October 2, 1978, pp. 14-15. The Department of Agriculture apparently believes cooperatives cannot restrict the amount of production of producers. USDA Comments on the Department of Justice Report on Milk Marketing, May 26, 1977, p. 16.

¹⁴ Youde, *op. cit.*

of market power tend to have higher market shares, differentiate their product through advertising, and market a more highly processed product.¹⁵

Restrictions of membership creates the greatest potential for substantial market power in specialty products where production is concentrated in a small geographic area. In such situations, a cooperative controlling a very large market share may not be disciplined by the actual or potential entry of new producers. In such circumstances, the Secretary of Agriculture has a special obligation to monitor pricing behavior for undue price enhancement.

Moreover, there is considerable merit to the argument that the Capper-Volstead Act "authorizes collective processing, handling, and marketing, but not collective 'producing.'"¹⁶ Because of the potential power conferred by controlling agricultural production, it seems consistent public policy that production control should be permitted only when authorized by specific Congressional acts, as has been done from time-to-time in various agricultural programs including the Agricultural Marketing Act of 1937. Such a policy argues against granting per se exemption from the antitrust laws for those cooperatives restricting production.¹⁷

Marketing Agents in Common

The Capper-Volstead Act authorizes cooperatives to have "marketing agents in common." Under this provision,

¹⁵ *Ibid.*, p. 7. Youde found that only four of 30 leading cooperatives restricted membership for purposes of market power. He found that only two of a sample of 119 additional regional marketing cooperatives restricted membership for purposes of market power. These involved minor products—olives and honey. *Ibid.*, p. 7.

¹⁶ *Commission Staff Paper on Agriculture, op. cit.*, p. 15.

¹⁷ A rule of reason standard is appropriate in determining the legality of cooperatives that restrict production.

cooperatives may form marketing or bargaining federations to act collectively, apparently to fix prices, or to engage in other mutually beneficial collective conduct.

Because market agreements in common can assume many forms, it is not possible to generalize concerning their effects on competition. It is therefore necessary to look to the purpose and effects of such arrangements, not merely to their form. Historically, federations of cooperatives have performed important and legitimate functions; should this provision of the Act be repealed, it would force many cooperatives to operate less efficiently or change their corporate form. The milk cooperative consent decrees suggest that the Justice Department believes it has authority to deal with predatory conduct by marketing agents in common. I therefore do not endorse the Commission staff's Option 2 recommending legislative modification of the Capper-Volstead Act with respect to marketing agents in common.

Mergers Among Cooperatives

If cooperatives may fix prices, may they also merge with immunity? What if a merger between two cooperatives restricts the choice of farmers to select voluntarily whether they wish to be a member of an acquiring cooperative?

Answering the first question depends partly on whether one accepts the premise that public policy should foster the growth of cooperatives, recognizing that a primary objective of such growth is to enhance farmers' bargaining power in the market. Since this premise obviously is contrary to that underlying Section 7 of the Clayton Act, it may justify applying different standards to mergers among cooperatives than among noncooperatives.

Another issue relates to whether mergers unduly restrict the freedom of choice of individual farmers. The question

here is whether there is something so unique about the business decision to merge that the general rule of majority consent should be abandoned. Apparently farmers think so, since most states require at least a two-thirds majority approval before a cooperative may be acquired. It seems questionable whether farmers' interests would benefit by imposing more severe restraints. Finally, in evaluating the cooperative merger issue it is important to recognize that farmers are both patrons and stockholders of their cooperative corporations. Their role as patrons transcends that of stockholders, for without their patronage the cooperative corporation cannot survive. Should farmer-patrons of two cooperatives wish to form a single association, they have three options: (a) they may combine as stockholder-patrons of the two cooperatives; (b) one of the cooperatives could disband and all or most of its patrons could voluntarily affiliate with the other cooperative; or (c) both cooperatives could disband and their patrons could form a new association. These options are not viable alternatives in all situations, especially when large capital investments are involved. But bargaining and many marketing cooperatives could pursue options b and c if the law foreclosed option a. Thus, prohibiting mergers among cooperatives might cause farmer-patrons inconvenience and financial hardship, but not necessarily prevent the same end result.

I agree with the Justice Department position that a farmer should not be forced to remain in a cooperative if he disapproves of a merger.¹⁸ If a cooperative places unreasonable restraints on exit from merging cooperatives, the Justice Department might challenge such a merger under existing law. In the AMPI case the Justice Department did not seek

¹⁸ This position was first stated by former Assistant Attorney General Donald Turner. Also see DOJ *Milk Report*, p. 581. The Department's *AMPI Report* concluded several mergers it examined did not allow members this option.

relief for mergers among cooperatives. Until the antitrust agencies test the legal status of cooperative mergers under the existing laws, new legislation seems premature.

Undue Price Enhancement

A final unsettled issue is whether the Secretary of Agriculture should continue to have authority to enforce Section 2 of the Capper-Volstead Act, the "undue price enhancement" provision. Certainly the record of the past half century demonstrates that no Secretary of Agriculture has been enthusiastic about enforcing this provision. What, then, are the alternatives?

Secretary Bergland has testified that the Department is in the process of establishing a systematic procedure for monitoring and enforcing Section 2. The Department's treatment of the formal petition filed by the National Consumers Congress in 1976 demonstrates that the Department has the capability to evaluate such problems quite effectively and expeditiously, at least as compared to other regulatory agencies. In less than a year the Department's Capper-Volstead Committee issued a fairly comprehensive report.¹⁹

The Department's enforcement effort could be enhanced and made more responsive to the public interest, however, if the Justice Department and other public and private parties participated in such proceedings. Also, if it had reason to believe undue price enhancement existed, the Justice Department might petition Agriculture to hold such hearings. Experience with other regulatory agencies illustrates that often they have been derelict in taking competitive considerations into account in making decisions until the Justice Department

¹⁹ "The Question of Undue Price Enhancement by Milk Cooperatives," by the Capper-Volstead Committee, USDA, December 1976. For a brief discussion of this report see Appendix A.

or the Congress intervened. (The SEC and Banking authorities are only two examples.) I think such participation by Justice could have a similar salutary effect.

Some insist, however, that even under the best of circumstances the Agriculture Department will not enforce Section 2 aggressively enough. The Commission staff's Option 4 recommends that authority for enforcing Section 2 be transferred to the Federal Trade Commission and that a legislative standard be established by which to judge undue price enhancement. This is a matter deserving serious attention. I believe many persons do not fully appreciate the unique regulatory power granted by Section 2, which potentially makes it the most potent provision of any antitrust law. Whereas the other antitrust laws impact on business conduct and industry structure, Section 2 could deal directly with performance. It provides the potential to place restraints on prices. In my view, if it is deemed in the public interest to control directly the price performance of cooperatives that unduly enhance prices—and I think there is merit in such a policy—some public policy argues for such a standard in *all* sectors of the economy. This could be accomplished by including an undue price enhancement provision in the FTC Act or the Sherman Act.²⁰ Then, if the appropriate antitrust agency had "reason to believe" any corporation (including a cooperative), "shared monopoly," was monopolizing or restraining trade to such an extent as to unduly enhance prices, the agency could require the corporation to show cause why an order should not be made directing it to cease and desist from such monopolization or restraint of trade.

²⁰ The late Senator Hart's proposed "Industrial Reorganization Act" included an excess profit standard in determining that a firm presumed to have monopoly power. Section 101, b1 provided that there shall be a rebuttable presumption that monopoly power is possessed by a corporation if its rate of return on net worth after taxes exceeds 10 percent over a period of five consecutive years. S. 1167, 93rd Congress.

Numerous empirical studies have shown that many industries have sufficient market power to unduly enhance prices. Yet, virtually nothing has or is likely to be done about such abuse of power under the antitrust laws. Although the antitrust agencies are now experimenting with shared monopoly theories, and some persons are contemplating new legislation to deal with excessive corporate power, there is little reason to believe that the bastions of excessive corporate power will fall in this generation.

Unless something is done to cope with the pervasive problem of undue price enhancement in other areas, pleas for hard-line enforcement of Section 2 of the Capper-Volstead Act seem unjustified.²¹ I believe the historical record supports

²¹ The Justice Department Task Group on *Milk Marketing* argues that the Congress intended to permit cooperatives to achieve market power so as to countervail the power of buyers but not to permit cooperatives to achieve any power of their own: "While Congress intended that farmers be allowed to associate for the purpose of exercising countervailing power in their dealing with corporate entities, Congress did not contemplate that the organizations, in turn, would hold such a degree of market power that competition and the consumer would be adversely affected." *Milk Report*, p. 52. This view challenges the basic premise of public policy that cooperatives may achieve a degree of market power so long as they do so legally, and that they may enjoy the fruits of such power so long as they are not too luxuriant. As I read the legislative history of the Act, the Congress' concern with inequality in bargaining power of farmers did not rest solely on the assumption that buyers had market power which cooperatives might countervail. Rather, there was a widely held belief that farmers were disadvantaged because they operated in a world where many others had market power but farmers had none. Farmers, as Congressman Towner put it, are in a "disadvantageous position with regard to all of the rest of the business world." Quoted in *Milk Report*, p. 39.

The Justice Department Task Group also argues that the Congress intended to help "organizations largely local in nature," not large regional organizations. *Ibid.* Congress doubtless spoke mainly of small local organizations, since practically all cooperatives were very small at the

Secretary Bergland's view that the chief reason little action has been taken under Section 2 is: (1) for most of the period since 1922 farm prices (and incomes) have been seriously depressed, relative to the rest of the economy; and (2) until recently few cooperatives in significant industries were powerful enough to raise serious questions under Section 2.²²

This is not to say that there should be no restraints on the achievement and use of market power by cooperatives. But, as I interpret the record, very substantial restraints exist under

such organizations. Western Congressmen already were familiar with the large fruit cooperatives (the predecessors to Sunkist and Sun Maid) that emerged in California around 1900 and midwesterners were familiar with the milk federations of the early 1900's that ultimately evolved into Land O'Lakes in the early 1920's. And clearly those promoting the Capper-Volstead Act envisioned that large-scale cooperatives would emerge once their legal status was settled. The latter expectations were realized, as the number of larger cooperatives literally exploded after the Capper-Volstead Act was enacted. Whereas local associations predominated until 1920, "following 1921, hundreds of associations were organized every year—not only locals but regional, federated, and centralized ones. . . ." H. Bakken and M. Schaars, *Economics of Cooperative Marketing*, McGraw-Hill, 1937, p. 68.

²² One reviewer of an earlier draft of this piece questioned these conclusions, citing my own studies documenting illegal activities of milk cooperatives (see *supra*, note 7). It is true as I noted above that cooperatives have from time-to-time engaged in anticompetitive practices in violation of the Sherman Act. A careful reading of these cases reveals, however, just how fragile is the market power of cooperatives absent illegal practices. Also, restraints of trade, though illegal, do not necessarily result in immediate price increases. At least I find it difficult to infer from the records of these cases whether there existed undue price enhancement, since they dealt with attempts to monopolize and restraints of trade. Also, with few exceptions, all the private and public cases involving milk cooperatives occurred in recent years, supporting the Secretary's conclusion that cooperatives generally did not have much economic muscle until quite recently.

existing law. Until the outer boundaries of the antitrust immunity conferred by Capper-Volstead have been explored through litigation, and the Secretary's proposed new monitoring program has been given a chance to prove itself, I question whether it is necessary or appropriate to consider amending the law toward agriculture cooperatives.

APPENDIX A
THE CAPPER-VOLSTEAD COMMITTEE REPORT
ON UNDUE PRICE ENHANCEMENT BY
MILK COOPERATIVES

Producer cooperatives negotiate Class I premiums which increase the effective Class I differentials of federal orders. The National Consumers' Congress charged that Class I price premiums negotiated by cooperatives in 1974-75 constituted undue price enhancement in violation of the Capper-Volstead Act. The Secretary of Agriculture appointed a Capper-Volstead Committee to analyze these charges. The committee rejected this allegation, arguing that Class I premiums represented mainly compensation to producers for market-level services rendered and were justified by the unusual economic conditions confronting producers during 1974-75.¹ Regarding the finding of the Capper-Volstead Committee, Agriculture Secretary Bergland said: "That detailed study of milk prices throughout the entire industry during 1974-75 found no undue price enhancement by any cooperative."

Clearly, unusual conditions confronted federal order milk producers in 1974-1975. Federal order minimum Class I prices fell 14 percent, from \$10.05 during the first half of 1974 to \$8.65 during the last half of the year, and remained under \$10.00 until November 1975. During 1974-1975, prices paid by dairy farmers for inputs rose about 13 percent. Moreover, according to the Capper-Volstead Committee, USDA denied requests from producers for increases in federal order minimum prices during this period, telling them to "negotiate such increases as they could in the marketplace" (p. 34). Producers responded by negotiating Class I premiums which averaged \$.55 and \$.52 per hundredweight during 1974 and

¹ USDA, Capper-Volstead Committee, *The Question of Undue Price Enhancement*, December 1976.

1975, respectively, in 17 representative federal order markets.² These Class I premiums were about \$.35 per hundredweight higher than the average premiums for the preceding nine years in the 17 markets and were higher than could be justified by the costs (approximately \$.25 per hundredweight) producers incurred for providing market-level services.

It appears that producers would have experienced a cost-price squeeze if they had failed to negotiate the larger Class I premiums in 1974-75. The cost-price squeeze would have had varying effects ranging perhaps from increasing producer debts to forcing some farmers out of business.

The Agricultural Marketing Agreement Act specifies that federal milk orders shall set only the minimum (not ceiling or exact prices) which regulated handlers must pay for milk. It was argued by the Capper-Volstead Committee that this provision was included in the AMAA partly to permit price increases (outside the pricing mechanisms of the orders) when adverse economic conditions faced milk producers. If one accepts this argument, then it appears that producer cooperatives were justified in negotiating larger Class I premiums during 1974-75.

The Capper-Volstead Committee's analysis seems quite persuasive, though I make no pretense of having analyzed it in detail. There seem to be reasonable grounds for the Secretary's conclusion that the average Class I premiums for the unusual 1974-1975 period were justified by special economic conditions. However, the Justice Department concludes that USDA erred in interpreting its own analysis of the relationship between cooperative concentration and the size

² W.D. Dobson and L. Salathe, "The Effects of Federal Milk Orders on the Economic Performance of U.S. Milk Markets" (forthcoming in *American Journal of Agricultural Economics*, 1978).

of over-order premiums.³ The DOJ conclusions are consistent with those of Dobson and Salathe that market power was probably responsible for some of the larger Class I premiums (e.g., those in Southern Michigan).⁴ Thus, it is conceivable that the Secretary was wrong. But evidence that prices in some markets were enhanced because cooperatives had market power does not necessarily mean the premiums violated Section 2, unless one accepts the view that every supracompetitive price represents undue price enhancement.

In sum, there seems to be no question but that milk cooperatives negotiated significant above-order premiums during 1974-1975. The Secretary of Agriculture concluded that under the circumstances these premiums did not represent undue price enhancement. Of course, it is possible that the cooperatives could not have achieved these above-order premiums had they not engaged in certain practices subsequently enjoined by the Justice Department.⁵ But this, I believe, is another matter. It is possible for cooperatives as well as other corporations to violate the antitrust laws even though their practices do not result in a monopoly price. Thus, the standard which the Secretary of Agriculture must apply differs from antitrust standards. He must find that a cooperative "monopolizes or restrains trade *to such an extent* that the price of any agricultural product *is unduly enhanced* by reason thereof" (emphasis added).

³ DOJ, *Response*, September 1978, p. 74.

⁴ Dobson and Salathe, *op. cit.*, p. 8.

⁵ The DOJ believes that the AMPI consent decree caused some premiums to fall. DOJ, *Response*, p. 75.