

BEFORE THE
UNITED STATES DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C.

CALL FOR ADDITIONAL PROPOSALS FOR
A MARKETING ORDER FOR RED TART
CHERRIES UNDER THE AGRICULTURAL
MARKETING ORDER ACT

COMMENTS OF THE DEPARTMENT OF JUSTICE

Anne K. Bingaman
Assistant Attorney General
Antitrust Division

Robert E. Litan
Deputy Assistant Attorney
General
Antitrust Division

Communications with respect to this document should be
addressed to:

Roger W. Fones
Acting Chief
Transportation, Energy &
Agriculture Section
Antitrust Division

Theodore R. Bolema
Attorney
Transportation, Energy &
Agriculture Section
Antitrust Division
U.S. Department of Justice
555 4th Street, N.W.
Washington, D.C. 20001
(202) 307-6627

November 8, 1993

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UNITED STATES DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C.

CALL FOR ADDITIONAL PROPOSALS FOR
A MARKETING ORDER FOR RED TART
CHERRIES UNDER THE AGRICULTURAL
MARKETING AGREEMENT ACT

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COMMENTS OF THE DEPARTMENT OF JUSTICE

By notice dated October 8, 1993, the United States Department of Agriculture ("USDA") requested additional proposals for a marketing order on red tart cherries.^{1/} The initial proposal was submitted by the Cherry Marketing Institute on behalf of interested cherry growers and processors. The Cherry Marketing Institute proposes a marketing order designed to control the annual shipment volume of tart cherries through a combination of processor-owned cherry reserve pools and on-tree or at-plant diversions (including destruction) of cherries. The volume controls would apply in years when the volume of cherries produced for market exceeds some "optimum supply" level calculated by an administrative board composed of producers and handlers of tart cherries.

^{1/} U.S. Department of Agriculture, Office of Public Affairs, News Release No. 0862 93.

POSITION OF THE DEPARTMENT OF JUSTICE

The Department of Justice ("DOJ") urges USDA to reject without hearings, pursuant to 7 C.F.R. §900.3 2/, the Cherry Marketing Institute proposal or any other marketing order proposal that imposes volume controls. Such a marketing order would at best substitute government regulation for a well-functioning market with many producers, relatively easy entry and readily-available information. There is no evidence that this industry has experienced the kind of market failure that would justify imposing volume regulation.3/

2/ USDA's procedural rules provide:

Upon receipt of [a proposed marketing agreement or marketing order], the Administrator shall cause such investigation to be made and such consideration thereof be given as, in his opinion, are warranted. If the investigation and consideration lead the Administrator to conclude that the proposed marketing agreement or marketing order will not tend to effectuate the declared policy of the act, or that for other proper reasons a hearing should not be held on the proposal, he shall deny the application

7 C.F.R. § 900.3

3/ For the reasons set forth in these comments, DOJ also opposes those provisions in the proposed marketing order providing for minimum quality standards for tart cherries. We oppose those provisions because they also appear to establish volume controls; that is, they appear to give the administrative board the discretion to vary quality standards from year to year in response to the size of the cherry crop. To the extent those provisions are aimed at quality control, we note that the Secretary has already promulgated numerous standards for grades of tart cherries. See, e.g., 7 C.F.R. §§ 52.771-84, 52.801-12 (1993). DOJ does not oppose that part of the proposed order providing for the establishment of market research and promotional activities.

Furthermore, the actual proposal, when examined, reveals the flaws one would expect in an attempt to supplant a well-functioning market with self-interested regulation devised by producers and enforced by the federal government. The proposed order would impose continuing costs on society by increasing the price of tart cherries above the level that would prevail in the absence of volume regulation and by inducing wasteful overproduction of tart cherries.

The Cherry Marketing Institute claims that the benefits of its proposed marketing order will come from "stabilizing supply conditions for the purpose of fostering market establishment, market maintenance and market growth."^{4/} A number of factors demonstrate, however, that these benefits are achieved at a lower cost and more efficiently in a free market. First, all the available evidence, although limited, of price stabilization benefits achieved under a previous marketing order unambiguously suggests that this order would not lead to more stable prices. Second, the costs associated with such a plan, including administrative expenses and the wasteful production of cherries that are later destroyed, are

^{4/} Letter from C. Richard Johnston, Managing Director, Cherry Marketing Institute, to the Honorable Mike Espy, dated August 18, 1993.

potentially great. Finally, volume restrictions do not provide any risk reduction that producers cannot better achieve through the many free market mechanisms available to producers of agricultural commodities.

Given the clear and persistent net costs of such volume restrictions and the likelihood that the benefits claimed by the Cherry Marketing Institute could better be achieved through a free market for tart cherries, neither the proposed marketing order nor any other marketing order with volume restrictions should be adopted. Based upon these considerations, USDA should reject the Cherry Marketing Institute's application and terminate this preceding.

DISCUSSION

I. SUMMARY OF THE PROPOSED MARKETING ORDER

Under the proposed marketing order, the Cherry Industry Administrative Board ("the Board") will be established to administer the order, to make rules and regulations to effectuate the terms and provisions of the order, and to report violations to the Secretary. Each year, the Board would establish an "optimum supply" level for the crop year, calculated as 100 percent of the average sales of the three prior years plus no more than 20 million pounds. If the USDA crop forecast for tart cherries exceeds the optimum supply, then the Board will calculate preliminary "free market tonnage" and "restricted percentages", make such adjustments as

necessary to achieve the optimum supply, and then, no later than September 15 of each crop year, recommend final free market and restricted percentages to the Secretary.^{5/}

The proposed marketing order broadly defines "handlers" so as to apply to anyone who brings tart cherries into the current of commerce from a commercially significant cherry producing state. The volume regulation would initially apply to the three leading production states, which are Michigan, Utah and New York. However, the proposed order would be extended to all handlers in other cherry producing states if production in those states met certain conditions.^{6/}

Handlers and growers in regulated states would be required to hold their restricted percentage of cherries in inventory or to direct them out of the current of commerce, e.g. by contributing the cherries to Board-approved food banks, by

^{5/} Simple arithmetic demonstrates the restrictive nature of the proposed order. From 1989 to 1991, the average utilized tart cherry production was 211.9 million pounds. In 1992, the utilized production was 313 million pounds. Fruit and Tree Nuts Situation and Outlook Yearbook, July, 1993, Table B-14. If the proposed marketing order had been in effect in 1992, the optimum supply would likely have been between 211.9 million and 231.9 million pounds. Therefore, the restricted percentage would have been between 25.9% and 32.3% of the 1992 crop.

^{6/} Volume regulations would be permanently extended to Oregon, Pennsylvania, Washington and Wisconsin if production in these states for one year either exceeds 15 million pounds or increases by 50% over the average production during the period between 1989 and 1992. If any other state's production exceeds 5 million pounds, that state will be added to the production area covered by the proposed marketing order.

feeding the cherries to animals, or by destroying the cherries. Tart cherries held in restricted inventories would be released only if the Board finds that the total available supply for use in normal commercial outlets did not at least equal the amount, as estimated by the Board, needed to meet the demands of such outlets.

II. THE STATUTORY BASIS FOR THE PROPOSED MARKETING ORDER

The Secretary of Agriculture is empowered by the Agricultural Marketing Agreement Act of 1937, as amended, 7 U.S.C. §§ 601 et seq. ("AMAA" or "the Act"), to regulate the handling of a broad range of agricultural commodities. Under the Act, marketing agreements and marketing orders are the basic mechanism through which the Department of Agriculture promotes the Act's policies. The Act authorizes handlers, with the consent of the Secretary of Agriculture, to enter into marketing agreements that are exempt from the antitrust laws and cover many significant aspects of the handlers' business. The Secretary of Agriculture is also authorized to issue marketing orders, which are regulations that govern the activities of all specified handlers of a particular product.

To implement a marketing order, the Secretary must determine that such action is likely to promote the Act's policies. 7 U.S.C. §§ 608c(3), 608c(4). As these Comments will demonstrate, the proposed marketing order will contribute little if anything to effectuate the policies of the Act, and more likely will substantially undermine those policies.

Three of the stated objectives of the Act are of particular relevance to the issues raised by the proposed marketing order:

[T]o establish and maintain such orderly marketing conditions . . . as will establish . . . parity prices . . .

7 U.S.C. § 602(1).

To protect the interest of the consumer by (a) approaching the level of [parity prices] . . . by gradual correction of the current level at as rapid a rate as the Secretary of Agriculture deems to be in the public interest and feasible in view of the current consumptive demand in domestic and foreign markets, and (b) authorizing no action under this chapter which has for its purpose the maintenance of prices to farmers above the level [of parity].

7 U.S.C. § 602(2).

[T]o establish and maintain such orderly marketing conditions . . . as will provide, in the interests of producers and consumers, an orderly flow and supply [of the particular product] to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.

7 U.S.C. § 602(4).

Courts generally have recognized protection of the purchasing power of farmers as a central aspect of the Act.^{7/} The language of the statute, however, expressly directs the Secretary to temper the objective of enhancing grower income with the requirement that the interests of consumers also be

^{7/} See, e.g., *Stark v. Wickard*, 321 U.S. 288, 303 (1944); *United States v. Rock Royal Co-op*, 307 U.S. 533, 549-550 (1939); *Rasmussen v. Hardin*, 461 F.2d 595 (9th Cir. 1972), cert. denied, 409 U.S. 933 (1972). Thus, a declared policy of the Act is to promote parity prices for farmers.

taken into account.^{8/} In order to protect consumers, the rate of any price adjustments must be compatible with the "public interest." 7 U.S.C. § 602(2). Furthermore, orderly marketing conditions should be sought as would benefit both producers and consumers. 7 U.S.C. § 602(4).^{9/}

In the final analysis, the Secretary must act in pursuit of the overall public interest. Competitive considerations, including the efficient allocation of resources, generally are considered to be an important element of the "public interest" standard, which applies to not only this program, but also many other types of federal economic regulatory programs.^{10/} Accordingly, the Secretary, in the past, has identified the maximization of producer returns within the context of open and competitive marketing and the achievement of a more efficient

^{8/} The Secretary of Agriculture in determining "crucial facts and conclusions . . . cannot be guided solely by deference to industry desires." *Walter Holm & Co. v. Hardin*, 449 F.2d 1009, 1016 (D.C. Cir. 1971); *Fairmont Foods Co. v. Hardin*, 442 F.2d 762, 766 (D.C. Cir. 1971).

^{9/} In discussing "orderly marketing" conditions, both USDA and commentators have stopped short of defining the term. Indeed, in its response to comments filed in response to a proposed rule for volume regulation in navel oranges in the 1990-91 season, USDA stated that no definition was required since the Act speaks in terms of avoiding unreasonable fluctuations in supplies and prices. See Final Rule, Dkt. No. FV-90-174PFR, 55 Fed. Reg. 50162.

^{10/} See, e.g., *United States v. FCC*, 652 F.2d 72, 88 (D.C. Cir. 1980); *Sabin v. Butz*, 515 F.2d 1061, 1069 (10th Cir. 1975); *Cities of Statesville v. Atomic Energy Commission*, 441 F. 2d 987 (D.C. Cir. 1969); *Northern Natural Gas Co. v. FPC*, 399 F.2d 953, 959-61 (D.C. Cir. 1968).

allocation of resources as important goals in administering fruit and vegetable marketing orders. See USDA, Guidelines for Fruit, Vegetable and Specialty Crop Marketing Orders (1982). Consistent with the important role of competition policy in the public interest standard, courts have concluded that the Secretary has considerable discretion to pursue procompetitive policies under the Act.^{11/} Based on past experience and well-established economic principles, it appears that on balance the proposed marketing order will do more to frustrate than promote the goals set forth both by the Secretary and the Act itself.

III. THE PROPOSED VOLUME CONTROL IS NOT IN THE PUBLIC INTEREST

Under the proposed order, volume controls in the tart cherry industry would be set each year based on recommendations by the Board and would specify the percentage of the tart cherry crop that handlers must place in a restricted inventory. In effect, the proposed order authorizes the Board to act as a legalized cartel to set the output for tart cherries. Production in excess of the permissible quantity

^{11/} In *Pescosolido v. Block*, 765 F.2d 827 (9th Cir. 1985), the Ninth Circuit gave the Secretary broad authority to balance other policy goals against the pursuit of parity. The court held that it was sufficient if the order "tended" to promote parity. "'[P]arity' is a goal toward which the Secretary must strive, rather than the process of setting an objective, fixed price." *Id.* at 830. See also, *Schepps Dairy, Inc. v. Bergland*, 628 F. 2d 11 (D.C. Cir. 1979).

would be placed in a restricted inventory, destroyed or left on the tree unharvested.

The Cherry Marketing Institute's claim that this marketing order would stabilize supply and therefore promote market growth does not withstand analysis. First, it is unlikely that this marketing order would stabilize the annual supply and prices of tart cherries. Second, even if the Cherry Marketing Institute's proposal did stabilize supply and prices, any financial benefit to producers would be temporary, and in any event outweighed by clear harm to consumers and a wasteful misallocation of society's resources. Finally, the Cherry Marketing Institute claims no benefits from the proposed order that could not be better achieved in the free market. Therefore, tart cherry markets will operate more competitively and more efficiently if the proposed marketing order is not implemented, with no loss of stability.

A. A Previous Marketing Order Did Not Stabilize Prices

The previous marketing order for tart cherries was in effect from 1972 until it was terminated by vote of handlers effective in April of 1987. Under that order, average grower prices (in cents per pound) for all tart cherries ranged from lows of 10.2 in 1975 and 14.1 in 1982 to highs of 47.2 in 1979 and 44.5 in 1983. Since 1987, prices have varied from 14.5 to

46.4.12/ Thus, the pertinent data provides no support for the claim that the proposed marketing order would stabilize tart cherry prices.

If, as the evidence indicates, the proposed marketing order would not stabilize prices, then none of the benefits asserted by the Cherry Marketing Institute will be realized. However, all of the costs associated with creating a producer cartel whose output restricting decisions are policed by the government will be incurred, including those costs discussed below.

B. Volume Controls Offer No Long Run Producer Benefits

The higher prices that follow from volume controls can enhance producer income only in the short run. The volume controls can raise prices and producer revenues by suppressing the volume of sales permitted from a given level of tart cherry production, but at the same time, the proposed order does not preclude new entry into tart cherry production or expansion by existing producers. Any artificially raised returns to producers will provide incentives for increasingly inefficient new tart cherry production. The new inefficient production

12/ Fruit and Tree Nuts Situation and Outlook Yearbook, July, 1993, Table B-14. In 1987, tart cherries sold for 7.8 cents per pound, but that was the year in which the order was terminated, when order-restricted cherries were released into the now-free market. Thus, it appears that the 1987 price of 7.8 cents was due in part to the release of inventories accumulated under the previous marketing order.

will drive up producer costs, erode profits and create pressure for further diversion. Producer returns fall back to the point where they equal the long-run costs of production and producers would earn only a normal return on their investment.

C. Volume Controls Harm Consumers

While in the long-run, producers earn only the normal competitive market return, volume controls impose both short run and long run costs on consumers -- higher prices and lower shipments of tart cherries to market, and foregone alternative uses of acreage devoted to unnecessary tart cherry production. Thus, any short term supernormal grower returns dissipate, while the higher consumer prices persist and wasteful destruction of the crop increases.^{13/}

D. The Proffered Price Stabilization Benefits Are Speculative

The Cherry Marketing Institute claims that its proposed marketing order, by stabilizing supply, will foster market growth. This argument assumes that volume restrictions produce a societal benefit by lowering the risk that the crop will be so large that prices and grower revenues are low. This argument has two steps: First, it is argued that volume

^{13/} The magnitude of the waste caused by marketing orders can be quite substantial. For example, DOJ has established that the waste caused by the volume control provisions in the California-Arizona navel orange marketing order has been as high as \$40 million per year. Comments of the Department of Justice, Dkt. No. FV-91-408PR, (Navel oranges) October 20, 1991.

restrictions reduce grower risk by constraining sales during large crop years and second, to the extent that growers prefer to avoid or reduce risk, it is argued that they will tend to view the resulting reduction in risk as a reduction in their cost of production. Such reductions in costs would tend to result in an increase in the quantity supplied at a given price.

This argument is inconsistent with the available evidence, supra, and does not withstand analysis. Volume controls can produce their own destabilizing effect on the tart cherry market. Handlers simply will not know how much the Board will allow them to ship until the restricted percentage is announced. Such uncertainty about the timing and implementation of quantity controls introduces a "regulatory risk" that interferes with efficient marketing.

Moreover, the fact that prices may be relatively low in one year, or even over several years, does not in itself indicate that the tart cherry business entails unusual risks. Rather, the relevant question is whether prices and yields over the life of a tree vary significantly from what the producer expected when the tree was planted. Over the life of a tree, many fluctuations in yield and price will offset each other and the revenue over that period will be more stable than might appear from a study of just one year. There is no evidence that these year-to-year variations in cherry prices portend risks that are any larger than risks handled successfully in

other unregulated markets, including markets for agricultural commodities.

Indeed, numerous market mechanisms currently exist to reduce the risks associated with tart cherry production without incurring the social costs of volume controls. In many comparable commodity industries, market-based mechanisms such as those described below are used successfully to reduce grower risks.

For example, forward contracts, or agreements between growers and buyers in which a price is set well in advance of the harvest, could be and are used to reduce the risk of price fluctuations. In this way, growers effectively transfer the risk of low prices at harvest time to the buyer. Long-term contracts among growers, handlers and buyers are also used to reduce the risk of price fluctuations. Such contracts specify prices and quantities that do not vary through years of high and low industry production.

Growers may wish to reduce their risk by diversifying their crops and thereby reduce their reliance on any one crop. Some tree fruits that may combine well with tart cherries are sweet cherries, apples, plums, pears and peaches.

Better use of storage also reduces risk. Growers determine the amount that should be stored in unregulated markets by balancing the cost of storage during periods of low prices against the probability of receiving higher prices at a later date. When storage is an option for growers and handlers,

price fluctuations within those time periods present less of a financial risk to growers. Since the vast majority of tart cherries are processed and a large share of the crop is sold in frozen form, unregulated storage offers more potential for stabilizing supply in the tart cherry industry than in most other agricultural industries.

E. The Costs of Volume Controls Outweigh The Benefits

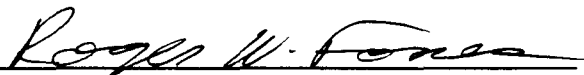
Evaluating the overall effect of volume controls on society requires a balancing of the costs of reduced tart cherry consumption and resource misallocation against any benefits of increased supply due to a program to stabilize prices. Here the evidence strongly suggests that the order proposed by the Cherry Marketing Institute would not stabilize prices or increase long term producer income. Instead, the same instability and competitive producer returns that exists today would occur under the proposed order, but at significantly higher consumer prices. However, even if the proposed order would stabilize prices, the costs described above are great, and there exist many free market alternatives that provide the same benefits of price stabilization without the high costs and market misallocations associated with the proposed order.

CONCLUSION

For the reasons stated above, the marketing order proposed by the Cherry Marketing Institute or any other marketing order designed to impose volume controls on tart cherry handlers would not effectuate the purposes of the Agricultural Marketing Agreement Act. The Secretary should therefore reject without hearing all such marketing order proposals, and terminate the proceeding.

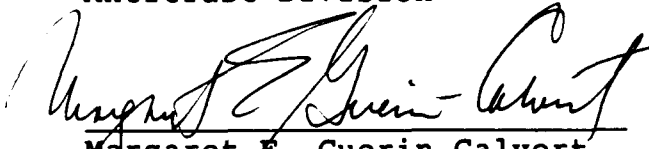
Respectfully submitted

Anne K. Bingaman
Assistant Attorney General
Antitrust Division


Roger W. Fones
Acting Chief

Robert E. Litan
Deputy Assistant Attorney
General
Antitrust Division


Theodore R. Bolema
Attorney
Transportation, Energy &
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Washington, D.C. 20001
(202) 307-6627


Margaret E. Guerin-Calvert
Assistant Chief
Economic Regulatory Section
Antitrust Division

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