

From: "John H Vetne" <johnvetne@comcast.net>  
To: agriculturalworkshops@usdoj.gov  
Sent: Monday, January 4, 2010 2:49:42 AM GMT -05:00 US/Canada Eastern  
Subject: Agriculture and Antitrust Enforcement Issues in the 21st Century

Attached are comments and suggested areas of inquiry for the Ag antitrust workshop on dairy

John H. Vetne  
Attorney at Law  
11 Red Sox Lane  
Raymond, NH 03077  
Ph: 603-895-4849

---

**From:** John H Vetne [mailto:johnvetne@comcast.net]  
**Sent:** Tuesday, January 05, 2010 7:46 PM  
**To:** ATR-Agricultural Workshops  
**Subject:** Re: Agriculture and Antitrust Enforcement Issues in the 21st Century - comments resubmitted in MS Word

I reviewed instructions on the ATR workshop webpage, and noticed that .pdf only format will not be accepted. Although last week-end I submitted comments in text-based, word-searchable pdf format (the only format accepted by federal courts), I am sending the previously-transmitted one-document submission as 4 documents in Word (2010) . Please contact me if you have any questions.

John H. Vetne  
Attorney at Law  
11 Red Sox Lane  
Raymond, NH 03077  
Ph: 603-895-4849

ANTITRUST DIVISION  
UNITED STATES DEPARTMENT OF JUSTICE

---

Proposed Hearings and Public Comment on   Agriculture and Antitrust Enforcement   Issues in Our 21 <sup>st</sup> Century Economy	74 Fed. Reg. 43725 (Aug. 27, 2009)
--	------------------------------------

To: Legal Policy Section,  
Antitrust Division, U.S. Department of  
Justice, 450 5th Street, NW., Suite  
11700, Washington, DC 20001.

COMMENTS AND SUGGESTED INQUIRY CONCERNING  
THE EFFECT OF USDA-AMS MARKETING ORDER PROGRAMS  
ON THE DEVELOPMENT AND MAINTENANCE OF MONOPSONY,  
MARKET FORECLOSURE AND MONOPOLY POWER

By John H. Vetne<sup>1</sup>

<u>Contents:</u>	<u>Page</u>
Introduction	3
The Unique Opportunities in Marketing Order Rules for Anticompetitive Conduct	5
Milk Pooling Rules in Marketing Orders and Their Anticompetitive Abuse	8
What Can or Should the Antitrust Division and Undersecretary of Agriculture Do?	13

---

<sup>1</sup> The undersigned, John H. Vetne, has focused 36 years of law practice on agricultural law issues, primarily economic regulation of the dairy industry through state and federal marketing order programs, including seven years in the Office of the General Counsel, USDA, and 29 years of private practice in Washington, D.C. and New England.

*The [federal milk] order system... creates incentives as well as opportunities for cooperatives to extend and maintain cartelization of the dairy industry. \*\*\*\* Thus, it is particularly important to understand the incentives and means provided cooperatives by the order system to achieve and protect a larger share of the market.*

Dept. of Justice, Antitrust Div., *Milk Marketing* (1977)

### *Prologue*

A.D. 1949

“‘[F]ull supply contracts’, however legal they may be in other circumstances... are illegal when made for the purpose of eliminating and suppressing competition.\*\*\* [A] combination of producers and distributors to eliminate competition and fix prices at successive stages in the marketing of an agricultural product is not privileged.”

*United States v. Md. & Va. Milk Producers Ass’n*, 179 F.2d 426, 429 (D.C. Cir.), *cert. den.* 338, U.S. 831 (1949)

A.D. 1962

Marketing Order regulations “harbor possibilities for abuse... if they become the means by which certain ‘insiders’ can gain or maintain an unduly favorable position as against other producers or handlers....”

Federal Milk Order Study Committee, Report to the Secretary of Agriculture (Edwin Nourse, Chair).

A.D. 1977

“Dairy cooperatives are more prone to use market orders for predatory purposes and in exclusionary fashion in areas where they have a large market share....” “Pool loading is a predatory practice without parallel outside of the dairy industry: it can only occur within the framework of the federal order system.”

Department of Justice, Antitrust Div., *Milk Marketing*, Report to the Task Group on Antitrust Immunities.

A.D. 2005

The current USDA Marketing Order “system both insulates exclusionary and exploitative conduct from appropriate antitrust review and imposes significant costs on consumers....”

Peter C. Carstensen, Young-Bascom Professor of Law  
University of Wisconsin Law School, Presentation to the  
Antitrust Modernization Commission

A.D. 1611

“What’s past is prologue.”

William Shakespeare, *The Tempest*, Act 2, scene 1

## Introduction

DOJ's Antitrust Division, and USDA's Undersecretary for Marketing and Regulatory Programs, have announced that a joint inquiry will be conducted during 2010 concerning antitrust policy and enforcement in Agriculture. This inquiry is long-overdue, as is government action to curtail certain anticompetitive conduct.

These comments will focus on the desirability of inquiry into the continued use and abuse of AMS marketing order regulations as tools for dominant industry players to gain and maintain market share at the expense of competitors, to foreclose market access to competitors, and to enhance prices at the expense of consumers. As explained below, it is also suggested that: (1) the Antitrust Division restore and enhance its former role of review and comment on proposed AMS marketing order rules for anticompetitive or anti-consumer impact; (2) USDA's Office of the Secretary, by the Undersecretary for Marketing and Regulatory Programs, restore its pre-2001 role as final decision-maker of marketing order regulations that have been recommended for constituent stakeholders by subordinates in AMS; (3) USDA's Office of Chief Economist take a more active role in providing advice to the Undersecretary by independent review of marketing order decisions and policies, with particular attention to anti-competitive consequences, and to impact on consumer prices and on consumer choices, that may result from AMS staff recommendations; and (4) the Antitrust Division take a new look at supply and pricing agreements between cooperative cartels and dominant milk processors, within the context of newly-restricted market access rules, for evidence of efforts to curtail competing suppliers or distributors by design or effect.

For purposes of these comments, it is presumed that the Antitrust Division is familiar with the literature and history of anticompetitive practices of agricultural concerns operating under marketing orders. The most comprehensive study of marketing orders, competition, predatory practices, antitrust enforcement policy, and litigation was published for the Gerald Ford Administration by the Antitrust Division three decades ago – *Milk Marketing: A Report of the U.S. Department of*

Justice to the Task Group on Antitrust Immunities (“DOJ Milk Marketing”) – but its analysis is still timely. The DOJ Report was cited in *Minnesota Milk Producers Association v. Glickman*, 153 F.3d 632, 647 (8th Cir. 1998) (Judge Loken, concurring), and is recommended as a primer for all government policy-makers engaged in this antitrust review process. Other literature addressing marketing orders and the types of anticompetitive activity that may be fostered by market order regulation are listed, in part, in the attached bibliography.<sup>2</sup>

It is also anticipated that the Office of the Undersecretary of Agriculture will use this opportunity to draw from Antitrust Division resources, to review regulatory activities of AMS during the past decade for potential anticompetitive consequences of marketing order rules and practices, and to enlist the independent perspective of the Office of the Chief Economist. A retrospective review is arguably essential, since regular review of marketing order decisions and policies at an agency level higher than the Administrator, AMS, was largely abandoned in 2001. For more than a half-century prior to 2001, final marketing order decisions were issued (and presumably reviewed) by the Assistant Secretary or Undersecretary who had supervisory responsibilities over AMS, while the AMS Administrator issued recommended decisions prepared by Dairy Programs staff. This pre-2001 procedure was consistent with the allocation of decision-making functions in agency Rules of Practice and the APA. Since 2001, the AMS Administrator has undertaken to review and finalize his or her own recommended decisions without any apparent or visible oversight by the Secretary’s office. (22) 9-29-05 Letter-Request to Secretary Johanns.

---

<sup>2</sup> References to bibliography publications will be made by number assigned to the publication in the bibliography. “(1)”, for example, is a reference to the 1977 DOJ Milk Marketing report. Most of the bibliography publications, in turn, contain a comprehensive bibliography of additional authorities and resources. These comments focus on milk marketing orders and antitrust issues, but some of the publications in the bibliography also address anticompetitive consequences or public welfare costs of AMS fruit and vegetable marketing orders. *E.g.*, Antitrust Div. (3) through (6), Anderson (7) and Gattuso (13).

## *The Unique Opportunities in Marketing Order Rules for Anticompetitive Conduct*

Marketing Orders are the product of New Deal efforts to stabilize agricultural markets and stem destructive competition during the Great Depression.<sup>3</sup> Marketing Order regulation is funded by the regulated industry and authorized only if producers (farmers and cooperatives), the regulatory beneficiaries, consent to USDA regulation of handlers. 7 U.S.C. §608c(8) and (9). Since producer cooperatives may bloc vote approval or disapproval of marketing orders, dominant cooperatives have great influence on the content of marketing order regulations and on the continued existence of civil service jobs that support marketing order programs. As explained in the 1977 DOJ Milk Marketing Report (at 332):

With one-third representation [in a designated marketing or production area], a cooperative has an absolute veto over the issuance or amendment of a marketing order.... With one-half representation, a cooperative can unilaterally vote out an order. With two-thirds representation, a cooperative can control the issuance and terms of an order. This control is subject to the veto of the Secretary of Agriculture. The cooperatives with over two-thirds are nonetheless in extremely strong bargaining positions insofar as influencing the final provisions in an order.

The unique power of producer cooperatives over marketing order program purse strings reinforces the need for vigilant oversight, and independent review, of regulatory policies and rules recommended by AMS for its agricultural constituents where rules changes are made by initiative and request of the constituents.<sup>4</sup>

---

<sup>3</sup> See: *Zuber v Allen*, 396 U.S. 168 (1969); *Nebbia v New York*, 291 U.S. 502 (1934). With gilded pen, Judge Frank explained in *Queensboro Farms Prods. v. Wickard*, 137 F.2d 969, 974-75 (2d Cir.1943), that “the ‘milk problem’ is exquisitely complicated. The city-dweller or poet who regards the cow as a symbol of bucolic serenity is indeed naive. From the udders of that placid animal flows a bland liquid indispensable to human health but often provoking as much human strife and nastiness as strong alcoholic beverages....”

<sup>4</sup> Whether participation in marketing order decision-making by AMS employees whose jobs may be on the line if cooperatives are dissatisfied with the result represents a conflict of interest has been addressed to the Secretary and federal courts, but not resolved. See 5-16-06 letter-request for disqualification, <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELPRDC5057323>, and *White Eagle Cooperative v Conner*, 533 F.3d 467, 475-77 (7<sup>th</sup> Cir. 2009). For purposes of these comments, the existence of potential personal or professional incentives by AMS employees to accommodate desires of constituent cooperatives in marketing order rules is raised only to emphasize the importance of oversight and independent review of AMS marketing order recommendations that may adversely affect competition in or access to the regulated market.

Milk Marketing Orders, by design, provide for price discrimination. Rather than allow the market freely to set competitive milk prices, USDA fixes monthly minimum milk prices, by economic formulas, based on how milk is used by price classification. Milk used for manufactured products (Class III or IV) ordinarily has the lowest price, and a differential is added to the manufacturing milk value for Class I milk in beverage use, with geographic or location variables. Revenues from these uses are pooled, so that dairy farmers (producers) receive an average (blend or pool) price based on all uses of milk in the market. (19) USDA Report to Congress, 2004, at 36 – 42; (24) Vetne, Federal Marketing Order Programs, 1 *Agricultural Law* 116 – 132. The result of price discrimination is that milk used in manufactured products is somewhat cheaper than it would be if it was procured in unregulated competition with fluid milk processors, and fluid (Class I) milk is somewhat more expensive than it would be without regulation. (19), *supra*.

Regulated classified price discrimination alone, however, is not the primary cause of concern for antitrust policy and enforcement inquiry. Rather, the source of historical predation and potential abuse lies in rules that define how pooled revenues are distributed among producers, and which producers have access to the regulated markets and pooled revenues. These pooling rules and standards, which are purportedly designed to protect regulated price discrimination benefits for producers, are addressed at length in the 1977 DOJ Milk Marketing Report and in antitrust litigation during the same period of time.<sup>5</sup> In short, marketing order rules may be exploited by dominant producers and processors to reduce revenue to competitors or to increase competitor costs. A notorious means employed by cooperatives to reduce the revenue of competing producers in the 1970s, by abuse of marketing order rules, was “pool loading” – assignment of low-value diverted Class

---

<sup>5</sup> *Alexander v. NFO*, 687 F.2d 1173 (8<sup>th</sup> Cir. 1982); *In re Midwest Milk Monopolization Litigation* (JPDML/M.D. Mo 1974 – 1979), 379 F.Supp. 989, 380 F.Supp. 880, 386 F.Supp. 1401, 398 F.Supp. 676, 405 F.Supp. 118, 435 F.Supp. 930, 441 F.Supp. 930. As a result of this litigation, DOJ achieved consent decrees against three cooperatives, Dairymen, Inc., Mid-America Dairymen, and AMPI, specifically limiting cooperative conduct under federal milk marketing order rules. *E.g.*, *United States v. Associated Milk Producers*, 394 F.Supp. 29, 49 (W.D. Mo. 1975), *aff'd* 534 F.2d. 113 (8<sup>th</sup> Cir. 1979). These cooperatives merged twenty years later to create Dairy Farmers of America.

III milk to the revenue pool of a target market, thereby artificially depressing producer prices in the target market and artificially enhancing producer prices in the protected market. DOJ Report at 308. The DOJ Report (at 292, 294, 333) concluded that...

The [federal milk] order system, particularly those features which protect high price levels, creates incentives as well as opportunities for cooperatives to extend and maintain cartelization of the dairy industry.

\* \* \* \*

Dairy cooperatives are more prone to use market orders for predatory purposes and in exclusionary fashion in areas where they have a large market share and face competition mostly from independent farmers, small local cooperatives, or regional cooperatives without a substantial share in any one market.... Thus, it is particularly important to understand the incentives and means provided cooperatives by the order system to achieve and protect a larger share of the market.

\* \* \* \*

The most fertile ground for tailoring order provisions to the cooperative's needs, other than the diversion provisions discussed above, is in the area of pool plant qualification

Before the anticompetitive abuse of the 1970s, the 1962 Nourse Report (21) cautioned USDA about the potential for marketing orders to foster anticompetitive behavior or anticompetitive results, and to unduly enhance Class I (consumer fluid milk) prices. The Report recommended:

- The Secretary take an active role, in the public interest, to monitor and remove “exclusionary devices” from order rules by “friendly persuasion,” order amendment, or suspension of marketing order rules. (Nourse Report at III-27).
- The Secretary “circumscribe... restrictions on the free market movement of milk” where pooling provisions and other rules “become the means by which certain ‘insiders’ can gain or maintain an unduly favorable position as against other producers or handlers qualified and desiring to enter the Class I market or to shift between regulated markets.” *Id.* III-28.
- “[T]he Secretary must exercise care to avoid short-run partisan positions in the interests of fluid milk producers as may run counter to other dairy interests or the general economy.” *Id.*, III-31.
- If Class I prices are maintained above USDA-established levels (“premiums or “over-order prices”), the Secretary should “review the level of Class I prices and any limitations on free access to the market. If, thereafter, such

premiums still persist consideration should be given to suspension of the pricing and pooling provisions of the order.” *Id.*, III-26 (emphasis supplied).

Notwithstanding the counsel of the Nourse Report in 1962, and antitrust experience of the 1970’s revealing predatory abuse of marketing order rules, the first decade of the 21<sup>st</sup> Century has revealed resurgent exploitation of USDA marketing orders by dominant dairy cooperatives and milk handlers to gain and maintain market share by limiting or foreclosing market access, or to increase marketing costs, of competitors. These activities have been aggravated or facilitated by lax antitrust enforcement, inattention of agency heads to actions of subordinates, lax attention to anticompetitive consequences of agency rules, rapid consolidation of cooperative and handler segments of the dairy industry, and consolidation of marketing order regions in which the emergent goliaths may more effectively exercise (and abuse) their greater economic and political power.

*Milk Pooling Rules in Marketing Orders and Their Anticompetitive Abuse*

The 1977 DOJ *Milk Marketing* report identified various marketing order pooling rules as “fertile ground” for anticompetitive exploitation. Some readers of these comments may perceive, as did Judge Posner of the 7<sup>th</sup> Circuit, that the vocabulary of milk order regulation is simply “gobbledygook.” *Alto Dairy v. Veneman*, 336 F.3d 560, 570 (7<sup>th</sup> Cir. 2003). Even with eventual understanding, the reader may concur with Chief Judge Bauer in *County Line Cheese Co. v. Lyng*, 823 F.2d 1127 (7<sup>th</sup> Cir. 1987) (concurring opinion), that some milk pooling rules represent “a marvelous example of government nuttiness” and a “weird piece of human behavior.”

The word “pool” has several meanings in marketing order jargon. As a noun, it means the total of minimum price revenue from handlers that are blended to create an average pooled price for distribution to producers. As an adjective applied to “pool handler” it is synonymous with “regulated,” but as applied to “pool producer” it means a farmer participant eligible to receive the blended price. As a verb, “to pool” means undertaking activities under regulations by which a producer

becomes an eligible participant in blend price revenues, or a plant becomes regulated. “Pressure pooling,” as used in the 1977 DOJ *Milk Marketing* report, means activities of dominant cooperatives, by exploitation of USDA pooling rules, to adversely affect (reduce) the revenue received by competing milk suppliers so that competitors are either eliminated from the market or forced to market milk through the dominant cooperative.

Congress designed marketwide pooling of milk revenues in the 1930’s to eliminate cutthroat competition among producers for lucrative fluid (Class I) milk sales. By pooling all milk revenues in all uses, producers of milk sold to plants for manufactured product use (cheese, butter, milk powder), could share in the greater revenues of milk sold to fluid milk processors and receive the same blend price as dairy farmers that supply fluid milk plants.<sup>6</sup> Not surprisingly, during the succeeding seven decades, producers supplying fluid plants have made efforts to minimize or avoid revenue sharing with producers supplying manufacturing plants by restricting access to pool participation.

During the last half of the 20<sup>th</sup> Century, most U.S. dairy farmers converted their operations to produce “Grade A” rather than manufacturing grade milk. “Grade A” status was necessary to supply fluid milk plants, and to participate in milk order pooling benefits. Much of the new Grade A production was not needed for fluid use, so it was shipped to manufacturing plants for use in lower-valued Class III products. USDA’s milk order policy makers responded to this additional production by allowing producers who stood ready, willing and able to supply milk for fluid (Class I) milk to participate in federal order blend price revenues, even if their milk was not needed for fluid use.<sup>7</sup>

---

<sup>6</sup> *Zuber v Allen*, 396 U.S. 168, 173 (1969); *Nebbia v. People of the State of New York*, 291 U.S. 502, 517-18 (1934).

<sup>7</sup> The relationship between USDA and milk producers in this process is akin to that of trustee and trust beneficiary. *Stark v. Wickard*, 321 U.S. 288, 305-06 (1944).

During decades leading up to the 1996 Farm Bill, USDA had progressively liberalized federal milk order “pooling provisions,” including producer milk “diversion limits” – rules that fix standards for eligibility of dairy farmers’ surplus milk production to share in the blend price generated by price regulation of handlers. This trend of regulatory history and policy was described by an expert dairy economist to the responsible House Agriculture Subcommittee: “... the strict rules which determined whose milk got pooled on which market when the system was in its infancy have long since given way to a de facto practice of allowing any farmer to get his milk pooled in one place or another through one means or another.”<sup>8</sup> Consistent with this historical trend and policy, the pooling standards resulting from the five-year reform effort were fairly inclusive. 64 Fed. Reg. 16026, 16130 (April 2, 1999) (“producers [in federal milk orders] are dairy farmers that supply the market with milk for fluid use or who are at least capable of doing so if necessary.”).

About the time that Federal Order reform rules were implemented in 2000, DFA organized Dairy Marketing Services and other regional milk supply cartels to provide a single source supply organization for milk processors. DFA and its supply affiliates also made full supply agreements with dominant processors, including a 20-year supply agreement with Dean Foods with contingent liquidated damages up

---

<sup>8</sup> Andrew M. Novakovic, Director, Cornell Program on Dairy Markets and Policy, testimony presented to the House of Representatives, Subcommittee on Livestock, Dairy, and Poultry, Committee on Agriculture (March 23 and 25, 1995). This policy is reflected in decades of USDA adjustment, suspension, and amendment of pooling standards to allow more surplus milk to be pooled when production increased, when fluid milk consumption declined, or when producers lost fluid milk markets. *E.g.*, discussion under “Market Structure and Accessibility” in 41 Fed. Reg. 12436, 12439-43 (March 25, 1976), analysis of market disorder resulting from loss of “pooling base” due to handler consolidation in 52 Fed. Reg. 27372, 27374 (July 21, 1987); 58 Fed. Reg. 33347, 33349-33362 (June 17, 1993) (discussing, and relaxing, plant and producer pooling standards for Mideast-Area markets). 59 Fed. Reg. 48557 (Sept. 22, 1994) (relaxing requirements); and 55 Fed. Reg. 35137 (Aug. 28, 1990) (increasing requirements); 53 Fed. Reg. 24296, 24308 (June 28, 1988) (Chicago Order Decision); 52 Fed. Reg. 27505, 27210-12 (July 20, 1987) (Decision, Michigan and Ohio Marketing Orders); 47 Fed. Reg. 44268, 44293 (October 7, 1982) (Southwest Plains pooling standards); 43 Fed. Reg. 12695, 12699 (March 27, 1978) (New England Order Decision).

to \$96 million payable to DFA if Dean should breach its purchase commitments.<sup>9</sup> Contemporaneously, DFA also initiated efforts to change the reform rules so as to restrict competing dairy farmers' eligibility for blend price participation. DFA, with Dean Foods' understandable assistance, urged USDA (AMS) to abandon the "ready, willing and able" standard for producer pool participation and adopt, instead, a fluid milk delivery standard for markets in which there were competing raw milk suppliers. AMS obliged.<sup>10</sup>

With few accessible market options not already under the control of DFA and its affiliated suppliers, competing producers were forced by this market foreclosure – a combination of more restrictive rules and DFA's existing supply dominance – to retreat from the target pool, or to undertake costly transportation for the sole purpose of retaining pool qualification, or yield to economic pressure and join DFA or DMS.<sup>11</sup> The new form of pressure pooling worked without antitrust enforcement consequences because, unlike pool loading by DFA predecessors in the 1970's,<sup>12</sup> AMS served as an active partner with DFA in helping to reduce competition that DFA could not accomplish with its market power and regulatory sophistication alone. An economist for Agri-Mark, a northeast cooperative competitor of DFA, observed that this was simply a continuation of...

...DFA's history of exploiting monopoly-building opportunities under USDA's Federal Milk Order market access ("pooling") rules. A prime

---

<sup>9</sup> Dean Foods Co. – DF, Form 10-Q report to the Securities and Exchange Commission, Aug. 6, 2009, <http://nyse.10kwizard.com/cgi/convert?rtf=1&ipage=6451374&num=-3&rtf=3&xml=1&dn=2&quest=1&rid=12>, at pp. 25, 41.

<sup>10</sup> In 2002: 67 Fed. Reg. 7040 (Upper Midwest), 3981 (Mideast), 69910 (Central). In 2005: 70 Fed. Reg. 4932 (Northeast), 43335 (Central). In 2006: 71 Fed. Reg. 54152 (Central). AMS also recommended new pooling restrictions for the Western market, 68 Fed. Reg. 49375 (2003), but these were not nearly as restrictive as DFA had requested, so the order was terminated upon DFA's disapproval. 69 Fed. Reg. 8327 (2004). No pooling amendments were made in or proposed for the Southwest marketing order, where the DFA-dominated Greater Southwest Agency ("GSA") already controlled virtually all of the milk supply.

<sup>11</sup> Bibliography: (11) Cotterill, *Vertical Foreclosure*; (18) Miyakawa, *Competitive Issues*. Wellington, Testimony prepared for the United States Senate Judiciary Committee (July 23, 2003), Exhibit 3 to Cotterill, *Vertical Foreclosure* (pdf pages 27 - 32).

<sup>12</sup> In 1971, USDA acted affirmatively to curtail pressure pooling by cooperatives who then dominated relatively small milk markets. 36 Fed. Reg. 10776 (1971).

example of this exploitation can be seen in the regulatory “reform” of Milk Order rules and USDA’s receptiveness to new regulatory limits on market access, limits fashioned and proposed by DFA, the largest cooperative constituent of USDA programs.<sup>13</sup>

Discussing the proposed NDH/Hood merger in 2002, including a proposed replacement of DFA rather than Agri-Mark as the supplier of Hood plants, an American Antitrust Institute White Paper explained:

Under the Classified Pricing System, this would cause serious harm to Agri-Mark member farmers, namely denial of access to a regulated federal market order pool, because Agri-Mark might not be able to sell enough of its members’ milk to Class 1 fluid milk plants if it would lose Hood as its customer. In that case, Agri-Mark members would receive only the lower cheese and butter prices rather than the higher Class 1 price for part of their milk sales. As a result, if the merger had been consummated as planned, Agri-Mark members would have been compelled either to sell Class 1 milk at more distant plants in an attempt to stay in the pool or to join DFA/DMS.<sup>14</sup>

Agri-Mark was eventually able to retain its supply to Hood, and thereby keep its farmer-members pooled and eligible for the milk order blend price.

St. Alban’s Cooperative had a similar experience, with less favorable results. In 2000, the Stop and Shop supermarket chain in New England decided to accept an offer from Suiza (now Dean Foods) to supply packaged milk to their stores, and to close the milk bottling plant that Stop and Shop operated. The problem for St. Albans was that it had a long-term supply contract with Stop and Shop, which represented one-third of St. Alban’s milk supply and its primary access to the fluid milk market. Without a fluid market access, St. Albans would not be eligible for pooling or able to pay its members the average “blend” price under the federal milk

---

<sup>13</sup> Wellington, Testimony, *supra* n. 12, at 4 (*Veritcal Foreclosure* pdf page 30).

<sup>14</sup> (18) Miyakawa, *Competitive Issues in the Dairy Industry* at 13. The price received by Agri-Mark members without loss of pool eligibility would not have been the Class 1 price, as stated by Miyakawa, but rather the pooled blend price. This would have harmed Agri-Mark by an estimated \$50 million per year, or \$30,000 per farmer-member. Wellington, *supra*, at 2. For further discussion on how loss of a little access to distributing plant markets will serve to make a much greater volume of farm milk ineligible for pooled blend prices, see letter of Feb. 23, 2005, “re Milk Marketing – pressure pooling 2000’s-style,” from John Vetne to Allee Ramadhan and Joan Huggler, Antitrust Div., USDOJ, attached to these comments.

order program. Some temporary relief was provided by vigorous antitrust enforcement activity by the New England Attorneys General, led by Vermont Attorney General William Sorrell. In early 2003, however, St. Albans joined DMS/DFA because its only access to the fluid market was to Dean Foods, and Dean Foods could only be served through DFA.

Whether market foreclosure results from exclusion by more restrictive agency pooling rules or from cooperative supply agreements with fluid milk plants, or a combination, the results are the same. The competitor receives a lower price for ineligible milk, or is required to incur greater costs to retain some eligibility by marketing milk to distant independent plants (if any remain), or is pressured to pay for the privilege of pooling through DFA, or to join DFA and its supply allies.<sup>15</sup>

*What Can or Should the Antitrust Division and Undersecretary of Agriculture Do?*

For antitrust enforcement purposes, predatory and anticompetitive practices undertaken by cooperatives within the structure of USDA/AMS marketing orders, and marketing order promulgation, present obvious difficulties – *i.e.*, Capper-Volstead Act, Noerr-Pennington doctrine, AMAA Section 608b. However, to protect the welfare of independent producers, small cooperatives, small handlers and consumers that have most to lose from the abuse of market power within regulated markets, the experience of the Midwest Milk Monopolization litigation in the 1970s, and guidance from DOJ's *Milk Marketing* Report, still provide some useful tools for the Antitrust Division. Should the Undersecretary of Agriculture take an interest in the problem, the Nourse Report to the Secretary of Agriculture in 1962 continues to provide timely solutions, as do regulatory decisions of prior administrations that squarely confronted competitive difficulties of market structure and market accessibility (fn. 8, *supra*).

---

<sup>15</sup> Illustrations of pay-to-play, to overcome pooling impediments or to abuse pooling opportunities, were revealed in many of the AMS milk order pooling hearings between 2001 – 2006. Carl Rasch of Michigan Milk Producers testified about diminishing market access due to DFA's supply agreements, but expressed willingness to live with more restrictive pooling if other market participants offered access without pooling fees. Transcript of hearing, March 8, 2005 pp. 566 – 67, 71, Docket AO-166-A72 <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELDEV3098375>

The Antitrust Division should more closely examine full supply and restricted supply agreements between dominant cooperatives and milk processors, and the circumstances in which such agreements arise. (9), (11), (16)-(20). Full supply agreements do not enjoy any immunity from antitrust enforcement. *E.g., United States v. Md. & Va. Milk Producers Ass'n*, 179 F.2d 426, 429 (D.C. Cir.), *cert. den.* 338, U.S. 831 (1949). While such agreements may be benign, experience has shown that they are more likely to have predatory purpose and effective anti-competitive result in a regulated milk order environment. If USDA continues its policies of the last decade for restrictive pool access regardless of whether there is a need for fluid milk deliveries, antitrust attention to milk supply arrangements and methods used for market expansion by dominant milk distributors is even more imperative.<sup>16</sup>

As a neutral guardian of the public welfare, the Antitrust Division provided competitive analysis on proposed marketing order rules on several occasions during the 1990s even where proposed restraint of competition was immune from, or did not constitute violations of, antitrust laws. (2) – (6). This, I believe, was very useful in providing neutral perspective to USDA policy makers, and in keeping occasional parochial impulses in check. The Antitrust Division should restore this function. At a minimum, this function will help remind USDA of its public interest obligation to “estimate the scope and appraise the effects of the curtailment of competition which will result from” economic regulation. *MacLean Trucking Co. v. United States*, 321 U.S. 67, 87 (1944); *United States v. Federal Communications Commission*, 652 F.2d 72, 87-88 (D.C. Cir. 1980) (en banc).

More effective controls of anticompetitive conduct in regulated markets, without restraints of antitrust enforcement immunities, are available to the Undersecretary of Agriculture. The Office of the Undersecretary of Agriculture for

---

<sup>16</sup> During the course of a USDA milk hearing in Cincinnati in June 2009, proffered evidence revealed that Dean Foods had paid a large advance to a New Mexico chain store customer in order to secure an exclusive supply of milk products (not just shelf space) to the store, and eliminate that market for a small, independent competitor. DFA also benefitted from this transaction by gaining Class I market share for its member milk. If Dean’s acquisition of this account was financed by competitive credits from DFA or GSA, no party would enjoy immunity from antitrust enforcement.

Marketing and Regulatory Programs is also, unfortunately, a place where political pressure or perceived constituent obligations may most strongly counsel do nothing, or look the other way. That may be what occurred during 2001 to 2009.

A major improvement in anticompetitive oversight by the Undersecretary would be achieved by a return to the pre-2001 practice of providing substantive review of recommendations made by the AMS Administrator and Dairy Programs staff, and issuing final marketing order decisions for the Secretary, as provided by Rules of Practice, 7 C.F.R. §§900.12 – 900.13a. At a minimum, the appearance of higher level oversight of activities by AMS subordinates would enhance public confidence in the decision-making process. Substantive oversight may also reveal that some pre-2001 milk pooling policies of USDA in prior administrations, which promoted producer inclusion rather than exclusion, may be the best way to curtail anti-competitive conduct in regulated markets during the 21<sup>st</sup> Century.

The Undersecretary is also one of three USDA officials that comprise the Capper-Volstead Act Committee (“CVAC”) whose duties include monitoring activities of cooperative associations for “monopolization or restraint of trade.” 7 C.F.R. §2.22.(a)(9). The other members are the General Counsel and the Chief Economist, who serves as chair of the committee. *Id.* §§2.29(a)(9) and 2.31(n). The CVAC has been inactive for many decades, but large agricultural cooperatives have not been inactive in efforts to monopolize or restrain trade. Although the CVAC includes one member who is charged to be the architect of marketing order rules (the Undersecretary),<sup>17</sup> and another member who is charged with defending marketing order rules (the General Counsel), the Chief Economist is charged with providing independent analysis of USDA programs. It would be useful for the architect and defender of marketing orders to at least consult with the Chief

---

<sup>17</sup> There is clearly some tension in marketing order and Capper-Volstead functions which the Undersecretary must balance. Additional tension with marketing order activities that tend to deny farmers a right to market agricultural products as members of the cooperative of their choice, or independently, is found in the Agricultural Fair Practices Act, 7 U.S.C. §2301 et seq., for which the Undersecretary is also responsible. 7 C.F.R. §2.22(a)(1)(viii)(Q).

Economist where genuine public concerns are raised during rulemaking proceedings that cooperative behavior in the regulated market monopolizes or restrains trade.

I look forward to reviewing comments and responses of other interested persons, and stand ready to provide additional information and views that the Antitrust Division or Undersecretary may request.

Respectfully submitted,

John H. Vetne, Esq.  
Attorney at Law  
11 Red Sox Lane  
Raymond, NH 03077  
603-895-4849  
[johnvetne@comcast.net](mailto:johnvetne@comcast.net)

Antitrust Division, U.S. Department of Justice:

- 1 *Milk Marketing: A Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities* (January 1977)
- 2 Comments of the Department of Justice on Milk Marketing Orders National Hearing, May 1990 <http://www.justice.gov/atr/public/comments/200599.htm>; Reply Brief May '91 <http://www.justice.gov/atr/public/comments/200631.htm> *see also* <http://www.justice.gov/atr/public/comments/200629.wpd> (memorandum on efforts by USDA to marginalize DOJ's participation in the proceeding).
- 3 Comments of the Department of Justice on proposed Hops Marketing Order regulations (Feb. 2004) <http://www.justice.gov/atr/public/comments/202477.pdf>
- 4 Comments of the Department of Justice on proposed Citrus Marketing Order regulations (Oct. 1990) <http://www.justice.gov/atr/public/comments/200602.htm>
- 5 Comments of the U.S. Department of Justice on proposed Cherry Marketing Order regulations (Nov. 1993) <http://www.justice.gov/atr/public/comments/200660.htm>
- 6 Comments of the Department of Justice on proposed Grapefruit Marketing Order regulations (Sep. 1994) <http://www.justice.gov/atr/public/comments/200662.htm>
- 7 Anderson, James E., *Agricultural Marketing Orders and the Process and Politics of Self-Regulation*, Policy Studies Review; Nov. 1982, Vol. 2 Issue 2, pp 97-111, <http://connection.ebscohost.com/content/article/1040542225.html?jsessionid=84B3DC5054BCBBDA8DE87C35B6A82D3A.ehctc1> and <http://www3.interscience.wiley.com/journal/119567255/abstract?CRETRY=1&SRETRY=0>
- 8 Balagtas, Joseph V. and Daniel A. Sumner, *Dissipation of Regulatory Rents: How Milk Marketing Orders Made Milk Producers Worse Off* (Revised: August 18, 2005) <http://www.ncsu.edu/project/arepublication/milkrents.pdf>
- 9 Carstensen, Peter C., *Buying Power and Merger Analysis—The Need for Different Metrics*, Statement prepared for and presented at the Workshop on Merger Enforcement held by the Antitrust Division of the Federal Trade Commission (Feb. 2004) [www.usdoj.gov/atr/public/workshops/docs/202606.htm](http://www.usdoj.gov/atr/public/workshops/docs/202606.htm)
- 10 Carstensen, Peter C., *Comments To The Antitrust Modernization Commission On Statutory Immunities and Exemptions from Antitrust Law* (2005) [http://govinfo.library.unt.edu/amc/public\\_studies\\_fr28902/immunities\\_exemptions\\_pdf/050715\\_Carstensen.pdf](http://govinfo.library.unt.edu/amc/public_studies_fr28902/immunities_exemptions_pdf/050715_Carstensen.pdf)
- 11 Cotterill, Ronald W. *Vertical Foreclosure: The Impact of the Proposed Reduction in Diversion Limits on the Exercise of Market Power and the Economic Performance of Milk Marketing Channels in the Mideast Federal Milk Marketing Area* (Food Marketing Policy Center, Issue Paper, 2005), available at [http://digitalcommons.uconn.edu/cgi/viewcontent.cgi?article=1001&context=fmpc\\_ipapers](http://digitalcommons.uconn.edu/cgi/viewcontent.cgi?article=1001&context=fmpc_ipapers)

- 12 Dobson W.D., and Larry E. Salathe, *The Effects of Federal Milk Orders on the Economic Performance of U.S. Milk Markets* 61 AJAE (May 1979).
- 13 GAO, *DAIRY INDUSTRY, Information on Milk Prices, Factors Affecting Prices, and Dairy Policy Options* (GAO-05-50) <http://www.gao.gov/new.items/d0550.pdf>
- 14 GAO, *Milk Marketing Orders, Options for Change* (GAO/RCED-88-9).
- 15 Gattuso, James L. *The High Cost and Low Returns of Farm Marketing Orders* (Heritage Foundation Backgrounder #462, Oct. 1985)  
<http://www.heritage.org/research/agriculture/bg462.cfm>
- 16 Klein, Joachim and Hans Zenger, *Predatory Exclusive Dealing* (Department of Economics, University of Munich Discussion paper 2009-9), available at [http://www.univie.ac.at/RNIC/papers/Klein\\_Joachim\\_PED.pdf](http://www.univie.ac.at/RNIC/papers/Klein_Joachim_PED.pdf) and <http://epub.ub.uni-muenchen.de/10626/2/PED.pdf> .
- 17 Lungard, Paul, *Eternal Sunshine on a Spotless Policy? Exclusive Dealing under Article 82*, EC ECJ VOL. 2 (Special Edition, July 2006)  
<http://www.tilburguniversity.nl/tilec/meetings/seminars/2008/januari/eternal.pdf>
- 18 Miyakawa, H. *Competitive Issues in the Dairy Industry: The Pending DFA/NDH/Hood Transaction*, (The American Antitrust Institute, 17 February 2004)  
<http://www.antitrustinstitute.org/recent2/299.pdf>
- 19 Packalen, Mikko, *Market Share Exclusion* (American Law & Economics Association Annual Meetings Year 2007 Paper 75) available at <http://law.bepress.com/cgi/viewcontent.cgi?article=2061&context=alea> and <http://www.canlecon.org/submissions/docs/MikkoPackalen10APR2007MarketShareExclusiona.pdf>
- 20 Spector, David, *Exclusive Contracts and Demand Foreclosure* (Paris School of Economics, September, 2004) <http://www.pse.ens.fr/document/wp200707.pdf>
- 21 Rural Business Cooperative Service, USDA, *Antitrust Status of Farmer Cooperatives: The Story of the Capper-Volstead Act* (Cooperative Information Report 59, Sept 2002)  
<http://www.rurdev.usda.gov/rbs/pub/cir59.pdf>
- 22 U.S. Department of Agriculture, *Economic Effects of U.S. Dairy Policy and Alternative Approaches to Milk Pricing* (USDA Report to Congress, July 2004)  
<http://www.usda.gov/documents/NewsReleases/dairyreport1.pdf> (“USDA Dairy Policy Report 2004”)
- 23 USDA, *REPORT TO THE SECRETARY OF AGRICULTURE BY THE FEDERAL MILK ORDER STUDY COMMITTEE* (April 1962) Chaired by Dr. Edwin G. Nourse (“Nourse Report”)  
[www.cpdmp.cornell.edu/CPDMP/Pages/Publications/Pubs/Nourse.pdf](http://www.cpdmp.cornell.edu/CPDMP/Pages/Publications/Pubs/Nourse.pdf)

- 24 Vetne, John H., 9-29-05, Letter-Request to Secretary Johanns and Under Secretary Hawks for Capper-Volstead Investigation, and Review by USDA Agency Superiors of Subordinate Milk Marketing Order Recommendations, and AMS response.  
<http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELDEV3097973>
- 25 Vetne, John H., FEDERAL MARKETING ORDER PROGRAMS, in 1 *Agricultural Law* 75 - 181 (John H. Davidson ed., Shepards/McGraw-Hill 1981)

J. Vetne Comments to DOJ and USDA, Antitrust Issues 2010

ATTACHMENT

Telephone (978) 465-8987  
Fax (978) 465-8987  
Cell (978) 618-8192  
jvetne@justice.com

February 23, 2005

Allee Ramadhan, Esq.  
Joan Huggler, Esq.  
US Dept of Justice  
Via email only

Re: Milk Marketing – pressure pooling 2000’s-style

Dear Attorneys Ramadhan and Huggler:

This follows up my email and phone conversation last month with attorney Huggler concerning DFA predatory practices in the post-“reform” era of federal milk marketing orders. My hope is that DOJ will take a more active role in seeking to mitigate anti-competitive rules under consideration by USDA, or anti-competitive practices of DFA in USDA’s federal milk order system.

In the 1960's and 1970's, cooperative predecessors of DFA (Mid-America Dairymen; Dairymen, Inc., and Associated Milk Producers (southern)), engaged in a number of predatory practices to gain market share, gain membership, destroy competitors, and coerce dairy farmers to join their coops. This was during a time of more aggressive anti-trust activity by the Dept of Justice, and DOJ brought antitrust complaints leading to consent decrees that still apply, in part, to DFA conduct. These cases are reported in federal case law as "In re Midwest Milk Monopolization Litigation." A private antitrust case called Alexander v NFO eventually resulted in a large judgment for NFO against AMPI and Mid-AM.

The DOJ published a treatise on these activities called "Milk Marketing, A Report of the US Dept of Justice to the Task Group on Antitrust Immunities" (Jan. 1977).

Many of the predatory activities of DFA predecessors discussed in litigation, and in the DOJ Report at pp. 293-393, are unique to and depend upon USDA's federal marketing order program.

One of these practices was called "pool loading" or "pressure pooling," undertaken by market predators to lower milk prices for competitors and non-member dairy farmers." The DOJ report at page 308 said: "Pool loading is a predatory practice without parallel outside of the dairy industry: it can only occur within the framework of the federal order system. In simple terms, pool loading is a conscious effort to lower the blend price in a market order region."

The dairy regulators in USDA eventually responded to these activities by suspending rules that made pool loading possible. 36 Fed .Reg. 10776 (1971).

Today there is no one left in USDA's Dairy Programs that has personal memory of these events.

DFA is a bit less transparent in its current efforts to use the federal milk order program to secure market share and coerce competitors, but its current efforts are more effective.

What can be more effective than a low blend price to competitors resulting from DFA predecessors' pressure pooling? Well, today it is NO blend price at all, resulting from DFA's influence over pooling rules adopted by USDA's Dairy Programs, or a blend price received by DFA competitors only at great cost, unnecessary handling of milk, and wasteful transportation.

DFA's consistent objective at federal milk order rule amendment hearings in the past 4 years is to "reduce the volume of milk that is pooled or may be pooled in the future." In effect, this means "other peoples' milk," because DFA would not be adversely affected by the rule changes it has proposed, nor would it be adversely affected if its competitors throw in the towel and join DFA.

Last summer USDA proposed rules for the federal Western Milk Marketing Order that, for the first time in the history of the federal order program, was intentionally designed to exclude from the regulated market milk production of local dairy farmers whose milk was ready, willing and able to supply the fluid (Class I) market. The milk was not needed, however, because DFA had a virtual lock on market share to Class I milk plants. USDA did not go far enough to exclude its competitors' milk, however, so DFA voted against the rules and the federal milk order for the Western Market was terminated (see attachment).

During 2001-03, DFA and its marketing allies proposed changes in a number of federal milk orders to tighten "pool performance" (i.e., market access). USDA agreed, and made market access rules more restrictive. Wisconsin producers were forced to withdraw from the Central and Mideast markets. Their share of the Central market shrunk from about 450 million pounds per month to about 230 million. Their share of the Mideast market shrunk from about 400 million pounds per month to 300 million. These hearings represented the first stage of a strategy to use USDA to incrementally shrink market share of DFA competitors.

In hearings last year in Minneapolis and Kansas City, and next month in Ohio, DFA and Dean Foods are embarking on the next stage. Again, the objective of the proposed rules is to reduce the volume of milk that can be pooled; again, DFA's competitors will take the hit, but DFA will not be adversely affected.

### **Here is how it works.**

Under federal milk order program regulations, dairy farmers must have a share of the milk supply to fluid milk processors in order to have access to and participate in the market's "pool" of federally administered milk revenues. This share of the fluid milk supply is a "pooling base" allowing the supplier to market additional, surplus milk for non-fluid uses and still receive the pool price on that surplus. A pooling base to milk-pooled ratio of 1:4 is usually described in regulations as a "diversion" limit of 75%, with the remaining 25% of milk delivered to distributing plants. A 1:4 pooling ratio means that for each 100 pounds of milk sold to a distributing plant, the cooperative may pool 400 pounds. It also means that when a cooperative gains market share of 100 pounds in sales to a distributing plant, it denies its competitors the opportunity to pool 300 pounds of milk in manufacturing uses.

The “blend” or “pool” price received by farmers is an average of the value of all milk in all price classifications sold in the market during the month. Processor and cooperative consolidation, along with exclusive supply contracts, have made it increasingly difficult for small cooperatives and independent dairy farmers to find or maintain a share of the milk supply to fluid milk processors and thus secure “pooling base” to allow surplus milk to share in a market’s blend price.

In many markets, DFA’s dominance of market share to distributing plants has provided little opportunity to competitors to market milk, but in DFA’s views, the opportunity is still too great. At DFA’s request, USDA adopted a number of rule amendments during 2002-03 that reduced pooling opportunities for DFA competitors.

Rule amendments are again under consideration by USDA Dairy Programs that would further reduce dairy farmers’ access to the federal order market revenue pool. As a result, milk producers that have chosen to market through smaller cooperatives, or independently, will: (1) incur disproportionate expense to participate in the federal milk order program, (2) be forced to market milk through dominate suppliers such as DFA, (3) be required to pay tribute of higher pooling fees to dominate suppliers for providing market access, or (4) be excluded from the federal order milk pools altogether.

Here is an example:

Assume a regulated market with 1 billion pounds pooled milk, and 40% of the supply delivered to distributing (milk bottling) plants. There are 20 distributing plants, ranging in size from 3 million pounds of receipts per month to 40 million pounds per month.

There are three groups of suppliers, whose milk is marketed as follows:

ONE: DFA markets 50% of the raw milk (500 million pounds), including milk of some ‘independent’ farmers through federations such as DMS (Dairy Marketing Services), which DFA controls as manager. DFA markets 275 million pounds to 10 distributing plants by supply contracts with Dean Foods and other large distributing plant handlers. DFA therefore has a 69% share of the market to distributing plants, and markets 55% of its own milk for this purpose.

TWO: Independent dairy farmers unaffiliated with DFA supply 50 million pounds of milk to the market, primarily as producer patrons of 5 independent distributing plants. Of this volume, half (25 million pounds) is delivered to distributing plants; the other half is diverted to manufacturing plants and used to balance the distributing plants’ weekly and seasonal needs. Independent dairy farmers market 50% of their milk supply for distributing plant use.

THREE: Cooperatives unaffiliated with DFA market the remaining 450 million pounds of milk on the market, and supply 5 distributing plants with the remaining 100 million pounds of distributing plant receipts. Unaffiliated cooperatives share of the total market is 45%; their share of the market supply to distributing plants is 25%, and their use of pooled milk for this purpose is 22%.

These are aggregate figures. The farmers making up this supply do not each ship 22% of their milk to distributing plants, nor do the DFA farmers each ship 55% of their milk to distributing

plants. Likewise, unaffiliated cooperatives do not ship 350 million pounds of milk from the same dairy farmers each month to manufacturing plants, nor does DFA ship 225 million pounds to manufacturing plants from one group of farmers.

1. The aggregate volume and percentage vary by day, week and month because of variability of demand by distributing plants and counter-seasonality of milk production. So unaffiliated cooperatives will ship 25% aggregate to distributing plants during September, for example, and 15% in June.
2. Some dairy farmers are located close to distributing plants. Milk from these farmers, whether DFA members or members of unaffiliated cooperatives, will ordinarily be shipped to distributing plants every day. Other farmers are located far from distributing plants. Milk from these farmers will ordinarily be shipped (diverted) to a manufacturing plant. Producers located in-between, will ordinarily ship their milk to distributing plants some days, and to manufacturing plants on other days. Transportation efficiency drives marketing practices, *except* where federal milk order rules require inefficiency of transportation and handling practices.

The federal milk order hearings in Minneapolis, Kansas City, and Ohio (upcoming) will consider rules proposed by DFA and Dean to impose significant new burdens of greater inefficiency on cooperatives unaffiliated with DFA in transportation and handling practices. As described below, these rules, if adopted, will not burden DFA. They will, rather, benefit DFA to the extent competing producers and cooperatives are forced off the market, or are forced to join DFA to maintain a share of the market.

### **How the proposed rules would work to burden non-DFA cooperatives and benefit DFA.**

There are a number of federal milk order rules that fall under the category of “pooling standards.” These fix minimum limits of how much milk must be marketed to distributing plants, maximum limits for how much milk can be diverted to an unregulated manufacturing plant, and how much milk of individual dairy farmers must ‘touch base’ (be delivered to a distributing plant or other regulated ‘pool’ plant), in order for dairy farmers to have access to the market blend price. To simplify this illustration, I will refer only to so-called “diversion” and “touch-base” rules.

**Diversion Limits: Current:** In the illustrative market described above, the current diversion limit, expressed in the “producer milk” definition ( 7 C.F.R. 10xx.13 ), is 75% in the short supply months (September – November) and 85% in all other months. This is an aggregate limit, and means that the reciprocal percentage – 25% in the fall and 15% of aggregate cooperative supply in the other months -- must be shipped to distributing plants or other pool plants. The required shipments constitute a *pooling base* that defines and limits the volume of milk a cooperative (or other handler) may associate with the market. In this example, the fall pooling base allows association of 400 million pounds of total milk for each 100 million pounds shipped to a pool plant.

**Proposed:** In our illustration, DFA and Dean propose to reduce diversions to 60% in the short supply months, expand the short supply months to include all of July – January, and reduce diversions to 70% in all other months.

**Effect:** The cooperatives unaffiliated with DFA will be severely affected by this proposal. They currently ship 22% of their milk supply to distributing plants year round, and barely meet the seasonal requirements of 25% in the fall and 15% during flush production months. The months of July-August, and December-January, proposed to be added to the ‘higher’ performance months, are generally months of lower Class I demand or holiday surplus milk production due to holidays, so this expansion of high performance months will multiply the adverse effects of the proposal. Since market share of milk to distributing plants is largely locked up by DFA, and by independent patron milk supplies to some plants, the non-DFA cooperatives cannot increase pooling base (sales to distributing plants) to maintain their share of the market’s milk pool. Under the proposed rule, the cooperatives short supply shipments to distributing plants would be 40% or more -- the reciprocal of maximum diversions of 60%. Instead of pooling 4 times the pooling base, they would be limited to 2.5 times the pooling base. They must simply withdraw some 150 million pounds of milk from the market – about half of their milk used for manufacturing purposes -- in order to pool the remainder. The withdrawn milk would either not be pooled in any market, or be pooled in another market (such as the Upper Midwest) where it would also be used for manufacturing purposes and dilute the blend price.

DFA would be unaffected by its diversion limit proposal. Since DFA, in our illustration, diverts 45% of its aggregate milk supply, it would have no difficulty meeting its proposed diversion limits of 60 – 70%. Moreover, DFA could absorb all of the milk withdrawn from the market by its competitors, maintain (or return) this milk to the market, and still meet its amended diversion limit. The addition of 150 million pounds to DFA’s current milk supply (500 million pounds) on the market would result in a total of 650 million pounds milk pooled by DFA, of which 275 million (42%) is marketed to distributing plants, and 58% diverted for manufacturing – well within DFA’s proposed diversion limits of 60% - 70%. Similarly, the merger of DFA and its cooperative competitors would produce an aggregate milk supply of 950 million pounds, of which 375 million (39.5%) would be sold to distributing plants, allowing the merged entity to pool all (or virtually all) milk disassociated by the new rule.

If adopted, the new rules would also provide DFA with opportunity to create a new revenue source from its competitors. DFA, with pooling base and diversion capacity to spare, could ‘sell’ to its competitors the opportunity to pool milk through the DFA system. This has been a common practice in most markets. The record in the 2001 Minneapolis hearing disclosed that DFA was willing to sell pooling rights for 50% of the revenue gain to its competitor from pooling. If this is 50 cents per hundredweight, for example, the 150 million pounds of disassociated milk, if re-associated through DFA, would generate \$750,000 per month, or \$9 million per year, in new revenue for DFA and reduced revenue for its competitors.

**Touch base requirements:** The other element of this illustration is USDA’s “touch base” requirement, also found in Section 13 ( 7 C.F.R. 10xx.13 ) of federal milk order rules. These rules state that, in order for a producer’s milk to be eligible for to for diversion (i.e., to receive the market’s blend price on diverted milk), “the equivalent of at least   x   day's milk production is caused by the handler to be physically received at a pool plant in each of the months of \_\_\_\_\_.” As noted above, transportation efficiency drives rational marketing practices, *except* where federal milk order rules require inefficiency of transportation and handling practices. For producers located close to a distributing plant, whose milk is

delivered to that plant day after day, the ‘touch base’ requirement is of no direct consequence – his or her milk touches base every time it delivered. For a distant producer, whose milk is most efficiently delivered to a manufacturing plant, the ‘touch base’ requirement is significant. It mandates that on the touch base days, his or her milk is transported inefficiently to a distant customer to touch base. At the same time, milk of producers close to the distributing plant is displaced, and must also be transported inefficiently to a distant manufacturing plant. These costs are borne by all dairy farmers who are members of the cooperative who markets milk involved in these transactions.

**Current Rule:** For illustration, our hypothetical market requires individual producers to ‘touch base’ one time each month. Beyond that requirement, rational and efficient marketing choices govern.

**Proposed Rule:** In our illustration, DFA and Dean propose to increase touch base requirements to 4 days’ production per month.

**Effect:** In our example, the cooperatives unaffiliated with DFA will be uniquely and severely affected by this proposal. DFA’s milk more frequently touches base because it commands a greater share of the market supply to distributing plants. DFA has more plants, at more locations, to which its supply may touch base. And DFA commonly operates manufacturing plants that are ‘pool plants’ (cooperative balancing plants or cooperative supply plants) where its members’ milk may touch base while its competitor cooperatives commonly market surplus milk for identical manufacturing purposes to ‘nonpool’ plants where the receipt does not count as touch base.

Added costs for these inefficient practices include transportation, handling, rerouting, and others. Transportation costs alone are approximately 0.3 cents per hundredweight per loaded mile for a 50,000-pound milk tanker. If just four tankers per day are required to haul milk and extra 300 miles to meet the new requirement, it would add \$54,000 per month in new costs for the producers-members of the cooperative forced to undertake these inefficient practices.

### **Conclusion**

My point here is that pooling standard amendments serve the same function for DFA in gaining and maintaining market share in the 2000’s, and has the same adverse effect on competitors, that pool loading or pressure pooling served for DFA predecessors in the early ‘70s. The social costs from reduced competition and from higher costs passed on to consumers are the same. The important difference this time is that USDA is assisting rather than inhibiting DFA’s efforts, and DOJ remains silent.

Sincerely yours,

*John H. Vetne*