Comments for the United States Departments of Agriculture and Justice Workshops on Competition Issues in Agriculture

submitted by
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The Department of Justice (DOJ) and the Department of Agriculture (USDA) deserve real credit for setting up this workshop program. For years many of us who follow agricultural competition issues have lamented the failure of both antitrust enforcement and market facilitating regulation to deal with continuing problems that farmers and ranchers confront in both the acquisition of inputs and the marketing of their production.

My own involvement in this area started more than a decade ago when I was asked to review the potential role of antitrust law in responding to the various problems that confronted and continue to confront American agriculture. Over this period, I have had a number of occasions to learn from farmers and ranchers about conditions on the ground. I have supplemented that education with various kinds of more scholarly inquiries. The results include testimony over the years before various congressional committees, scholarly articles and book chapters as well as advocacy to the DOJ concerning the need for better enforcement of antitrust law.

The objective of these comments is to review briefly important competition and market related issues that currently confront American agriculture. In my view, these are issues that the USDA and DOJ need to address by making further inquiry and investigation. The USDA should then take appropriate regulatory action including adopted necessary market facilitating regulations where authority to do so exists and actively seeking additional regulatory authority where gaps appear. The DOJ needs to pursue the more active enforcement of the antitrust law with respect to both input and output markets associated with agriculture. Finally, both agencies must insist that the FTC undertake a better informed and active role in evaluating the buyer power risks created by mergers in the food processing and retailing industries over which it has primary authority.

These comments start with a brief discussion of the premises on which public policy ought to be based in this area. They will then outline the issues that I believe are important in the major output markets of dairy, meat and poultry, and crops. Next, there will be a consideration of issues concerning the input markets to which farmers and ranchers look for supplies. Finally, the comments will discuss the competitive policy issues presented by the Capper-Volstetad Act's antitrust exemption in relation to the power over some markets that the Agricultural Marketing Agreement Act creates.

I. Premises: Markets Rules, Referees and Need to Facilitate Competition by Regulation

A recurring problem in policy analysis with respect to markets is the failure to appreciate that markets require rules in order to operate in an efficient and socially desirable manner. Such basic elements as the law of contracts are foundational for market operation. Antitrust law is one form of market regulation that is, or ought to be, understood has seeking to facilitate the competitive process.[1] Antitrust is, however, a limited factor in the creation and maintenance of

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[1] Too often, policy makers including courts assert that the goal of competition policy is economic efficiency. While it is true that competitive markets overtime produce, generally, efficient results. Antitrust law and competition policy have as their objective the creation and maintenance of workably competitive markets. Hence, these comments adopt that goal as the primary criterion for judging the merits of both the USDA's market regulation and the USDOJ's

workably competitive markets. Essentially, antitrust is obliged to accept the legal framework within which markets operate as a given and its interventions must accept those constraints. This is unavoidable since antitrust acts through either the courts or an administrative agency (the FTC) that lacks the institutional capacity as well as the legal authority to revise or modify the underlying legal regime that orders the markets at issue.

Indeed, it is manifest that in a variety of contexts legal regimes exist for the express purpose of facilitating and protecting the market process. Whether the context is the sale of securities in a public market, the sale of insurance, the marketing of franchises, the provision of various financial or banking services, or the sale of consumer goods, regulations exist not to replace the market with command and control type constraints, but rather to facilitate the fair, open and efficient operation of the market in question though rules. The USDA has primary responsibility for developing and providing public enforcement for such regulations in the areas of agricultural product markets. The Antitrust Division of the DOJ has primary responsibility with respect to basic agricultural product markets, but unfortunately, it does not have primary authority over non-meat food processing or grocery retailing which rests with the FTC. The implications of this bifurcated authority are significant as is the absence of the FTC from visible participation in this process.

Finally, the significant size disparity between the producers of most agricultural inputs and the farmers and ranchers who buy those inputs as well as the similar disparity between farmers and ranchers and the buyers of their products create the kinds of contexts that warrant careful consideration of the role of antitrust and of market regulation in order to ensure

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enforcement of antitrust law.

reasonable workable markets. On the input side of the market, the primary emphasis ought to be on an active antitrust policy to enforce stricter standards against anticompetitive mergers as well as challenging marketing practices that result in excessive prices and unreasonable conditions for farmers as buyers. On the output side, there ought to be a blend of more active enforcement of existing antitrust law and a set of regulations on the conduct of buyers that facilitates the kind of open and efficient market that is the fundamental goal of public policy.

II. Dairy

The dairy business faces many serious economic problems. A number of them are directly related to the way in which milk is priced and the transactions that transfer it from the farm to the processor. Remedying these problems will not resolve all the issues facing dairy farmers. There are serious environmental concerns, potential problems of excess production as well as mis-location of dairy farms based on manipulation of the existing system of compensation for milk. Many of these problems require long run adjustment in milk production that the USDA and Congress should consider. These comments will focus on what I believe to be the most pressing competitive market issues in the milk production market although some comments related to the issues of cooperative regulation will also be considered separately.

First, the basis for setting the price for milk must be revised to reduce or eliminate the incentives to manipulate the related markets that currently determine the price as well as finding a methodology that is less cyclical in nature. The current pricing system is largely a function of the prices for cheese and butter set by a minuscule quantity of transactions on the Chicago Mercantile Exchange (Merc). To be sure, nominally the cheese price comes from cheese companies, but the reality is that cheese price is a function of the price set on the Merc. This basis for pricing is troublesome because it rests on an extremely thin market. Very little cheese or butter actually passes through the Merc. As a result, there is a documented history of price manipulation on the Merc and its predecessor cheese exchange in Green Bay, Wisconsin.

To date neither the Commodities Futures Trading Commission nor the Merc itself have engaged in effective policing of such manipulation. Indeed, given the thinness of the market, it is very questionable whether it is feasible to protect that market from manipulation. Certainly, the prices generated show a high degree of fluctuation and have varied in ways significant at odds with the logic of milk production and consumption. Most of these flaws have been well documented. The USDA can not deny its awareness of these problems.

One goal of these workshops should be to find a better way to create a floor price for milk.[2] Various market participants and observers have proposed alternatives. Some of these might be adoptable without requiring new legislation. It is time for the USDA to make an effort to identify a more reliable basis for setting milk prices.

More generally, the FMMO system is antiquated and needs significant re-evaluation. First, while historically many dairy farms were Class B operations, today nearly all farms produce Grade A milk, i.e., milk suitable for use as fluid milk. Second, today, about 2/3s of all milk is used in various manufacturing processes such as cheese making. Third, in some regions most Grade A milk is still used for fluid, but most regions, most of the time, have a surplus of

[2] Actual milk prices can and do vary significantly depending on the characteristics of the milk, the needs of the processor and other market conditions. The FMMO system serves to provide a floor for all milk from Grade A farms sold in this country. Given the many regional oligopolies and monopsonies, there remains a real need to have a base price that all buyers must pay to avoid undue exploitation of dairy farmers especially as processing of milk is becoming increasingly concentrated in many regions.

Grade A milk beyond the needs for fluid. Fourth, the proportion of Grade A milk used as fluid provides the basis for the blended price paid to farmers. Fifth, the current law allows cooperatives to pay farmers less than the minimum blend price, allocate payments among producers when the cooperative serves processors in different order areas, and favor some out-of-area producers with access to the order areas with high blend prices. Sixth, these same cooperatives have developed exclusive dealing arrangements with many, and in some regions the vast majority of fluid processing capacity, thus creating the ability to compel Grade A producers to affiliate with the cooperative in order to get access to the blend price. Seventh, these same cooperatives joined by some of the dominant processors have induced the order administrators to change the rules governing access to the pool to increase the delivery requirements with respect to both the quantity of milk and period of time during which it must be delivered in order to participate in the pool. This also forecloses small cooperatives and other handlers from independently competing within these regions. Eighth, the current law confers on the cooperative a statutory proxy to cast the votes of all its members with respect to changing the order. Where the cooperative has, by coercion or otherwise, obtained control over a majority of the votes in any order area, it has a veto over any changes in the order that might open the region to more competition regardless of the views of its farmer "members." Overall, regionally and inter-regionally dominant cooperatives are exploiting the current FMMO system to exclude other handlers and to exploit farmers.

The core strategy of the dominant cooperatives is to obtain exclusive supply contracts with fluid milk processors. Because a farmer can not participate in the FMMO pool unless his or her handler participates in supplying fluid milk, all dairy cooperatives and handlers must have access to fluid milk buyers. When the dominant cooperatives achieve control over the majority of fluid processing capacity serving an order area, they can compel all other handlers to participate in their organization and accept the prices, service charges, and other conditions they have determined. Absent understandings that serve the interest of the buyers of milk, such exclusive dealing agreements would appear questionable from the perspective of the processors. Hence, it is likely that these agreements, especially those with very large processors, include pricing or other conditions favorable to the buyer. Although the USDA could investigate and prohibit such agreements under its authority to regulate marketing orders, it has made no effort at all to control these agreements.[3] Moreover, given the proxy rights of the cooperatives, individual dairy farmers are helpless to challenge such terms even if they were disclosed.

Further, the management of the dominant cooperatives have a history of favoring insiders with sweetheart deals that transfer cooperative wealth to the friends and associates of management. Based on their exclusive supply rights, the cooperatives have also caused out-of-area of milk produced by other friends and associates of management to be shipped into areas with high pool prices. This out-of-area milk, not needed given with the level of production within the order area, dilutes the total pool and so reduces the revenue to in-area producers. The payments to theout-of-area producers substantially exceed the amounts that they would otherwise have received. That gain is further enhanced because the costs of shipping the out-of-area milk are paid for from pool proceeds.

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[3] The regional administrators are captives of these dominant cooperatives since the cooperative can, at its discretion, terminate the FMMO for the region and thereby destroy the employment of the administrator. The USDA should act to insulate its administrators from this economic coercion that can suborn there independence.

The Agricultural Marketing Agreement Act authorizes the Secretary to adopt rules of fair competition. The USDA has not used this power to police the rules and regulations adopted in the various FMMO regions. The current abuses of the system are such that it is necessary for the Secretary to use the powers conferred by Congress to impose a more open, fair, and transparent system for allocating milk revenues. The present system is inefficient, and encourages manipulation as well as insider dealings.

One of the reasons for the ability of a cooperative to obtain dominance over the supply of milk is the consolidation of the fluid milk processing stage of the industry. The consolidation of Dean and Suiza with the divested plants going to a venture that in turn was owned in substantial part by the cooperative supplying the Dean and Suiza facilities resulted in substantial increase in the concentration of the buying side of the market. This is turn gave the exclusive supply agreements a greater choke hold on the milk supply process. This means that there are now barriers to entry into milk processing (no competing handlers exist) as well as in the downstream retailing arena (also highly concentrated in many regions as result of the failure of the FTC to appreciate or avoid the risks of buyer power in the retailer mergers).

The process of acquisition by dominant firms has continued. In particular Dean is known to have made several acquisitions of fluid milk processors in the Midwest and Mid-Atlantic regions. Each such acquisition reduces the opportunity for independent cooperatives and other handlers to market fluid milk. As a consequence, competition for fluid milk is suppressed.

At this point, the best course could be to revisit the Dean Suiza combination and undo it. But that is probably not a politically feasible option. Instead, the DOJ should promptly require the merged company not to make any further acquisitions of fluid milk processors and eliminate the use of exclusive dealing arrangements for the acquisition of milk for its facilities.[4]

It is time for a major reform of the FMMO system. The USDA needs to take the lead in finding a better way to price milk and develop a new system for assigning dairy farms to market order areas as well as finding new criteria for determining which Grade A producers are to be included in the system. The DOJ needs to revisit its merger policy with respect to fluid milk mergers as well as the use of exclusive dealing contracts by dominant cooperatives.

III. Beef, Pork, and Poultry

These farm products are all subject to the Packers and Stockyards Act. This statute was written at a time when cattle and hogs were sold at stockyards and there was a significant history of market manipulation and exploitation of producers. The goal was to create a regulatory regime that would protect and facilitate the operation of the marketplace for livestock. Subsequently, poultry producers were added to the regulatory coverage as those markets moved from workable competition to ones dominated by processors. With increased concentration in both processing and retailing the ability of buyers directly (processors) and indirectly (large grocery retailers) to exploit the producers has increased. Even more regrettably, the USDA has failed to adopt regulations to facilitate these markets as they have moved from the old model of stockyards to direct sales at feedlots, contract sales, and contract production agreements.

Meat packers use a mixture of formal and informal supply contracts (captive supply) along with some livestock that they actually own to supply an increasing amount of their needs. The result is the open market transactions which still serve to define prices for many contractual

[4] Alternatively, each plant could be required to have a separate contract with a distinct handler that is unrelated to any other handler providing milk to any other plant belonging to that company within that FMMO area.

arrangements are subject to all the risks of thin markets.

The fact that there are only a few major beef packers means that the incentives to develop favorable terms to induce contractual relations are limited or non-existent. The ability of the beef packers to select arbitrarily among feeders those that will get the assurance of a formal or informal contract confers further power over these firms to control feeders and manipulate the market. There are proposals to have the USDA use its powers under the PSA to require that all feeders have access to contracts. By eliminating the buyer's arbitrary discretion to grant or refuse a contract, the USDA could ameliorate the problems associated with the use of captive supply. Some observers believe in fact that if access to contracts were open to all feeders, the captive supply system would collapse because it is inefficient in producing beef cattle, but provides pecuniary gain resulting only from the market price manipulation that it facilitates.

There are other advantages to a market facilitating regulation of contract and buying practices. Notably, such rules could specific conduct that is "unfair" or "discriminatory" and so ensure its elimination from the market. But, equally important, such rules could define "safe harbors" for contracts that would provide a clearer protection for packers using those terms and conditions.[5]

In the pork processing world, the Midwest still appears to have a workably competitive number of processors and the contractual terms available give producers more choice. The

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[5] In Wisconsin, producers and packers of vegetables worked together to develop regulations defining the contractual relationships that would exist in the industry. As an observer of the process, I was impressed with the willingness of both sides to work together to identify reasonable and equitable terms of trade since both sides appreciated the risks and needs central to such transactions. A similar process might, assuming good faith on both sides, provide for a similarly acceptable set of regulations defining contemporary transactions in cattle.

results seem to be that hog feeders have more ability to choose among alternatives including selling into the open market, various kinds of contractual commitments, and serving as a feeder paid for that service. There remain concerns and a need comparable to that in cattle markets to define both acceptable and unacceptable terms for contractual arrangements. The USDA has the capacity to impose such rules, but has not done so.

There is more reason for concern in the Southeastern United States. The DOJ allowed the only two major pork processors in that important hog producing region to merge. It claimed that feeders could still send hogs to a facility about 400 miles away and so the assertion was that the merger would not cause serious harm to producers. Simultaneously, the GIPSA division of USDA sponsored a large scale of pork and beef market issues that found for the priod prior to the merger that hog markets were subject to statistically significant buyer power. The merger would obviously increase that power especially in the Southeast. The DOJ's claim that shipping mature hogs long distances would be a plausible way to control the risks of exploitation given that substantial buyer power already adversely affected the prices paid hog feeders is without merit.

The DOJ should revisit its decision concerning that merger and the USDA should use its authority under the PSA to ensure that hog feeders in the Southeast are treated comparable to those in the more competitive Midwest hog feeding region.

Poultry farming is done almost exclusively on a contract basis where the farmer is paid for time and effort rather than on the market value of the poultry since there is no longer a public market for live chickens or turkeys. The resulting systems can be very abusive in their dealings with farmers. The contracts are very short-term–the duration of a growing cycle, but the investments needed to provide the growing service are long-term, sunk costs of the farmer. Here the USDA through its PSA administration is starting to move to provide rules that will govern these contracts and reduce their abusive character. Much more needs to be done to protect these farmers.

The DOJ has allowed mergers among poultry processors that have increased concentration. Moreover, it has not, so far as is known, looked critically at the practices of the firms in the industry. Two aspects suggest some kinds of collusion may exist. First, the firms tend to locate in a spacial way that leaves each with a region in which it is the only or one of very few processors. This means that the farmers who invest in poultry growing facilities often have only one buyer. Even where there are two or more processors, it appears that they often refuse to compete for each other's producers. This kind of tacit producer allocation further reduces the ability of farmers to get the economic benefits that should come from their investments, skill, and industry.

Overall, the primary failure to maintain fair, open, efficient and equitable market conditions rests with the USDA over a long period of time. The DOJ is also at fault for its failure to look critically mergers increasing buyer concentration and at the kinds of contracting and buying practices that the dominant firms employ. A number of these practices make economic sense only if engaged in by some or most of the these firms. Hence, the DOJ employing antitrust law might have ameliorated some of the harms resulting from the failures of the USDA to act. Finally, it is again notable that the failure of the FTC to take into account the potential harms to upstream markets resulting from increased concentration in the grocery industry has further exacerbated the problems. The contemporary situation requires both active USDA oversight and regulation of the markets for cattle, hogs and poultry and a parallel policing of anticompetitive, tacit collusion among the beef, pork and poultry processors with especially attention to their coordinated use of exploitative contract terms and tacit refusals to compete for supplies. Further, both the USDA and the DOJ need to make the FTC aware of the impact of its continuing failure to consider the impact of grocery mergers on the upstream markets for beef, pork and poultry.

In considering regulation, it is also important that both agencies take account of the recent (December, 2009), deeply divided, Fifth Circuit, en banc, decision in *Wheeler v. Pilgrim's Pride*, ___ F.3d___,2009 WL 4823002 (5th Cir. en banc, 2009). This decision declares that the unfair competition provisions of the PSA apply only if the plaintiff can show that the conduct has an adverse effect on competition in some relevant market. This majority purports its decision to be in accord with those other circuits, but the claim that the plaintiff must allege and prove an adverse competitive effect is not in fact consistent with all of the other circuit court decisions interpreting this provision. The dissenting opinion demonstrates the weakness both in the precedential analysis of the majority and highlights the radical rewriting of the statutory language inherent in the majority opinion. The majority interpretation is also in conflict with the interpretation of the statute set forth by the Secretary of Agriculture whom Congress charged with enforcing the statute.

If the *Wheeler* decision is allowed to stand uncorrected, it will destroy any effective protection for farmers producing hogs, cattle or poultry when they are victimized by unfair or discriminatory actions by buyers. Moreover, this decision would seem to constraint radically the rule making authority of the USDA with respect to such practices including those involving the failure to pay farmers for animals delivered to buyers.

It is imperative that the USDA and DOJ combine to continue to challenge this interpretation of the PSA. Indeed, to their credit, the DOJ through its Civil Division did participate in the *Wheeler* case as an amicus on behalf of the USDA. Regrettably, the majority of that circuit failed to accept the well reasoned views of the Secretary.

IV. Crops

There are two kinds of crops. Fruit, nut and berry production involves long term sunk costs while annual crops whether grain, vegetable or fiber reflect annual decisions among options available to the farmer. But in both situations, the challenge is to find outlets for the product that will yield a reasonable return. With the consolidation of railroads and buyers, it is increasingly the case that the options for such farmers are limited.

In the case of row crops such as corn, soybeans, cotton and wheat, there is a great need for careful examination of any further increase in concentration in the buying side. As I have discussed elsewhere, there are important differences between buyer and seller power.[6] This means that the reduction to four or fewer major buyers nationally raises serious concerns. In local markets, frequently, there is only one buyer. Historically, local cooperatives with access to railroads operating under rate and service regulation, were able to avoid the local monopsony and get access to a workably competitive national market.

My discussions with crop farmers of late have suggested that the number of local buyers for most crops has declined substantially. The one counter trend has come from the growth of ethanol producers that tend to be dispersed and pay a premium for local corn in part because they

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[6] *Buyer Power, Competition Policy, and Antitrust: The Competitive Effects of Discrimination among Suppliers*, 53 ANTITRUST BULL. 271 (2008); *Buyer Cartels Versus Buying Groups: Legal Distinctions, Competitive Realities, and Antitrust Policy,* 1 WILLIAM & MARY BUS. L. REV., forthcoming 2010.

do not have to absorb shipping costs. The Cargill-Continental merger approved in 1999 significantly reduced the number of existing integrated buyers. The hope of the divestiture plan was that it would bring in an international marketer for grain that would in turn link with local, independent grain buyers. The DOJ should revisit that settlement and see if its expectations were met. More generally, there should be strict scrutiny of any further increase in concentration at the grain buying or processing stage.

With respect fruits, vegetables and nuts, the Agricultural Market Agreement Act permits the creation of marketing orders. If a crop in a region (most orders are regional except for cranberries) is subject to an order, all producers in that region must adhere to the order. Hence, the order has the potential to be a government enforced cartel. These orders are not always very effective and they invite perverse conduct. For example, nearly 40% of pie cherries were destroyed this year in the dominant order area because the order administrators wanted to reduce supply in order to raise prices. It seems apparent that cherry growers are planting more trees and increasing output in order to get a larger share of the crop that they are permitted to sell. This means that resources are wasted in raising and picking cherries where the only goal is to increase the farmer's total production so that he or she gets are larger volume to sell under the order. Other orders have resulted in stifling the production of better types of the crop subject to the order.

Several decades ago, the USDA did a good job of reducing the number of these orders and eliminating a number of anticompetitive features in many surviving orders. It needs to revisit that process once again. Especially with the adoption of the Standards Development Organization Advancement Act, there is an alternative framework for some of the useful standard setting services that marketing order organizations provide that can facilitate the market process.

V. Inputs: Of Seeds, Tractors, and Other Components

The most prominent current issue on the input side of agriculture today relates to the conduct of Monsanto with respect to its genetically modified seeds. Monsanto has sought to exploit to the greatest extent possible its patent rights. It has done so in ways that unnecessarily harm both farmers and those who would innovate with respect to additional genetic traits. Both the DOJ and a group of states are currently investigating this conduct. In addition, several private actions are pending that involve these same issues.

The most directly harmful action of Monsanto to farmers is its refusal to allow farmers to save and replant seed from their cotton and soybean crops.[7] Monsanto has purported to impose this restraint based on unilateral patent license conditions that are associated with the sale of its seeds. To date, the Federal Circuit has upheld these restraints as valid licensing conditions inherent in the patent right.[8] Use of saved seed, assuming a reasonable royalty were paid for such a use of the seed, would provide farmers with a potentially lower cost for seed and would put some pressure on seed producers to moderate the total price of new (certified) seed. Indeed, one obvious effect of the license condition is that it precludes competition for saved seed to the benefit of all seed producers selling seed with Monsanto genetics.

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[7] My views on this policy are discussed in an article, *Post-Sale Restraints via Patent Licensing: A "Seedcentric" Perspective*, 16 FORDHAM INTEL PROP. MEDIA & ENTERTAINMENT L. J. 1053-1080 (2006). I should also note that I have been and continue to be an expert witness offered in one of the pending private actions, *Scruggs*, involving seed saving.

[8] See, Monsanto v. McFarling, 302 F.3d 1291 (Fed. Cir.2002); Monsanto v. Scruggs, 459 F.3d 1328 (Fed. Cir.2006).

It bears emphasis that Monsanto's patented genetics only provide resistance to a type of herbicide and/or a pesticide that kills certain harmful insects. The primary value of the seed is independent of these specific genetic characteristics and resides in the capacity to produce valuable crops. Thus, Monsanto has used its patent power to frustrate competition in the market for seeds to the advantage of its self and its seed producing licensees.

In light of the recent *Quanta* decision,[9] I would suggest first that the restraint on saving seed is no longer inherently immune from antitrust review as an element of patent right, but rather it is an example of a contract incidental to the sale of the commodity that incorporates a patented component. As such, it should be subject to standard reasonableness analysis under antitrust law. Such an analysis, assuming that the rights conferred by patent law provide a legitimate basis for some post-sale restraints, should focus on whether the restraint adopted was the least intrusive in the post-sale market context reasonably needed to protect any legitimate patent interest. My suggestion is that an absolute ban on saving seed is unduly restrictive in the context of the monopolistic dominance of the seed market by the Monsanto genetics. Instead, Monsanto should at most be allowed to require a royalty on the seed saved and re-planted based on the royalty it collects for new seed. Any more restrictive requirements are not necessary to protect the legitimate interests of the innovator and impose undue and unnecessaary restraint on competition in the sale of such seeds where saved seed historically was an important element in constraining the exploitation of the market by producers of new seed.

The second way in which Monsanto is engaging in anticompetitive conduct related to seeds more directly relates to innovation markets. It appears that it is using its licensing

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[9] Quanta Computer, Inc. v. LG Electronics, Inc., __U.S. ___, 128 S. Ct. 2109 (2008).

authority over its genetics to restrict or forbid other seed companies from combining its genetics with those produced by other innovators. Assuming the correctness of this claim, it appears again that these restraints arise from contract and not from some inherent patent right immune from antitrust oversight. Second, the effect of this conduct is to harm innovation and create a serious barrier to the development of new and more desirable options for farmers.

The Monsanto genetics are merely components of the seed. Much of the seed, as discussed earlier, is the result of conventional breeding. Indeed, the Monsanto genetics do not themselves create the economic value that the seed produces. They only lower the cost of raising the crop. Given, therefore, that Monsanto is licensing only a component of the seed, there is no justification for it regulating the other components that go into that seed. It is seeking to leverage its position of monopoly with respect to one or two components into control over the entire seed composition. The anticompetitive implications of such conduct are manifest. Moreover, there is no apparently legitimate justification for such a sweeping control over the composition of the end product (seed).[10]

Beyond the Monsanto situation, the use of patent based restraints has resulted in price discrimination facilitated by patent based assertions of inherent right to restrict the resale of patented goods. Absent the patent claim, these price differences would not be sustainable as they go beyond anything that makes economic sense in the market. As illustrated in *Ottawa* case,[11]

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[10] Monsanto might well insist that seeds that incorporate other genetics be so labeled, as the producer would be likely to want in any event. There is little risk of harm to Monsanto's producer good will if another seed company's effort at stacking genetics is unsuccessful. If anything, Monsanto's seed business might gain.

[11] Pioneer Hybrid Seed v. Ottawa, 283 F. Supp.2d 1018 (N.D.Iowa, 2003). I served as an expert for the defendant Ottawa. My views on the implications of this case are also discussed in

the patent holder can impose a restraint on the resale of seed (in this hybrid corn seed, i.e., seed that can not reproduce itself) such that a buyer getting a favorable price from the patent holder can not resell the seed to another buyer. The ability of Ottawa to buy corn seed from willing, favored customers of Pioneer and resell such seed to otherwise disfavored customers demonstrated the lack of cost justification for the price discrimination. Other examples exist of this same kind of conduct. Such restraints undermine the ability of the market to ensure efficient distribution of goods among willing buyers.

Beyond seed, there has been a noticeable increase in the concentration of most of industries supplying inputs to agriculture. There are fewer farm equipment makers, etc., than in the past. The result is increased risk of oligopolistic pricing. Because farmers are dispersed buyers, each taking a limited quantity of any of these inputs, these are markets in which coordination among sellers and unilateral exploitation of buyers is more likely. Basically, the buyers have little power or capacity to respond to such exploitative conduct. For this reason, mergers affecting the agricultural supply markets of all kinds merit very close attention and should be challenged even in contexts where the resulting concentration is at the lower end of the scale used to decision on intervention.

VI. Mergers Creating Buyer Power from Processing to Retailing

As noted earlier, the absence of the FTC from these proceedings is troublesome. The FTC in the past had strong concerns for concentration in dairy and took a stricter view of the dangers to competition inherent in horizontal mergers in the grocery and food processing industries. In more recent times, the FTC has not shown any awareness that in addition to the

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the article cited in note 7 supra.

competitive effects of a horizontal combination in the selling of groceries, any combination among domestic food retailers will result in a reduction of competition on the buying side. Regional buying concentration is most likely to affect dairy and local produce suppliers while national concentration will affect other types of food processors. Moreover, as retail buying becomes more concentrated, it creates upstream buying power in the hands of the surviving suppliers to the retailers. This power can be and is often used to exploit upstream input suppliers especially those such as farmers and ranchers who have very little bargaining power.

One consequence of these workshops, therefore, should be strong reminder to the FTC that it should take account of the upstream impact of retail and food processor combinations within its jurisdiction. Further it needs to be mindful that the upstream effects maybe manifest in markets one or two stages removed from the initial buying market affected by the merger.

VII. Cooperatives: Revisiting the Scope and Meaning of Capper-Volstead

Agricultural commodity cooperatives appear to have an abiding belief that the Capper-Volstead Act is essential to their existence. This is a myth. The original reason for the statute related to protecting exclusive dealing agreements between farmer-members and their joint venture. Today such agreements are commonplace in a variety of industrial contexts and raise little or not antitrust concern. Overtime, the statute came to be seen as providing a safe-harbor for agricultural commodity cartels. Indeed, by exempting agencies in common from antitrust oversight, it is possible to fashion a commodity wide cartel. However, empirical evidence shows that such cartels when not protected and authorized by statutes conferring the power to exclude new competitors and expansion of production by existing market participants have been largely unsuccessful in achieving and retaining lawful cartels.[12]

Producer cooperatives can serve any of three related functions. They can take the farm product and produce a product from it, e.g., cheese; they can act as marketing agents, taking title to the product, causing it to be prepared for market and selling it, e.g., cooperative grain elevator organizations, or they can act as bargaining agents who obtain agreements from buyers as to the prices that they will pay for the goods they acquire directly from the members of the cooperative. Hence, the transaction remains between the farmer and the downstream buyer. This third function is essentially cartelistic since the cooperative binds its members to require the price set by the cooperative.[13]

Neither those cooperatives that engage in the processing of farm products to create marketable consumer goods or inputs to such goods nor cooperatives that act as legitimate agents acting for a group of farmers to prepare their goods for market and selling those goods in consolidated transactions raise serious prima facie antitrust issues. To be sure, if the cooperative is so dominant in an area or engages in collusive dealings with non-cooperatives to restrain competition, then there could be antitrust problems. But in general cooperatives following these business models would, today, raise no serious competitive concerns. However, absent an antitrust exemption, the pure bargaining cooperative would be indistinguishable from a cartel in

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[12] See, WILLARD F. MUELLER, PETER G. HELMBERER, THOMAS W. PATERSON, THE SUNKIST CASE: A STUDY IN LEGAL-ECONOMIC ANALYSIS (1987); VICTORIA SAKER WOESTE, THE FARMERS BENEVOLENT TRUST: LAW AND AGRICULTURAL COOPERATION IN INDUSTRIAL AMERICA 1865-1945 (1998) (raisin cooperative achieved market power only by predatory acts including burning crops of non-members and other acts of violence).

[13] A more extended analysis of cooperatives and their impact on competition is found in ABA SECTION OF ANTITRUST LAW, FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW, MONOGRAPH 24, at 87-132 (2007).

that it implements a price fixing agreement among a group of sellers and so would raise serious antitrust concerns since such activity is ordinarily per se illegal.

There are situations in which a cooperative acting as a bargaining agent for its members who themselves make sales to the ultimate buyer can provide some useful protections against abusive buyer power and perhaps improve the sophistication of the sellers. More often, what emerges is a frustration of exploitative goals as the potential conspirators defect or new entry occurs. Thus, in general farm cooperatives are harmless from a competitive perspective when standing alone.

However, when the cooperative operates within the scope of a marketing order as is the case in various fruits, nuts, and vegetables as well as milk, it is possible for the cooperative to cause more harm to the farmers over which it has jurisdiction and to consumers. The problems with abusive practices harming both farmers and consumers in milk were discussed earlier.

Outside of dairy, there are examples of the destruction of vast amounts of pie cherries, the prohibition of better quality winter tomatoes, etc., arising from the abuse of market order powers. Only a few orders, e.g., cranberries, cover the entire domestic market. Most orders cover only regional production where alternative sources exist. As such the primary victims are likely to be innovative farmers within the territory controlled by the order managers. Consumer harm comes usually when several orders can combine to create exploitive prices or restrict alternatives.

Thus, it is the combination of the Agricultural Market Agreement Act's authorization of market orders and the use of cooperatives with their right to cast the proxy votes of all members in such an order area that creates competitive problems.

Solutions should start with a renewed effort by the USDA to trim back or eliminate orders as it did with success thirty or so years ago. Second, it can use its authority in the AMAA to regulate the conduct of the cooperatives that are part of the order process. It is probably the case that it could require dominant cooperatives, e.g., those with 35% or more of the proxies in an order, to return the voting right to their members so that the cooperative can not act contrary to the desires of its members.

Turning to Capper-Volstead, the Act provides some important tax benefits to members which can readily be separated from its antitrust exemption. It also provides a blanket exemption from federal registration of securities issued by cooperatives as well as the corporate governance rules applicable to similarly large public corporations. There is no continuing justification for large cooperatives, whose members lack any real control over the entity, to be immune from the basic requirements of proper accounting, information disclosure, and other standard rules of corporate governance. More generally, the USDA has not policed in any visible way the creation or operation of cooperatives. For example, billion dollar, publicly traded companies in the egg business have been able to associate in a cooperative to which Capper-Volstead arguably applies because each participant owns some land on which chickens produce eggs which is the basic definition of a farm for Capper-Volstead purposes. Such an entity bears no relation to the kind of cooperative that Congress had in mind when it passed the legislation.

In sum, it is time, long past time, to modernize the Capper-Volstead and AAMA statutes. For some types of agriculture, there is a strong argument that a bargaining cooperative akin to a labor union is a socially desirable innovation. But, in that case, there should be regulatory oversight similar to that provided by the NLRB. For the cooperatives that are engaged in production, statutory revisions should facilitate raising capital while allowing farmers to retain control over the enterprise. Finally, for those cooperatives that act as agents to sell the products of their members with some level of processing, there should be regulation providing guidance as to the content of the services that may be provided.

Conclusion

The USDA and DOJ should be commended for undertaking this kind of broad industry review of the competitive conditions of the various markets and the role, positive or negative, antitrust law and regulation can play in those markets. As the foregoing discussion illustrates, there are a vast number of important and complex issues that merit focused attention. These comments have sought to provide some context and framework within which to assess the more focused factual and experiential submissions that ought to be made in this proceeding.

The basic message of these comments is two fold: first, the antitrust agencies have not been as active and forceful in investigating and enforcing antitrust law standards as they ought to have been with respect agricultural markets–on both the input and output sides, but the failure is greater on the output side. Perhaps, the fact that those issues involve problems of buyer power may explain, in part at least, this failure. It is important that antitrust law enforcement take buyer power seriously and develop appropriate standards for identifying the competitive risks in that area. In addition, the DOJ needs, tactfully, to prod the FTC into a fuller recognition of the relevance of buyer power to the overall agenda of competition policy.

Second, the USDA needs to use the powers it has long possessed to focus on the development and enforcement of rules and regulations that will in fact facilitate fair, open, and efficient markets for agricultural commodities. The need to use the PSA to create regulations that to better govern markets in cattle, hogs and poultry is compelling. Similarly, the existing uses of market orders in both milk and other commodities are causing harm to both producers and consumers. The USDA has the ability to remedy the misuse of the order system. Even more, it can use its powers to make the order system serve the public interest in efficient and open markets for those commodities. Finally, both the USDA and DOJ need to look closely at the ways in which the Capper-Volstead Act, on its own or in conjunction with marketing orders, operates to affect both producer and consumer interests. That review should result in a sustained effort to modernize that statute so that it protects legitimate agricultural interests and is less useful as a shield for anticompetitive and harmful conduct injuring both consumers and producers.