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The American Antitrust Institute

Competitive Issues in the Dairy Industry: The Pending DFA/NDH/Hood Transaction

PREFACE

The following White Paper by AAI Research Fellow Hiromitsu Miyakawa places a current transaction in the dairy industry into the larger context of a trend that raises important questions about the role of huge dairy cooperatives in vertical collaboration with major milk processors and dominant grocery chains.

In order to assure a reliable milk supply and adequate income for farmers, Congress and ensuing regulation created a complex system of regional districts within which the minimum prices paid for milk would be regulated. Historically dairy cooperatives have dominated the handling of milk between the farm and the processor. Such producer cooperatives were granted a partial exemption from the nation's antitrust laws so that they could overcome what was viewed as the destructive competition among independent farmers, including dairy farmers. A series of mergers among dairy cooperatives, however, has led to a situation that today is quite different: instead of too much competition, we are faced with too little. We now see a small number of huge cooperatives that have extended their power beyond the assemblage of farmers, stretching vertically by ownership and alliances through the chain of production and distribution, all the way to the retail level.

As each level of the chain becomes more concentrated and more closely tied to other levels, competition ceases to work in the consumers' and farmers' interests. One would think that the buyers of raw milk would prefer to deal with competing suppliers – if not individual farmers, then at least multiple cooperatives—so as to play one off against the other in order to bargain for the most advantageous terms. The cooperatives, on the other hand, would want to minimize competition between them so that they could bargain more effectively. Under the Capper Volstead antitrust exemption, agricultural cooperatives (including dairy cooperatives) can cooperate to strengthen their bargaining position, but there are still antitrust limits on their market conduct. A first question, therefore, is how far the exemption for agricultural cooperatives goes in permitting anticompetitive behavior? Our White Paper suggests that the Capper Volstead exemption does not cover the proposed Hood/NDH/DFA transaction or certain conduct of the mega-cooperatives.

How can a dairy cooperative achieve control over its market? First, the cooperatives can consolidate so that there is minimal competition between them. This can sometimes be achieved through persuasion and we have witnessed a whole series of apparently friendly mergers. When there are cooperatives that for whatever reason do not wish to join the dominant cooperative, other tactics can come into play. If there is a dominant buyer of milk, and the dominant cooperative can gain exclusive access to that

buyer (perhaps by contract, perhaps by ownership), other cooperatives can be frozen out of the market. This freezing out can be facilitated by the government's regulatory system, which, as described in the White Paper, creates a practical necessity of selling to large fluid buyers, i.e., supermarket and chain convenience stores or processors such as Dean Foods. The threat of foreclosure puts enormous pressure on a competing cooperative to give up and join the dominant cooperative.

As the White Paper shows, this dynamic is not merely hypothetical. Our ability to provide evidence is admittedly limited, but we are impressed by allegations that Dairy Farmers of America (DFA), the largest dairy cooperative, has been following this pattern of gobbling up competitive cooperatives through activities that make the threat of foreclosure credible. In the current transaction, DFA already holds a 50% interest in National Dairy Holdings (NDH), a major fluid milk processing firm. An earlier effort of NDH to merge with H.P. Hood (Hood), a similar firm, was terminated after the Justice Department raised questions about the likelihood of foreclosure of a competing cooperative.

Now, the transaction has been restructured, to appear more innocuous. Hood will acquire a 30% interest in NDH. DFA will acquire a 15% interest in Hood. As part of the deal, the chief executive of Hood will be the new chairman and chief executive of NDH, and the president of NDH (which, to repeat, is controlled by DFA) will be the new president of Hood. The strange exchange of executives in this context raises a bright red flag. Will this transaction really be innocuous? This transaction is not exempt from antitrust law because it involves firms that are not cooperatives. Hence, the government must ask: will the three entities have such an overlap of ownership and management ties that their interrelationships will be cooperative rather than competitive? Indeed, does this transaction lead to the de facto extension of the largest dairy cooperative into a controlling position in some markets at the next level up in the distribution chain?

The concern doesn't end there. DFA has a joint venture in milk assembly, called Dairy Marketing Service (DMS), which is the largest milk assembler in the United States. DMS has a supplier agreement with Dean Foods, the largest fluid milk processor in the nation. The DFA/DMS and Dean vertical alliance has gained a dominant position in the Northeast fluid milk market. Both the fluid milk assembly and the processing markets are highly concentrated. If the proposed transaction among DFA, NDH and Hood is consummated, the fluid outlets of the other dairy cooperatives in New England, if not foreclosed, could be impaired and also barriers to entry in processing could be increased.

Finally, the concentration of buying power that exists at the retail level must be taken into account. A strong supermarket chain can make an all or nothing offer to a supplier in order to drive the price below a competitive level. This power is easier to exercise if there are multiple suppliers. In order to withstand such power through countervailing power, suppliers are merging and developing vertical strategic alliances. At each level of the milk distribution chain, we are finding higher and higher levels of concentration in a spiral of countervailing strategies that increasingly present a model quite different from market competition.

There is no reason to think that consumers or even farmers themselves are benefiting from this: to the contrary, both appear to be victimized by the resulting

increased spreads between farm gate and grocery store prices, according to evidence cited in the White Paper.

Apart from the question of prices for consumers, there is good reason to expect that the concentrated milk marketing channel with vertical strategic alliances is not working in the best interests of dairy farmers. In a perfectly foreclosed system, farmers will have only one outlet for their fluid milk, DFA/DMS. As other cooperatives are squeezed, they may suffer until conceding and joining DFA/DMS.

But, one might ask, wouldn't one big monopoly cooperative be in the best interest of dairy farmers? Maybe not. For one thing, there will still be an imbalance of bargaining power between retailer/processors and farmers. Within the confines of the federal milk market order system with its blend price paid to farmers, processors can undermine cooperative bargaining efforts by offering side payments to farmers who would defect. Moreover, a monopoly cooperative means that if management is able to operate the coop in its own interest (as some critics of DFA have argued), or pursues policies favoring one region at the expense of another, or otherwise fails to represent the particular farmer's interest, the farmer has no practical alternative. That is, a monopoly cooperative is still a monopoly, with all of the disadvantages of monopoly.

While the reach of antitrust law with regard to agricultural cooperatives has been limited by certain statutory exemptions, it appears to us that antitrust can fairly clearly reach the type of agreements involved in the DFA/NDH/Hood transaction. This, then, means that it will be up to the Department of Justice, the agency currently investigating this transaction, to determine if the transaction is anticompetitive on the vertical foreclosure grounds presented in this report or, perhaps, for other reasons.

Events in the dairy industry appear to be rushing toward an end-game and antitrust intervention at this point, if it occurs, will undoubtedly come late in the game. But perhaps it is not too late to re-shape the dynamic that seems to be replacing competition with countervailing powers in the dairy industry. Farmers in affected regions of the country as well as consumers have a vital stake in the Department of Justice completing a full and aggressive investigation.

As always when a non-party attempts to evaluate an antitrust case that is under investigation by the government, there is a risk that the government's ability to interview witnesses and subpoena documents will uncover information which, if known to the analyst, would modify his opinion. We recognize the limitations of our effort, which can only report on the basis of what we have been able to learn from public sources and from asking questions to a variety of experts. We have raised questions in good faith and look to the Department of Justice to provide appropriate answers.

**Albert A. Foer, President
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Competitive Issues in the Dairy Industry: The Pending DFA/NDH/Hood Transaction

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I. Introduction

In November, 2002, National Dairy Holdings Corp. (“NDH”) and H.P. Hood (“Hood”), two of the major fluid milk processors in the country, announced their proposed merger.² The antitrust issue raised was not only the unification of two large fluid milk operators but also their vertical integration with Dairy Farmers of America (“DFA”), the largest dairy cooperative in the United States marketing approximately 48 billion pounds of milk in 2002. Since DFA has a 50% stock interest in NDH, DFA would have held a substantial ownership stake in the newly merged company.³ Moreover, DFA was to gain a critical milk supply relationship with the new processing company.⁴ On May 13, 2003, however, the press reported that, in order to ease the Antitrust Division’s concerns and to make a concession to a New England based dairy cooperative that had objected to the proposed merger, the parties abandoned their merger but stated their intention to restructure the transaction in the unusual form of an exchange of both stock and CEOs.⁵ The purpose of this paper is to examine the revised transaction against the background of more general competitive issues in the dairy industry.

In 1914, Congress enacted section 6 of the Clayton Act⁶ that granted an antitrust exemption to cooperatives that did not have capital stock.⁷ The antitrust exemption was

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² Ronald W. Cotterill, Adam N. Rabinowitz, and Li Tian, *Milk Market Channel Structure: Its Impact on Farmers and Consumers, and the Inadequacies of Antitrust Enforcement as a Foundation for Dairy Policies: Evidence from the Northeast Dairy Industry*, Testimony before the United States Senate Committee on the Judiciary (October 30, 2003), at 16, available at <http://www.fmpc.uconn.edu/milk/Testimony103003.pdf>.

³ Peter C. Carstensen, *Monopsony in Markets for Agricultural Products: A Serious Problem in Need of a Remedy*, Statement Prepared for the hearing on “Monopsony Issues in Agriculture: Buying Power of Processors in Our Nation’s Agricultural Markets” held by the Senate Judiciary Committee (October 30, 2003), available at http://judiciary.senate.gov/testimony.cfm?id=975&wit_id=2782.

⁴ *Id.*

⁵ Bruce Mohl, *National Dairy, Hood Scrap Deal Plan Alternative to Merger to Skirt Regulatory Worries*, *Boston Globe*, May 13, 2003, at D2.

⁶ 15 U.S.C. § 17 (1988) (“The labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade under the antitrust laws.”).

expanded to capital stock cooperatives engaged in collective processing, handling and marketing products for the mutual benefit of the members by the enactment of the Capper-Volstead Act⁸ in 1922.⁹ These antitrust immunities for agricultural cooperatives encouraged the development of effective cooperatives and enabled some of them to gain enormous economic power. In the last two decades, the dairy market has dramatically changed. The level of concentration in the industry has increased and the process of consolidation still continues today as seen in the above proposed transaction.¹⁰

The development of economically powerful large dairy cooperatives and changes in dairy market structure provides a context for analyzing the proposed DFA/NDH/Hood transaction.

II. Cooperative Antitrust Immunity and Regulation

1. The Capper-Volstead Act

Eight years after the enactment of section 6 of the Clayton Act in 1914, the Capper-Volstead Act further expanded antitrust immunity to capital stock cooperatives that satisfy certain statutory requirements.¹¹ The rationale behind enacting both section 6 of the Clayton Act and the Capper-Volstead Act was “the vicissitudes of agriculture” and “the relative weakness of the individual farmer’s bargaining power in the agricultural market.”¹² The Capper-Volstead Act has two provisions. Section 1 of the Act provides “a limited exemption from the antitrust laws for agricultural producers to market their products on a cooperative basis.”¹³ Section 2 provides “a mechanism to make sure

⁷ Stephen D. Hawke, *Antitrust Implications of Agricultural Cooperatives*, 73 Ky. L. J. 1033, 1034, 1035 (1984).

⁸ 42 Stat. 388 (1922), 7 U.S.C. §§ 291-292 (1982).

⁹ Hawke, *supra* note 7, at 1035.

¹⁰ Peter C. Carstensen, *Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy*, 2000 Wis. L. Rev. 531, 531 (2000).

¹¹ Hawke, *supra* note 7, at 1035. In order to receive immunity granted by the Act, the members of cooperative must produce agricultural products, the cooperative must be operated for the mutual benefit of members, the cooperative cannot deal in the nonmember products to an amount greater in value than its member products, no member is allowed more than one vote or the cooperative may not pay dividends exceeding 8% per year on stock or membership capital, cooperative membership must be voluntary, but membership can be closed; one can consent to join and be excluded, and the cooperative must perform one of the enumerated functions in the statute. *Id.* at 1039, 1040.

¹² *Id.* at 1037. For detailed analysis of legislative history, see Donald A. Frederick, *Antitrust Status of Farmer Cooperatives: The Story of the Capper-Volstead Act*, Cooperative Information Report 59 (Sep. 2002), available at <http://www.rurdev.usda.gov/rbs/pub/cir59.pdf>.

¹³ 7 U.S.C. § 291 (“Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged. Such associations may have marketing agencies in common; and such associations and their members may make the necessary contracts and

producers do not abuse their collective power to the detriment of the general public.”¹⁴ Although the language of statute itself appears specific, the scope of the immunity is not clear and it has been one of the main issues in an array of litigations regarding the Act.¹⁵

In *Maryland & Virginia Milk Producers Association v. United States*,¹⁶ the Supreme Court established a so-called “predatory action” test ruling that Congress did

agreements to effect such purposes: Provided, however, That such associations are operated for the mutual benefit of the members thereof, as such producers, and conform to one or both of the following requirements:

First. That no member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein, or,

Second. That the association does not pay dividends on stock or membership capital in excess of 8 per centum per annum. And in any case to the following:

Third. That the association shall not deal in the products of nonmembers to an amount greater in value than such as are handled by it for members.”). See Frederick, *supra* note 12, at 88.

¹⁴ 7 U.S.C. § 292 (“If the Secretary of Agriculture shall have reason to believe that any such association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced by reason thereof, he shall serve upon such association a complaint stating his charge in that respect, to which complaint shall be attached, or contained therein, a notice of hearing, specifying a day and place not less than thirty days after the service thereof, requiring the association to show cause why an order should not be made directing it to cease and desist from monopolization or restraint of trade. An association so complained of may at the time and place so fixed show cause why such order should not be entered. The evidence given on such a hearing shall be taken under such rules and regulations as the Secretary of Agriculture may prescribe, reduced to writing, and made a part of the record therein. If upon such hearing the Secretary of Agriculture shall be of the opinion that such association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced thereby, he shall issue and cause to be served upon the association an order reciting the facts found by him, directing such association to cease and desist from monopolization or restraint of trade. On the request of such association or if such association fails or neglects for thirty days to obey such order, the Secretary of Agriculture shall file in the district court in the judicial district in which such association has its principal place of business a certified copy of the order and of all the records in the proceeding, together with a petition asking that the order be enforced, and shall give notice to the Attorney General and to said association of such filing. Such district court shall thereupon have jurisdiction to enter a decree affirming, modifying, or setting aside said order, or enter such other decree as the court may deem equitable, and may make rules as to pleadings and proceedings to be had in considering such order. The place of trial may, for cause or by consent of parties, be changed as in other causes. The facts found by the Secretary of Agriculture and recited or set forth in said order shall be prima facie evidence of such facts, but either party may adduce additional evidence. The Department of Justice shall have charge of the enforcement of such order. After the order is so filed in such district court and while pending for review therein the court may issue a temporary writ of injunction forbidding such association from violating such order or any part thereof. The court may, upon conclusion of its hearing, enforce its decree by a permanent injunction or other appropriate remedy. Service of such complaint and of all notices may be made upon such association by service upon any officer or agent thereof engaged in carrying on its business, or on any attorney authorized to appear in such proceeding for such association, and such service shall be binding upon such association, the officers, and members thereof.”). It should be noted that the court in *United States v. Borden Co.*, 308 U.S. 188 (1939) ruled that section 2 of the Capper-Volstead Act is not “a substitute for the provision of the Sherman Act” and that “the procedure under § 2 of the Capper-volstead Act is auxiliary.”

See Frederick, *supra* note 12, at 88. See also David L. Baumer, Robert T. Masson, and Robin Abrahamson Masson, *Curdling the Competition: An Economic and Legal Analysis of the Antitrust Exemption for Agriculture*, 31 Vill. L. Rev. 183, 191 (1986).

¹⁵ Hawke, *supra* note 7, at 1039-1041.

¹⁶ 362 U.S. 458 (1960).

not intend “to immunize cooperatives engaged in competition-stifling practices from prosecution under the antimonopolization provisions” of the Sherman Act.¹⁷ In that case, the Association had about 2,000 dairy farmers supplying approximately 86% of the milk purchased by all milk dealers in the Washington D.C. metropolitan area. The complaint alleged that “the Association had ‘threatened and undertaken diverse actions to induce or compel dealers to purchase milk from the defendant [Association], and induced and assisted others to acquire dealer outlets’ which were not purchasing milk from the Association.”¹⁸ The Supreme Court reversed the dismissal of the Sherman Act section 2 claim and remanded for trial. The complaint also charged, among other things, that the association bought all assets of Embassy, the competitor of the association’s dealer, in violation of section 7 of the Clayton Act. The court held the District Court’s findings that the motive for and result of the acquisition was to: “eliminate the largest purchaser of non-Association milk in the area; force former Embassy non-Association producers either to join the Association or to ship to Baltimore, thus both bringing more milk to the Association and diverting competing milk to another market; eliminate the Association’s prime competitive dealer from government contract milk bidding; and increase the Association’s control of the Washington market,” and thus that the acquisition tended to create a monopoly or substantially lessen competition in violation of section 7.¹⁹

The court, in *Fairdale Farms, Inc. v. Yankee Milk, Inc.*,²⁰ faced the issue whether a cooperative may maintain a monopoly which is not achieved through predatory conduct.²¹ The court gave a broader construction to the antitrust immunity stating that “when Congress enacted the Capper-Volstead Act, it did not intend to prohibit the voluntary and natural growth that agricultural cooperatives needed to accomplish their assigned purpose of effective farmer representation.”²² Subsequently, the Second Circuit affirmed the district court’s dismissal of the monopolization claim on remand holding that there had been no predatory conducts by the cooperative.²³

¹⁷ *Id.* at 463. See Hawke, *supra* note 7, at 1044-1049. The court established two criteria that an agricultural cooperative must meet in order to receive the immunity. “First, the cooperative must try to achieve a legitimate objective of being a cooperative engaged in an agricultural business activity. Second, the cooperative must not use predatory trade practices in achieving its goal.” *Id.* See also Frederick, *supra* note 12, at 167 (“Farmers may agree among themselves on the price or prices they will receive for their products and to use their collective economic power to impose those prices on purchasers of their products. Producer associations may use tools such as full-supply contracts to establish and protect markets for member products, but not to eliminate or suppress competition.”).

¹⁸ *Maryland & Virginia Milk Producers Association*, 362 U.S. at 468.

¹⁹ *Maryland & Virginia Milk Producers Association*, 362 U.S. at 469.

²⁰ 635 F.2d 1037 (2nd Cir. 1980).

²¹ Hawke, *supra* note 7, at 1065-1069.

²² *Fairdale Farms, Inc.*, 635 F.2d, at 1043.

²³ *Fairdale Farms, Inc. v. Yankee Milk, Inc.*, 715 F.2d 30 (2nd Cir. 1983). See Hawke, *supra* note 7, at 1068-1069.

In *United States v. Dairymen, Inc.*,²⁴ the Sixth Circuit applied a narrower antitrust immunity standard for attempt to monopolize cases.²⁵ The court stated that “the district court set too high a burden on the Government when it required the Government to show that D.I.’s practices rose to the level of predatory practices, i.e., anticompetitive practices without any business justification” and that the offense of “attempt to monopolize requires only that the defendant has engaged in anticompetitive conduct with a specific intent to monopolize and that there was a dangerous probability that the attempt would be successful.”²⁶ The Eighth Circuit also emphasized the importance of the element of intent in the case of *Alexander v. National Farmers Organization*.²⁷ The court noted that the lawfulness of a cooperative’s practice “is not merely a question of whether it is ‘predatory’ in a strict sense, e.g., lacking a legitimate business justification” and that “[A] cooperative may not use its position, no matter how lawfully acquired, ‘to stifle or smother competition.’”²⁸ The court further stated that “[W]here such an unlawful intent is clear, overt acts in furtherance of this purpose are not immunized simply because they might also have other justifications or because they are merely ‘anti-competitive’ rather than ‘predatory.’”²⁹

Thus, while a dairy cooperative has immunity to exist and to market dairy products on behalf of farmer members, the immunity does not protect against acts intended to stifle competition or to monopolize through predatory or anticompetitive acts.³⁰

2. Classified Pricing and Federal Order System

In addition to antitrust immunity to agricultural cooperatives granted by section 6 of the Clayton Act and the Capper-Volstead Act, the “Classified Pricing System” within the “Federal Milk Market Order System” as provided by the Agricultural Marketing

²⁴ 660 F.2d 192 (6th Cir. 1981).

²⁵ Hawke, *supra* note 7, at 1074, 1075.

²⁶ *Dairymen, Inc.*, 660 F.2d, at 194. Claims of attempted monopolization under section 2 of the Sherman Act require proof of: (1) a relevant geographic and product market; (2) specific intent to monopolize the market; (3) anticompetitive conduct in furtherance of the attempt; and (4) a dangerous probability that the firm will succeed in the attempt. E.g., *United States v. AMR Corp.*, 335 F.3d 1109 (10th Cir. Kan., July 3, 2003). See also *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993). The court held that defendants may not be liable for attempted monopolization “absent proof of a dangerous probability that they would monopolize a particular market and specific intent to monopolize.” *Id.* at 459.

²⁷ 687 F.2d 1173 (8th Cir. 1982). See Hawke, *supra* note 7, at 1076, 1077.

²⁸ *Alexander*, 687 F.2d, at 1183.

²⁹ *Id.*

³⁰ Hawke, *supra* note 7, at 1076, 1077.

Agreements Act (AMAA)³¹ has had a significant effect on dairy cooperatives' practices.³²

Under the Classified Pricing System, Grade A milk³³ is divided into four classes that we will here call A1 to A4: Class A1, which is used for fluid milk; Class A2, is soft dairy products; Class 3 is cheese; and Class 4 is butter and nonfat milk powder. A price for Class A1 milk is set at a higher level than for all other classes of milk in each of the 11 federal market orders.³⁴ This difference is established by the U.S. Congress. The fluid milk premium over the higher of Class 3 and 4 manufacturing milk is \$1.70 per hundred pounds at Eau Claire, Wisconsin, the order system base pricing point. It increases to \$3.25 per hundred weights at Boston. This statutory price discrimination policy favoring fluid milk exploits inelastic demand for fluid milk in order to increase farmers' income. Each federal order pools receipts from sales of all classes of milk and pays a weighted average price back to farmers that is higher than what they would receive if there were no market order. In practice, it is important for dairy farmers to have access to Class A1 fluid milk plant customers in order to participate in the pool. For example, in the Northeast market order a cooperative must sell at least 20% of its milk during the fall and 10% the rest of the year to fluid handlers to participate in the pool. If they do not, their members receive only the lower cheese and butter prices for their milk. In some regions, a dairy farmer can expect to cover costs only with the income from premium-priced Class A1 milk.

We have heard reports, which ought to be investigated by an enforcement authority with subpoena power, that DFA has been able to manipulate this system to its advantage by coercing smaller cooperatives and non-members to join either DFA or DFA-controlled marketing agencies or otherwise force independent producers to pay a fee to pool their milk on the Federal Order.

III. Cooperative Practices in the Dairy Industry

1. Brief History of the Dairy Industry

Since the Depression of the 1930s, the United States Department of Agriculture (USDA), charged by Congress, has regulated the milk market by adopting various schemes to enhance farmers' incomes and to fulfill consumers' demand for fresh milk.³⁵

³¹ 7 U.S.C. §§ 671-674 (2003).

³² See Baumer, Masson, and Masson, *supra* note 14, at 204-209.

³³ Grade A milk is allowed to use as fluid milk for human consumption (Class 1 products) and is produced under stricter sanitary conditions. Therefore, Grade A milk may be used for all Class products. Grade B milk is used only for manufactured products, such as cheese and butter. Today, virtually all milk is Grade A, but that was not true when the orders were established in the 1930s.

³⁴ A federal market order is a specified geographic area defined as a market by the USDA, and is subject to the pricing system and other regulations.

³⁵ Frederick, *supra* note 12, at 249.

Although the income of dairy farmers was low during the late 1950s and early 1960s, technological developments, such as improved production methods and effective transportation and distribution systems, expanded competition among small regional markets.³⁶ Since milk is a highly perishable commodity, there were small isolated markets until the development of more effective distribution methods, such as interstate highways and large tank trucks.³⁷ Cooperatives responded to these problems first by forming federations in order to coordinate their activities.³⁸ Subsequently, the movement of consolidation began in the late 1960s. From 1967 to 1971, approximately 170 local cooperatives integrated into three large cooperatives with about 64,000 producers.³⁹

2. Current Market Situation of the Dairy Industry

Today, the dairy industry is characterized by high concentration, particularly in the buying and processing market, and vertical strategic alliances are progressing in several regional markets. For example, as mentioned below, Dean Foods (“Dean”) controls about 40% of the fluid milk processing market.⁴⁰ In addition, DFA has a long term contract with Dean and supplies milk to most of Dean’s processing plants.⁴¹ Allegations have been made that DFA has used this marketing relationship with Dean and other DFA-affiliated marketing agencies on a nationwide basis to increase its market control at the expense of local producers of milk—leaving smaller producers with no choice but to join or affiliate with DFA. Market concentration is also seen in related dairy products markets, such as cheese, butter and ice cream. In each of these markets, there are dominant firms, such as Land O’ Lakes, the leading butter producer, and Kraft, which dominates the cheese market.⁴²

DFA, a Kansas corporation with its headquarters and principal place of business in Kansas City, Missouri, is the largest dairy cooperative in the United States. It was formed in 1998 as a result of a series of mergers of large cooperatives, including the Southern Region of Associated Milk Producers, Mid-America Dairymen, Western Dairymen Cooperative and Milk Marketing, Inc.⁴³ It has more than 24,000 members in

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.* at 250-251. In 1967, six large members of Associated Dairymen, Inc., merged into Milk Producers, Inc. (MPI). After being joined by additional members, Pure Milk Association and four other cooperatives joined the renamed Associated Milk Producers Inc. (AMPI), which supplied more than 75% of the fluid milk in Chicago, Dallas, Houston, Indianapolis and several other markets. In 1968, cooperatives serving in Iowa, Kansas, Missouri and Illinois markets formed Mid-American Dairymen (Mid-Am), which included 31 former associations and 23,000 producers by 1971. Dairymen, Inc. (DI) was also formed in 1968 by eight cooperatives mainly serving the central and southeastern states, and had 9,800 members by 1971.

⁴⁰ Cotterill, Rabinowitz, and Tian, *supra* note 2, at 12.

⁴¹ Carstensen, *supra* note 3.

⁴² *Id.*

48 states, marketed approximately 48 billion pounds of milk, and had sales of \$6.4 billion in 2002.⁴⁴

In March 2000, the Department of Justice Antitrust Division filed a civil antitrust suit to block DFA's intended acquisition of SODIAAL North America Corporation ("SODIAAL"). The Department of Justice alleged in its complaint that DFA and SODIAAL were two of the three principal suppliers who accounted for more than 90% of branded butter sales in the New York and Philadelphia metropolitan area market and thus the proposed acquisition would result in a virtual duopoly in the market violating section 7 of the Clayton Act.⁴⁵ The chief competitor in the market was Land O' Lakes, an agricultural cooperative entitled to receive the Capper-Volstead exemption.⁴⁶ SODIAAL was a private subsidiary of a French cooperative not covered by the Capper-Volstead Act.⁴⁷ The Antitrust Division emphasized that, after the transaction, DFA and Land O' Lakes would engage in anticompetitive coordination in order to maximize their profit without antitrust scrutiny since both firms were agricultural cooperatives.⁴⁸ The case was settled. DFA agreed to transfer all assets necessary to manufacture and market its branded butter (including "Keller's" and "Hotel Bar" brands acquired from SODIAAL) to a newly formed company, Keller's Creamery LLC, which would not qualify as an agricultural cooperative under the Capper-Volstead Act.⁴⁹ As a result of this transaction, DFA expanded the market for its members' milk sales into the former SODIAAL's plants which were used for butter manufacturing, although it lost the ability to collaborate with its competitor, Land O' Lakes, to increase income from marketing branded butter in the relevant market for their farmer members.⁵⁰

In April 2001, Suiza Foods Corporation ("Suiza"), the second largest fluid milk processor, announced that it would acquire Dean Foods, the largest processor in the country, and the new company, Dean, would have approximately a 40% share in the U.S. processing market.⁵¹ Prior to the merger, in the New England market, during the years of 1997 and 1998, Suiza had acquired leading processors, such as Garelick, West Lynn Creameries and Cumberland Farms, and became a single dominant firm.⁵² The merger

⁴³ www.dfamilk.com/who_we_are/who_we_are_history.html.

⁴⁴ www.dfamilk.com/who_we_are/who_we_are_facts.html.

⁴⁵ Plaintiff's Verified Complaint at 2, *United States v. Dairy Farmers of America*, 2001-1 Trade Cas. (CCH) P73,136, 2000 U.S. Dist. LEXIS 19979.

⁴⁶ Plaintiff's Competitive Impact Statement at 2, *United States v. Dairy Farmers of America*, 2001-1 Trade Cas. (CCH) P73,136, 2000 U.S. Dist. LEXIS 19979.

⁴⁷ *Id.* at 4.

⁴⁸ *Id.* at 10.

⁴⁹ Frederick, *supra* note 12, at 323.

⁵⁰ *Id.* at 324.

⁵¹ Cotterill, Rabinowitz, and Tian, *supra* note 2, at 12.

⁵² *Id.* at 8.

between Suiza and Dean also involved vertical alliances. DFA owned a 33.8% equity interest in Suiza and Suiza had a full supply contract with DFA.⁵³ In order to resolve antitrust concerns in the Suiza/Dean transaction, the Department of Justice required the parties to divest 11 processing plants to NDH, a newly formed corporation at this time, owned 50% by DFA, while DFA was required to sell its equity interest in Suiza back to the company and to modify its supply contract with Suiza to ensure “that dairies owned by the merged firm in the areas affected by the divestitures will be free to buy their milk from sources other than DFA.”⁵⁴ As a result, NDH is now the third largest fluid milk processor in the national market, with \$2.3 billion sales in 2002, following Dean, the largest, with \$8.12 billion sales, and Kroger, the second largest supermarket chain and processor.⁵⁵

Meanwhile, DFA’s emergence in the northeast was enhanced by the formation of a marketing agency in common, Dairy Marketing Services (“DMS”).⁵⁶ DMS was formed by DFA and Dairylea, the leading dairy cooperative in New York, in 1999.⁵⁷ Subsequently, Suiza appointed DMS as the milk assembly agent for its independent farmers and NDH entered into full supply contract with DMS at plants in New Hampshire and New York, which made DMS the leading fluid milk assembler in New England.⁵⁸ DMS now supplies Dean and NDH plants in New York, New Jersey, Pennsylvania and New England.⁵⁹

According to reports brought to our attention, but which we have not investigated, DFA has similarly used its relationship with DMS and other marketing agencies to emerge as a powerful market force in other locations across the country. For example, it is said that DFA has used its control over NDH to become the exclusive marketing agent to the Velda milk processing plants in Florida. This, if confirmed, would take on additional significance because DFA has control over a large volume of milk which it can move into the Florida region to supply these plants and displace local dairy producers’ milk. DFA, through NDH, is said to have used these facts to pressure Southeast Milk, Inc, an independent dairy cooperative, to join or affiliate with DFA.

⁵³ *Id.* at 13.

⁵⁴ Press Release, The Department of Justice, Justice Department Requires Suiza Foods and Dean Foods to Divest 11 Dairy Processing Plants (December 18, 2001), available at http://www.usdoj.gov/opa/pr/2001/December/01_at_652.htm. See also Cotterill, Rabinowitz, and Tian, *supra* note 2, at 12. With regard to the Suiza-Dean merger, Professor Carstensen mentioned, at the hearing on “Monopsony Issues in Agriculture: Buying Power of Processors in Our Nation’s Agricultural Markets” held by the Senate Judiciary Committee, the lack of transparency regarding agency decisions stating that the public cannot learn “what the bases were for its settlement in the Suiza-Dean merger that created a single firm controlling 30% of all fluid milk purchases in the country.” Carstensen, *supra* note 3.

⁵⁵ Cotterill, Rabinowitz and Tian, *supra* note 2, at 12.

⁵⁶ *Id.* at 13-14.

⁵⁷ *Id.* at 14.

⁵⁸ *Id.*

⁵⁹ *Id.*

3. The Current DFA/NDH/Hood Transaction

The proposed transaction among DFA, NDH and Hood is the latest antitrust concern in the New England market.⁶⁰ In November 2002, NDH and Hood announced their original merger plan. NDH operates 33 dairy plants all around the country; has one plant in New England (Concord, New Hampshire) and two plants in New York (one at Binghamton and one near Albany), and Hood accounts for approximately 15% of fluid milk processing in the New England market.⁶¹ Therefore, NDH and Hood are horizontal competitors in New England and NDH is a potential supplier from its Binghamton plant as well. If the proposed merger would have been consummated as originally planned, the Agri-Mark Cooperative (“Agri-Mark”), the distant second largest fluid milk assembler following DFA/DMS in the New England market, would allegedly lose its sales to Hood because DFA would maintain its stake in the new company and the merged processors would seek to obtain an exclusive supply contract with DFA/DMS.⁶² 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.⁶³ 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.⁶⁴ 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.⁶⁵

On May 12, however, this deal was abandoned, reportedly because of strong objections by both the competing dairy cooperative and antitrust authorities. The parties announced, instead, that they restructured and intended to consummate the transaction in a form of an exchange of both stock and CEOs: (1) Hood will acquire a 30% interest in NDH; (2) DFA will acquire a 15% interest in Hood; (3) The chief executive of Hood will be the new chairman and chief executive of NDH, and the president of NDH will be the new president of Hood.⁶⁶ Although the new proposed transaction did not refer to any supply arrangement,⁶⁷ as noted above, it is speculated that DMS/DFA may seek to enter

⁶⁰ *Id.* at 16-17.

⁶¹ Mohl, *supra* note 5.

⁶² Cotterill, Rabinowitz and Tian, *supra* note 2, at 16.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* at 17.

⁶⁶ Mohl, *supra* note 5.

⁶⁷ As discussed in detail later, the owner of Hood assured Agri-Mark that their current supply contract would be fully honored and that Hood had no agreement or understanding with DFA that there would be a full supply agreement in future. Robert D. Wellington, [Prepared] Testimony to the United States Senate

into exclusive supply contracts with both NDH and Hood which, in turn, would deprive Agri-Mark of its outlet.

IV. Antitrust Issues in the Dairy Market

As concentration in the market (including both seller side and buyer side) increases, it is more likely that firms may try to implement their dominant market position in order to maximize their profits. This section surveys some examples of anticompetitive activities in the highly concentrated dairy markets.

1. Monopoly Issues: Sherman Act Section 1: Horizontal Coordination

Market concentration enables the market participants “more likely, more successfully, more completely to engage” in express or tacit collusion or coordinated interaction to the detriment of consumers.⁶⁸ As explained earlier, agricultural cooperatives are exempted from the application of antitrust laws for certain of their joint activities including the pricing and marketing of their products, but the scope of such antitrust immunity has long been disputed. Recently, an ice cream manufacturer brought antitrust action alleging that the two largest dairy cooperatives in the country, DFA and Land O’ Lakes, and other smaller companies conspired to inflate the Chicago Mercantile Exchange (“CME”) butter price in order to increase the wholesale prices of milk, cream and butter.⁶⁹ According to the complaint, since the price of milk has been decided by a formula which incorporates the CME butter or cheese price, whichever is higher, and trading of butter on the CME takes place just a few minutes per week, defendants can manipulate the CME butter market by buying very small quantities of butter on the CME in order to increase the prices of milk.⁷⁰ In this case, the court denied defendants’ motion to dismiss, which was based upon, among other things, the filed rate doctrine and implied immunity.⁷¹

Judiciary Committee regarding the Competitive Environment for Dairy and Livestock Producers (Oct. 30, 2003).

⁶⁸ See U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines (April 2, 1992), at § 2.

⁶⁹ *Ice Cream Liquidation, Inc. v. Land O’ Lakes, Inc.*, 253 F.Supp.2d 262 (2003).

⁷⁰ *Ice Cream Liquidation*, 253 F.Supp.2d, at 268, 269.

⁷¹ *Ice Cream Liquidation*, 253 F.Supp.2d. With regard to the filed rate doctrine, the court stated that plaintiff is “not challenging these USDA-set minimum prices or the formula used to calculate these prices, but rather the wholesale milk prices charged by defendants. Thus, since the prices charged by defendants were never approved by the USDA, the filed rate doctrine would not apply.” *Id.* at 276. The court also noted that “plaintiff is not challenging the FMMOs approved by the USDA, nor is plaintiff challenging the minimum prices set by the FMMOs” and thus “the implied immunity doctrine does not apply to plaintiff’s claims.” *Id.* at 277. *Cf. Servais v. Kraft Foods, Inc.*, 246 Wis. 2d 920 (2001). In this case, the appellants, dairy farmers, alleged that “through a manipulation of prices paid on the National Cheese Exchange and elsewhere,” the defendants, food manufacturing corporations including Kraft, “were able to lower the milk orders’ minimum pay prices for milk producers in their areas because the orders were calculated in part through the use of manipulated data.” *Servais*, 246 Wis. 2d, at 924. The court stated that “[B]ecause the federal milk marketing orders at issue here were established by a federal agency through formal rulemaking designed to implement a congressional scheme, they determine lawful rates. And because the filed rate doctrine precludes suits for damages developed through attacks on such lawful rates, whether the claims for

2. Monopoly Issues: Sherman Act Section 2: Intent to Monopolize

The role of vertical alliances, as a mean of achieving monopoly or monopsony, between a dominant milk assembly cooperative, a dominant milk processor, and a dominant retail supermarket chain in this market channel must be carefully examined. Vertical foreclosure strategies may exist wherein the retailers erect entry and mobility barriers for the dominant processor and assembler while the latter two assist in enforcing the dominant retailers' price leadership at retail. Farmers and consumers, as a result, both may suffer antitrust harm.

The formation of DMS and the current proposed transaction among DFA, NDH and Hood are examples of vertical alliances between dairy cooperatives and fluid milk processors. First, DFA/DMS and Dean vertical alliance has gained a dominant position in the Northeast fluid milk market. Both the fluid milk assembly and the processing markets are highly concentrated. Second, if the proposed transaction among DFA, NDH and Hood is allowed to be consummated, the fluid outlets of the other dairy cooperatives in New England, if not foreclosed, could be impaired and also barriers to entry could be increased.

In testimony submitted to the United States Senate Judiciary Committee in October 2003, Agri-Mark withdrew its previous strong opposition to the original merger plan, stating that the revised proposal did not include any formal supply agreement and that Agri-Mark had been assured by the owner of Hood that its "current supply contract will be fully honored into the future" and Hood and DFA did not have any formal or informal agreement or understanding that there would be a full supply contract in the future.⁷² However, the details and contents of "assurances" by the Hood owners, whether there is a formal agreement with regard to Agri-Mark's milk supply to Hood, and, if there is, what clauses are included in their agreement, are not clear. How long Agri-Mark's supply contract "will be fully honored" is also uncertain and DFA may still enter into a full supply agreement with Hood. Because it is possible to speculate that Agri-Mark will join DFA/DMS and complete the monopolization of fluid milk assembly market in New England, investigation of this transaction should not be terminated simply because Agri-Mark no longer objects.⁷³ Even though the parties abandoned the original merger plan, reciprocal ownership stakes and blended management in the restructured transaction must be investigated in terms of their potential in lessening competition in the already concentrated fluid milk processing market in New England.⁷⁴

relief arise under state of federal law, we conclude that the filed rate doctrine bars the appellants' action herein." *Servais*, 246 Wis. 2d, at 932.

⁷² Wellington, *supra* note 67.

⁷³ Cotterill, Rabinowitz, and Tian, *supra* note 2, at 17.

⁷⁴ *Id.* at 16, 17. While our primary focus in this paper is on vertical foreclosure, the restructured transaction may also be viewed as a horizontal collaboration at the processor level, raising the prospect of coordinated interaction. The *Antitrust Guidelines for Collaborations Among Competitors*, issued in April 2000 by the Federal Trade Commission and the Department of Justice, provide the antitrust enforcement policy of the Agencies regarding competitor collaborations. According to the guidelines, "[A] 'competitor collaboration' comprises a set of one or more agreements, other than merger agreements, between or among

Analysis of the 1996-2000 era IRI supermarket data for Southern New England showed that “Hood was more willing to compete on price.”⁷⁵ The “fish oil” battle in the Boston news media also documents Hood’s willingness to attack Garelick/Suiza (now Garelick/Dean).⁷⁶ This may establish a so-called “maverick” status for Hood, such that preserving its important role in the marketplace must be of particular public concern.⁷⁷

Finally, the DFA/DMS and Dean vertical alliance also extends to the retail level because of a 20-year vertical alliance between Dean and Southern New England’s dominant supermarket chain, Stop & Shop. Since its 1996 merger into the huge Royal Ahold chain, Stop & Shop has been the price leader on retail milk sales.⁷⁸ The recent price survey research by Cotterill et al. documents that Stop & Shop and the other supermarket chains that follow its lead routinely mark up Hood milk more than other brands thereby capturing Hood’s brand equity and impeding its ability to compete in a maverick fashion against private label and Garelick/Dean brands of milk.⁷⁹

The proposed transaction is not exempt from antitrust law because it involves firms that are not cooperatives. The transaction is still under antitrust scrutiny and the Department of Justice needs to carefully examine the impact of the transaction on price competition both in the processing and retail markets.⁸⁰

competitors to engage in economic activity, and the economic activity resulting therefrom.” “The competitive effects from competitor collaborations may differ from those of mergers” in that, among other things, “competitor collaborations preserve some form of competition among the participants” and “competitor collaborations are more typically of limited duration.” However, the guidelines provide that some competitor collaborations have competitive effects identical to those of mergers and that the agencies treat a competitor collaboration as a horizontal merger in a relevant market when: “(a) the participants are competitors in that relevant market; (b) the formation of the collaboration involves an efficiency-enhancing integration of economic activity in the relevant market; (c) the integration eliminates all competition among the participants in the relevant market; and (d) the collaboration does not terminate within a sufficiently limited period by its own specific and express terms.” The restructured transaction should be analyzed to determine whether the transaction may have the same likely practical effect of terminating competition between Hood and NDH would have had if these companies had actually merged into a single entity, as originally proposed. In this case, the merger may be virtually a 3-2 merger in the New England milk processing market.

⁷⁵ Ronald W. Cotterill and Andrew W. Franklin, *The Public Interest and Private Economic Power: A Case Study of the Northeast Dairy Compact* (May 3, 2001) at 6, 16-18, available at <http://www.fmpc.uconn.edu/compact/>.

⁷⁶ *Id.* at 15-18.

⁷⁷ For the concept of a maverick in an antitrust analysis, see Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects under the Antitrust Laws*, 77 N.Y.U.L. Rev. 135 (2002).

⁷⁸ Cotterill and Franklin, *supra* note 75, at 15-18.

⁷⁹ Ronald W. Cotterill, Adam N. Rabinowitz, and Li Tian, *Milk Prices in New England and Neighboring Areas of New York: A Prologue to Action?* (November 19, 2002), available at <http://www.fmpc.uconn.edu/milk/MilkPrices.pdf>.

⁸⁰ *Id.* at 9.

3. Monopsony Issues

Monopsony and buyer power issues are critical in today's dairy markets.⁸¹ Monopsony power is the symmetrical concept of monopoly power, that is, a monopsonist depresses the price of product it purchases by reducing the total quantity of its input while a monopolist raises the price of its product by reducing its output.⁸² A dominant buyer may also exercise its power in different ways, such as the manipulation of market prices.⁸³ However, distinguishing competitive price cutting and monopsonistic price reduction is not an easy task.⁸⁴ Furthermore, whether the exercise of monopsony power violates the antitrust laws only where buyer power results in consumer harm is also an open issue.⁸⁵ With regard to the latter, R. Hewitt Pate, Assistant Attorney General for

⁸¹ Carstensen, *supra* note 3.

⁸² See, e.g., R. Hewitt Pate, *Antitrust Enforcement in the Agricultural Marketplace*, Statement before the Committee on the Judiciary United States Senate (October 30, 2003), available at <http://www.usdoj.gov/atr/public/testimony/201430.htm> ("Monopsony is the mirror image of monopoly, except on the buying, not the selling, side of the market. One example of the exercise of monopsony power is a situation in which a purchaser with market power reduces the quantity it purchases in order to force down the per unit price it pays."). At its conference on June 22, 2004, the American Antitrust Institute will explore whether there might be additional differences between buyer and seller power.

⁸³ Carstensen, *supra* note 3. Professor Carstensen mentioned four categories of monopsonistic conduct: "(1) the manipulation of public market prices to ensure lower costs to buyer on the contractual side of the market; (2) direct manipulation and depression of producer prices often manifest in the increasing spread between the farm price and the wholesale or retail price of the product involved; (3) discriminatory contracting practices that avoid open, public market; (4) imposing inequitable burdens on the producers."

One example of the manipulation of market prices is cheese price manipulation at the National Cheese Exchange ("NCE") in Green Bay, Wisconsin, during the late 1980s and 1990s. NCE is a centralized cash auction market at which only 0.2% of all bulk cheese was traded. Trading was typically held just 30 minutes each Friday. However, similar to the above Ice Cream Liquidation case, there was a great incentive among traders for trying to influence NCE price, since NCE provided a reference price for a vast volume of bulk cheese transactions occurring outside NCE. NCE prices also determined the price of milk used for making cheese products. Kraft, the leading manufacturer of cheese products and the largest buyer of bulk cheese, was originally a buyer on the NCE, but became "exclusively a seller-trader" who made 74% of all NCE sales during 1988 to 1993. Because Kraft benefited from lower NCE prices as the largest buyer of bulk cheese, Kraft, with other leading manufacturers, participated in the trading as sellers in order to drive down the price of products which they were buying. In response to the reversed trading conduct of Kraft, major dairy cooperative cheese manufacturers, who sold their products to Kraft and other cheese product manufacturers, reversed their trading activities, from being sellers to being buyers on the NCE. However, the activities of buyer-traders did not affect NCE prices significantly because buyers lacked countervailing market power against Kraft, a dominant player in the cheese product industry, and its allies. According to the research by Professor Mueller and Professor Marion, "during the days Kraft and the other leading seller-traders were active on the NCE, prices increased during only 8 percent of the sessions, whereas they decreased during 43 percent of the sessions and remained unchanged during 22 percent of the sessions" and "in 27 percent of the sessions their selling activity moderated upward price trends." Willard F. Muller, Bruce W. Marion, et al., *Cheese Pricing: A Study of the National Cheese Exchange (Summary, Conclusions, and Policy Initiatives)* (A Report of the Food System Research Group, Department of Agricultural Economics, University of Wisconsin-Madison) (March 1996).

⁸⁴ See John R. Wilke, *How Driving Prices Lower Can Violate Antitrust Statutes: "Monopsony" Suits Mount as Companies Are Accused of Squeezing Suppliers*, *The Wall Street Journal* (January 27, 2004).

⁸⁵ For detailed analysis regarding the role of consumer harm in monopsony issues, see David Balto, *Punishing Monopsony Without Proving Consumer Harm?*, *The Sedona Conference* (November 20-21,

Antitrust, stated in his testimony to the United States Senate Judiciary Committee in October 2003 that “[W]hile we often speak of consumers as the targeted beneficiary of antitrust enforcement, suppliers also benefit, by having healthy incentives to provide the best products and services they can, with the expectation that they will be able to do so free from anticompetitive interference” and that “[P]rice fixing and other forms of collusion are just as unlawful when the immediate victims are sellers rather than buyers.”⁸⁶

Monopsony power in the raw milk and dairy commodity markets, together with the market power of large supermarket chains, results in low raw milk prices for farmers while monopoly power at retail results in high retail prices for consumers. In the New England market, as described before, concentration in the fluid milk processing market has increased and now Dean dominates the market. Relevant local retail food markets are also often dominated by a single supermarket chain.⁸⁷ The series of surveys conducted by Professor Cotterill revealed that this market concentration causes the increasing disparity between retail milk prices and raw fluid milk prices that farmers receive for their products.⁸⁸ For example, “the Federal Market Order Administrator’s retail price series for Hartford and Boston indicate that retail prices have dropped only a dime while farm prices have dropped as much as 50 cents over the past year.”⁸⁹ Moreover, “Milk is 70 cents per gallon cheaper in the surveyed NY area (Long Island, metro NY city and the Hudson river valley up to Albany) than in southern New England” and “when the raw fluid price dropped eight cents a gallon in Boston retail prices did not drop in New England but they did in New York.”⁹⁰ Indeed, the processing and retail market in New York is more competitive than the one in New England.⁹¹ The trend of retail milk prices shows that although Dean has gained “scale, capacity utilization, or distribution economies” as they became a dominant player in the processing market and

2003). Mr. Balto concluded that the antitrust laws should apply where the exercise of buyer power adversely affects the competitive process – even in the absence of specific consumer harm. *Id.*

⁸⁶ Pate, *supra* note 82.

⁸⁷ Ronald W. Cotterill, *An Antitrust Economic Analysis of the Proposed Acquisition of Supermarkets General Holdings Corporation by Ahold Acquisitions, Inc.*, Food Marketing Policy Center Research Report No.46 (April 1999), at 2, 3, available at <http://www.fmpc.uconn.edu/SERIES.HTML>. See also Ronald W. Cotterill, Tirtha P. Dhar, and Andrew W. Franklin, *Post Merger Price Conduct: A Case Study of Pricing in Connecticut Markets after the 1996 Royal Ahold-Stop & Shop Merger*, Food Marketing Policy Center Research Report No. 47 (October 1999).

⁸⁸ Cotterill, Rabinowitz, and Tian, *supra* note 2, at 18-21. See also Cotterill, Rabinowitz, and Tian, *supra* note 79, at 1. See also Ronald W. Cotterill, Adam N. Rabinowitz, and Li Tian, *A Law to Promote Efficient and Fair Pricing of Milk in Connecticut* (April 23, 2003); Adam N. Rabinowitz, Matthew Schwane, and Ronald W. Cotterill, *Retail Milk Prices in New England, New York, and Seattle: An Unresolved Issue* (September 23, 2003); Ronald W. Cotterill, *Recent Retail, Wholesale, and Farm Prices in New England and New York: Analysis of Excessive Retail Margins in New England* (November 17, 2003).

⁸⁹ Cotterill, Rabinowitz, and Tian, *supra* note 79, at 1.

⁹⁰ Cotterill, Rabinowitz, and Tian, *supra* note 2, at 20, 21. It should be noted that New York, in 1991, enacted a price gouging law which established a cap on retail milk prices. This law promotes price transmission from farm to retail sales and contributes to form lower retail prices. *Id.* at 17, 18, 21.

⁹¹ Cotterill, Rabinowitz, and Tian, *supra* note 79, at 8.

Royal Ahold claimed that economies of scale and procurement justified the Royal Ahold merger of Stop & Shop with its Edwards Supermarket chain, consumers have not yet benefited “in the form of a lower retail-farm marketing margin and lower retail prices.”⁹²

A retail buyer, who does not have enough market power required for monopsony, may still exercise its bargaining power against sellers.⁹³ By making a threat to refuse to deal or to transfer its business from one seller to another (an “all or nothing” proposition), a strong retailer can obtain prices that are below competitive levels. Large supermarket chains use their bargaining power to demand low prices or side payments such as slotting fees for allowing processors access to their retail space.⁹⁴ For example, the loss of a high volume private label milk contract could represent a significant share of a plant’s volume. Firms that cannot afford to go along with such demands may be denied access to the retail markets.⁹⁵ In addition, the processors may be able to pass these costs back to farmers.⁹⁶ As a result, retailer buying power hurts dairy farmers.⁹⁷ Note that the processor who passes price cuts back to farmers may not itself have market power. The processor may convey the following message to farmers. “If you do not give me a price break on raw milk price and related services, I will lose the contract and go out of business. Then you have no fluid market.” This clearly can be a credible threat in a vertical pricing game. It is similar to the credible threats that highly leveraged supermarket chains used against labor and suppliers during the leveraged buyout wave of the nations’ largest supermarket chains.⁹⁸

The restructured transaction among DFA, NDH and Hood also raises the buyer power questions. As described before, since DFA had a 50% equity interest in NDH and DFA would maintain its stake in the newly formed company, it was speculated that, under the original merger plan, the new processor and DFA/DMS would enter into an exclusive supply contract, and competing cooperatives in the New England market would be excluded from the market, particularly the all-important Class 1 fluid milk market.⁹⁹ In the current restructured transaction, an exchange of both stock and CEOs, one must ask whether the same exclusionary conduct can happen or, even absent full exclusion, competing cooperatives can only keep fluid contracts by giving discounts or rebates on its milk and services that result in a monopsonistically-suppressed price being paid to their

⁹² Cotterill and Franklin, *supra* note 75, at 18.

⁹³ Bargaining power may be exercised not only individually by a single firm but also jointly by a group of retailers. On this point, tacit collusion applies equally in buying as in selling power.

⁹⁴ Carstensen, *supra* note 3.

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ See Ronald W. Cotterill, “Food Retailing Mergers, Leveraged Buyouts and Performance” in L. Duetsch ed. *Industry Studies*, Prentice Hall, Englewood Cliffs (1993).

⁹⁹ Cotterill, Rabinowitz, and Tian, *supra* note 2, at 16.

members for their milk. Over time these members either individually or as a group would seem likely to gravitate to the dominant DFA/DMS operation, thereby giving them a full monopsony position in the assembly of milk. Farmers then would have only one access point to the fluid market.

In other words, the question is whether the entire scheme of the proposed transaction should be viewed as an exercise of monopsony power against farmers because buying activities of all major processors in the market will uniformly be conducted through the supply relationship with DMS/DFA or will be sufficiently threatened so that subsequent “market forces” will almost inevitably lead to the growth of DMS/DFA to monopsony status. Monopsony power is indirectly exercised by DMS/DFA through its vertical relationship with processors and retailers in this case. Although an exclusive supply contract is not known to be a part of the deal and Agri-Mark testified that it had been assured by Hood that its supply contract would be fully honored into the future, the current proposed transaction should be reviewed from the perspective of whether the whole transaction has an anticompetitive effect as an exercise of monopsony power.

As mentioned earlier, allegations have been made that DFA has used this technique of conducting all buying activities of all major processors in the market through a supply relationship with DFA or DFA affiliated purchasers to exclude competitors from the market, and that DFA has acted in a similar manner—acquiring exclusive supply contracts or taking outright control of bottling plants or marketing agencies to cut off smaller cooperatives and producers—in a number of areas across the country.

The modified proposed transaction among DFA, NDH and Hood presents the critical antitrust issues in today’s dairy industry, particularly monopsony power and vertical alliances, and the Justice Department’s clarification of the facts and its response to this transaction may suggest future policies for antitrust enforcement and dairy regulations.¹⁰⁰

¹⁰⁰ See, e.g., Carstensen, *supra* note 3. “[A] central problem in antitrust enforcement is the lack of clear standards specifically related to the risks posed by monopsony and buyer power.” “It is evident that buyer power can create anticompetitive potential even if the share of buying market is modest. In addition, the effects of buying power can occur in markets remote from the selling market on which the government is likely to focus in doing its traditional analysis.” *Id.*