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Small dairy farmers take on 'Goliath' cooperative

Dairy Farmers of America has become a dominant force in the U.S. milk market since 1998, soaking up the competition and angering many

By Andrew Martin Tribune national correspondent

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FRANKLINTON, La. -- A revolt among dairy farmers is under way in the piney hills of southeast Louisiana, led by a portly dairyman with thick glasses and a constant wad of Levi Garrett chewing tobacco in his cheek.

Jerome Walker, 54, a third-generation dairy farmer, has corralled several dozen other dairymen to upend the sale of a small family-owned milk plant to a subsidiary of Dairy Farmers of America, or DFA, the nation's largest and most powerful dairy cooperative.

If the sale of Dairy Fresh stands, Walker says the few remaining independent dairy farmers in Louisiana--those not affiliated with any cooperative--will be left with no choice but to join DFA, which already represents most of the dairy farmers in his state.

Walker's cause has been championed in The Milkweed, a rabble-rousing dairy trade newspaper, and has drawn the interest of antitrust prosecutors with the U.S. Justice Department, which recently sent a delegation to meet with Walker and other disgruntled farmers over a meal of fried catfish and sweet tea.

What makes Walker's campaign surprising is that farm cooperatives were created to help small dairy farmers. By pooling farmers' milk, a cooperative is supposed to increase members' market power and the size of their milk payments from buyers.

But Walker and his allies contend that DFA has used hardball tactics to force dairy farmers to join and then failed to deliver meaningful benefits once they are members. In the eyes of some farmers, DFA has abandoned David and taken sides with Goliath.

"If you look at what a dairy co-op is supposed to be, they have defied all those rules," Walker said in a soft drawl. "They are going to put us all out of business."

The dustup in Louisiana and growing pockets of dissatisfaction with DFA elsewhere reveal a broader debate about whether there is a place for relatively small farmers such as Walker, who has 40 cows, in an increasingly competitive marketplace.

Global competition as well as pressure from giant food companies and grocery store chains to reduce costs have helped force many small and mid-sized dairy farms out of business. The remaining farms are bigger



and, in theory, more efficient; some have as many as 10,000 cows.

While consolidation is supposed to make the production of milk more efficient, consumers have not benefited from the trend in terms of lower retail prices, experts say. Based on the consumer price index, the price of a gallon of milk, when adjusted for inflation, has stayed about the same since 1986, said Ed Jesse, a dairy economist at the University of Wisconsin-Madison.

Getting bigger and bigger

DFA has survived, and even thrived, by getting bigger--even as other cooperatives have struggled. Created in 1998 out of the merger of four dairy cooperatives, DFA has since swallowed up smaller cooperatives, signed exclusive supply agreements with bottling plants and diversified into everything from trucking to cheese manufacturing. It supplies milk to Dean Foods, manufactures bottled Starbucks Frappuccino and owns Borden cheese.

While the number of dairy farms that DFA represents dropped from 17,715 in 1998 to 13,445 in 2003, the amount of milk the cooperative and its affiliates market increased from 36 billion pounds a year to 57 billion pounds. The co-op finds markets for a third of the nation's raw-milk supply.

Despite the meeting in Louisiana, Justice Department officials declined to say whether DFA was under investigation. While not specifically referring to the co-op, the department's spokeswoman, Gina Talamona, said the antitrust division is "investigating the possibility of anti-competitive practices in the distribution of raw milk to dairies."

State attorneys general in Florida and New York are also looking into charges of anti-competitive behavior in the milk business.

Despite the investigations, the farmers' allegations remain unproven and DFA has not been charged with violating any laws.

Agnes Schafer, DFA's vice president of communications, said the Justice Department had contacted the organization. "The DOJ has inquired into DFA's marketing practices and business operations since the co-op's formation in 1998. Each time DFA has fully cooperated with the DOJ.

"Unfortunately, this is a reality of doing business in today's dairy industry," she said. "The DOJ, has historically, been interested in the milk business. It is their job to investigate; it is our job to market milk."

DFA officials declined to answer other questions for this article.

Previously, the officials have denied accusations of trying to corner the raw-milk market; rather, they maintain that the cooperative's aggressive expansion plans have given it leverage when negotiating with large milk processors and grocery store chains.

Many members agree with the co-op's strategy.

"We think that the direction [DFA] is moving provides dairy farmers with the best opportunity to have market clout, to positively affect our pay price," said Clark Hinsdale III, who runs a dairy in Vermont with his father.

Hinsdale said other parts of the food chain have consolidated to produce cheap, uniform products demanded by consumers, but noted that many farmers continue to cling to their independence.

"My view is, don't waste your time trying to change the system," he said. "What you need to do is get the system to work for you. You have to be big and few, just like the buyers who are big and few."

But others argue that DFA's drive to get bigger has come at the expense of dairy farmers. Instead of trying to reverse the trend of consolidation in the industry that puts small farmers out of business, DFA has helped facilitate it, they argue.

Albert Foer, president of the not-for-profit American Antitrust Institute, which produced a study on dairy consolidation earlier this year, said cooperatives were created with the idea of "helping out the little guys and helping consumers." But he said DFA has "morphed into something like an old-fashioned monopolist."

"It's not a question of their right to be large or their right to be larger," he said. "It's a question of the rights of farmers who don't want to be part of DFA."

Math of dairy prices

Consumers, some experts say, are not benefiting from the new balance of power.

Ronald Cotterill, an agricultural economist at the University of Connecticut, said prices for dairy products are higher in areas such as New England where a few players dominate the market.

Despite the higher retail prices, DFA members in New England are paid less for their milk than in other areas, he said.

And the region's few remaining supermarket chains are charging higher retail prices for milk than in states such as New York, said Cotterill, who regularly tracks retail milk prices.

Across the nation, over the last two decades, "farm level prices have probably declined while retail prices have increased at the rate of inflation," said Jesse, the dairy economist in Wisconsin. "Having said that, I don't know what would have happened if we didn't have consolidation, whether they would have been higher or lower."

While milk is a staple product and conjures images of simple times, the process of pricing it and getting it to market is staggeringly complex. It involves everything from somatic cell counts used to determine the overall quality of milk to federal price supports to the price of cheddar cheese and butter at the Chicago Mercantile Exchange.

Much of the complexity is due to the fact that milk is among the most perishable of commodities.

Unlike such items as corn and beef, where farmers have some discretion about when to sell their products, dairy farmers need to sell their milk several times a week, if not every day.

Dairy cooperatives have helped farmers find markets for their milk since the early 1800s. In the years since, dairy farmers have relied more heavily on such organizations than farmers of other commodities, according to Truman Graf, professor emeritus of agriculture economics at the University of Wisconsin-Madison.

Immunity from antitrust laws

Under the Capper-Volstead Act, the 1922 law governing farm cooperatives, the organizations are granted some immunity from antitrust laws so farmers can act together to market their products, though provisions in the statute warn against coercion and predatory practices.

Typically, a dairy cooperative will send milk trucks to a member's farm every other day to make a pickup. The milk is then hauled to processing plants where it is bottled or turned into a product such as cheese.

But under the federal government's complicated regional pricing scheme, farmers must sell a portion of their milk to bottling plants to qualify for the highest prices. As a result, having access to milk plants is crucial.

Critics contend that DFA has exploited the federal milk program's rules by controlling access to processing plants.

The cooperative has bought up stakes in some bottling plants and signed exclusive supply agreements with many others. Under the latter dealing, a dairy plant turns over the responsibility for finding milk to a cooperative, which in turn agrees to provide milk as needed.

The advantage for the plant is it is guaranteed a consistent supply of milk, while exclusive supply agreements give cooperatives control over who gets to sell milk to the processor.

Dealing with DFA

In areas where DFA has many members, such arrangements provide a guaranteed outlet for members' milk. But in places where membership is scarce, the agreements give the cooperative tremendous leverage over independent dairy farmers and an advantage over competing cooperatives.

If the independent farmers and the cooperatives want to continue selling milk, they have to work with DFA or find another processing plant outside its control, which in some parts of the country is nearly impossible.

Robert Wellington, a senior vice president at Agri-Mark dairy cooperative in Massachusetts, said dairy farmers and competing cooperatives are left with "a Hobson's choice: market through DFA to your former customer or cease dairy operations."

"Usually, local farmers quickly recognize that they have no choice but to capitulate and to join DFA in order to have a market for their milk," Wellington said in written testimony provided last year to the Senate subcommittee on antitrust issues.

DFA does not reveal how many of the nation's 350 or so milk plants it has a stake in and does not reveal the number of plants it has supply contracts with. The information is proprietary and not available in public records.

However, since it was created six years ago, DFA has signed supply agreements with some of the nation's largest milk processors and bought a stake in others.

For instance, it signed a supply agreement in 2003 to provide milk to most of the nearly 100 plants for Dean Foods, the nation's largest supplier of retail milk. The cooperative also bought 50 percent of National Dairy Holdings in 2001, and has supply contracts with the company's 12 milk plants.

Those deals and others helped DFA expand its control over the nation's raw-milk supply from 23 percent in 1998 to 33 percent last year, an increase of 43 percent, according to the organization's annual report.

Many of DFA's supply contracts are with smaller, regional dairies. In Utah, dairy farmer John Nye said the competitor obtained exclusive supply contracts in 1998 for several bottling plants that his cooperative, Magic Valley, was supplying.

DFA officials "showed up at one of our board meetings," he said. "They had the fluid [milk] contract for

those plants that Magic Valley was selling to. They either gave us a choice of dissolving the co-op and joining DFA or losing our fluid market."

Nye eventually joined DFA, and Magic Valley lost most of its members in Utah but still operates in Idaho.

In Florida, a state where DFA has only a handful of members, the cooperative has exclusive supply agreements with two Velda Farms milk plants owned by National Dairy Holdings, which is half owned by the organization. For years, DFA met its supply obligations by buying milk from the state's largest dairy cooperative, Southeast Milk.

Tussle with Southeast Milk

But last year, DFA officials complained that Southeast Milk was paying its members too much for milk and hampering DFA's efforts to lure new members in the region, said Joseph Wright, president of Southeast Milk. In a Jan. 29, 2003, memo to Southeast Milk titled "Proposal to Solve Pay Price Differences in Georgia and the Surrounding Area," DFA Senior Vice President John Collins wrote that Southeast Milk would lose access to the Velda plants unless it reduced payments to members.

DFA sought an agreement in which Southeast Milk would reduce the payments while DFA increased the money paid to its members.

"Without the [agreement], DFA would propose the following method of marketing milk in Florida: 1) DFA serve 100 percent of Velda plants at Winter Haven and Miami, FL," Collins wrote in the memo obtained by the Tribune.

Southeast Milk eventually agreed to pay a "market utilization adjustment" of \$3.5 million a year to continue selling milk at the Velda plants, an unusual arrangement that is the equivalent of a raspberry farmer being forced to pay a fee to continue selling to Smucker's. Though DFA has few members in Florida, Southeast Milk officials said they took the threat seriously because DFA is big enough to truck milk to Florida if necessary.

Said Wright, "They basically said, 'If you don't pay us money and lower your pay prices in certain areas, you're kicked out of Velda.'"

DFA controls access to other milk plants in the area, too. So, Wright said, we "swallowed hard and said yes."

"If they would have kicked us out . . . we would have had to pour the milk on the ground. We don't have anywhere to go," he added.

Southeast Milk, which has met repeatedly with federal antitrust prosecutors to discuss its arrangement with DFA, declined to provide the final agreement with DFA on the advice of its attorneys.

Charismatic leader

DFA's aggressive growth has been guided largely by its charismatic, 70-year-old president and chief executive officer, Gary Hanman. Known for his folksy manner and trademark red suspenders, Hanman is described as razor-sharp and politically astute, a dominating figure who is as comfortable schmoozing with corporate executives as he is cracking jokes with dairy farmers at a country barbecue.

"There's only one way to describe Gary," said Donald Schriver, DFA's executive vice president. "He's an icon."

At DFA's annual meeting in Kansas City, Mo., in March, Hanman presided over the festivities wearing bright red suspenders with "Dairy Farmers of America" emblazoned in white letters down the front. The co-op's board members, aligned on either side of him at the head table, wore matching red DFA ties.

"We now have members in 49 of the 50 states," Hanman told the audience. "We don't have a member yet in Alaska. I think there's only nine producers up there. We've got to go get one of them."

Hanman, through a spokeswoman, declined to be interviewed for this article and instead requested questions in writing. But he did not answer the written questions.

In an interview last month, DFA's general counsel, David Geisler defended the cooperative, saying it was not trying to corner the market for raw milk and noting that the Justice Department routinely reviews the cooperative's actions.

At DFA's annual meeting, Geisler was asked by a dairy farmer when the Justice Department would stop probing into the group's affairs. "I don't anticipate that happening in my lifetime," he said.

It's difficult to determine if many of DFA's ambitious plans and myriad joint ventures are paying off because most of its financial records are secret.

Unlike publicly traded corporations and labor unions, agricultural cooperatives are not required to disclose their finances. Though DFA issues an annual report to members, it excludes information on salaries paid to board members and top executives as well as detailed data on the performance of its joint ventures.

For instance, DFA has a joint venture with a New Zealand dairy cooperative that exports cheese to the United States, an arrangement that infuriates many dairy farmers. But since all the joint ventures are lumped into one line item in the annual report, it is impossible to know whether the deal is making money.

Some of DFA's business ventures are left out of the annual report altogether. For instance, the Tribune learned from a Texas lawsuit that DFA owns a 50 percent stake in Milk Transport Services, one of the nation's largest milk haulers. A hunting pal of Hanman owns the rest of the company.

"It's a question of transparency of corporate finances," said Pete Hardin, the editor and publisher of The Milkweed, a monthly trade publication that has been criticizing Hanman and his cooperatives for a decade. "They have hundreds of millions of dollars invested in these businesses, and these members don't know if they're making money or not."

"It's a massive, gray financial world," Hardin said.

But Hanman, in an August letter to members, defended the investments:

"DFA has invested in joint ventures because we have a strong interest in the long-term health of a competitive dairy industry," he wrote. "DFA wants to see processors survive and be competitive because competition increases demand. By putting our farmers' money in dairy operations, we believe that we help achieve that goal."

Disgruntled members

DFA's dominance of the raw-milk market might seem like a boon for its members. In areas such as New England and Louisiana, it markets an estimated 80 percent of the supply.

Some former members complain that DFA failed to deliver on its promise that expansion would benefit its constituents.

In New York, Steve Fleming said DFA hiked its rates for trucking his milk a year after he joined the cooperative because of cheaper hauling rates. In Michigan, Jim Meissner said the bonuses paid for milk have steadily declined since he started using a DFA affiliate. In Oklahoma, Charles Coblenz said he finally quit DFA because he was consistently being paid less than the minimum raw-milk price established by the federal government.

While milk bottlers must pay dairy farmers and cooperatives at least the minimum price established by the government, cooperatives are not required to return the full amount to their members.

"There were four months last year we got paid \$1.20 to \$1.40 [per hundred pounds of milk] below the federal order price," said Coblenz, who quit the organization in May to join a new dairy cooperative.

There are few places where DFA's dominance is more apparent than in Louisiana, and there are few dairy farmers more resistant than Walker, the dairyman who has badgered prosecutors and rallied his neighbors in his fight against the mammoth co-op.

Walker and his neighbors said they were thriving a decade ago as members of Gulf Dairy, a small local cooperative that sold most of its milk to a bottling plant in New Orleans. The problems began when the bottling plant signed an exclusive supply agreement with Mid-America Dairymen, a Missouri cooperative that was run by Hanman and later merged with three other groups to form DFA.

Having the upper hand

"They had the upper hand," said Lee Gray, who was Gulf Dairy's accountant and was fired after the merger. "They wanted to take over Gulf Dairy or let Gulf Dairy go down the tubes."

Gulf Dairy merged with Mid-America Dairymen in 1994. Within a year, Walker and his neighbors said their checks started getting smaller. What made matters worse: Mid-America Dairymen threw its local representative, Carole Knight, off the board in 1996 for asking too many questions about how the cooperative was spending money, Knight said.

Knight and her husband sued Mid-America Dairymen alleging that once the couple was forced out of the cooperative, they were forced to sell their dairy farm. "In a monopoly market, we had nowhere else to go," she said. "It was Mid-Am or the ditch."

In awarding Knight a \$356,000 settlement in 1999, Washington Parish Judge Patricia Hedges said, "Mrs. Knight wanted answers to her questions, especially those questions about where the money was going and why the farmers' checks were decreasing. It is clear that the members of the co-op were deliberately kept ignorant of facts."

Walker and many of his neighbors quit Mid-American Dairymen and found an outlet for their milk as independent dairy farmers with Dairy Fresh, a small family-run dairy in nearby Hattiesburg, Miss. He estimates that DFA now represents about 80 percent of the 330 dairy farmers in Louisiana.

But the cooperative is closing in on the rest. Last year, a DFA subsidiary bought Dairy Fresh, a sale being reviewed by the Justice Department.

Given his history with Hanman and what has happened elsewhere in the United States, Walker said he fully expects that if the sale is approved, he will eventually be given a choice: Join DFA or find another place to

sell his milk.

"If this sale is approved and they do away with our independent status, I'm gone," the Louisiana dairyman said. "I will not go back to the co-op."

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