**Cooperatives and Anti-Trust**

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The 1800’s were a period of rapid growth in the U.S. economy. Rapid industrialization was driven by the expansion of railroads, financed by large banks. The U.S. government initially encouraged the growth of large scale industry but then became concerned over the power of wealthy individuals. Industrialist, often referred to as “Robber Barons” took a stranglehold on American Industry. They formed “trusts” which were corporations or combinations of corporations formed mainly for the purpose of regulating the supply and price of products. Some trusts eliminated competition and essentially monopolized industries or geographic markets. The “Robber Barons” found that by forming trusts they could fix prices, make excessive profits and accumulate wealth. During the 1800,s the number of millionaires in the U.S. rose from 300 to 4,000. The “Robber Barons” had great influence over politicians which led to increased economic benefits in terms of tariffs and discriminatory railroad rates and rebates.

The Sherman Anti-Trust Act of 1890

The Sherman Anti-Trust Act was created to respond to the public outcry against monopolies and their damaging effect on prices, consumers and small producers including farmers. As the name implies, the Sherman Anti-Trust sought to rein in formation and activities of Trusts formed to restrain free competition. The act sought to prohibit anti-competitive practices and the formation of monopolies.

The Sherman Anti Trust Act explicitly prohibited some activities, referred to as Per Se Offences. Under the Per Se rule the defendant is not allowed to offer competitive justifications. All the government has to do is establish that the Per Se Offense existed. Traditional Per Se offenses included:

Price Fixing: Activities:Agreements between competitors or between a manufacturer and distributor to establish the price to be charged to a third party. Price fixing can include an element of price such as credit terms, interest rates or a formula for determining prices.

Market Division Between Competitors: Agreements by businesses to allocate customers and territories is a Per Se offense. Such an agreement allows one firm to raise prices with the knowledge that other firms will not compete for the customer.

Certain Types of Boycotts: The practice of one or more competitors boycotting or refusing to deal with a third party which refuses to participate in price fixing is a Per Se offense. However, other less severe boycotts may be judged under the Rule of Reason, explained below.

While Section 1 of the Sherman Anti-Trust Act deals with Per Se Offenses, Section 2 prohibits monopolization or attempts to monopolization which are judged under the Rule of Reason which analyzes whether there was an intent or conspiracy to monopolize. Under the Rule of Reason the firm must have both monopoly power (the ability to control prices or exclude competition) plus the willful acquisition to acquire or maintain that power. Market power that developed from the growth or acquisition of a superior product or historical accident might not be deemed illegal under the rule of reason. High market share may not be sufficient to establish monopolization. For example, if there are no barriers to entry, a firm with high market share could not unfairly raise prices without other firms entering the market and competing.

Section 2 of the Sherman Act also prohibits attempts to monopolize. This prohibition is aimed at conduct by a firm with market power falling short of a monopoly but if continued could pose a dangerous probability of achieving a monopoly. Again, under the rule of reason an agreement between firms was judged on both the pro-competitive and anti-competitive effects on competition in a defined relevant market.

Although intended to curb the anti-competitive activities of large firms such as trusts, banks and railroads the first groups impacted by the law were farm and labor association. If read literally, Section 1 of the Sherman Act prohibits any coordination of supply or pricing among competitors. Agricultural producers are technically competitors in the same industry so any type of joint marketing activity by farmers could be challenged as illegal price-fixing.

**The Clayton Act of 1914**

In an attempt to address the unintended consequences of the Sherman Anti-Trust Act, congress passed the Clayton Act of 1914. The Clayton Act provided exemptions from antitrust laws for both associations of producers and labor organizations. The part of the Clayton Act applying to producer organizations provided:

Nothing contained in the antitrust laws shall be construed to forbid the existence and operation agricultural, or horticultural organizations, instituted for the purpose of mutual help, and not having capital stock, or conducted for profit, or to forbid or restrain individual members of such organizations from carrying out the legitimate objects thereof, nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws

The Clayton Act therefore exempted “associations for the purpose of mutual help, not having capital stock or conducted for profit”. The Clayton Act proved not to be very useful for producer organizations. First, while it would clearly exempt a producer organization focused on education, it was not clear it would exempt an organization (like modern day cooperatives) that was formed to create profits and distribute the profits to the members. Section 6 of the Clayton Act also did not clearly define the activities that producer organizations could engage in. It merely said “legitimate objects” of such organizations. The phrase “without capital stock” also suggested that producer organization could not raise investment and fund infrastructure such as grain bins, warehoused or cotton gins.

The failure of the Clayton Act to effectively exempt producer organizations from anti-trust prosecution, led congress to look for a clear definition of what types of organization and what types of activities they were seeking to protect. Representative Volstead (one of the sponsors of the Capper Volstead Act) argued that corporations were owned by numerous stockholders who through the corporation were allowed to act collectively. He argued that the flaw in interpretation of the Sherman Antitrust Act was the assumption that each farmer was a separate competing business entities. He maintained that it was impractical for farmers to combine their farms into corporations but when they combined their crops with their neighbor to more efficiently market them the farmer was charged with anti-competitive behavior. In crafting the legislation to create an exemption for farm organization Representative Volstead and the other sponsors looked to the concept of cooperatives and Rochdale principles.

**The Capper Volstead Act of 1922**

The Capper Volstead Act has been termed the “Magna Carta of Agricultural Cooperatives” in the U.S. The law provided (1) an explicit exemption from anti-trust legislation for producer organizations, (2) specified the required structure of an organization to qualify for the exemption and (3) described the protected activities that such organization could engage in.

***Exemption and Description of Protected Activities:***

The Capper Volstead Act States:

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 agreements to effect such purposes.

In simple terms the Capper Volstead allowed producers to do everything necessary to collectively market their crops and therefore provided marketing cooperative with an exemption from Anti-Trust prosecution. The act further provided that the Secretary of Agriculture has enforcement authority to challenge the operation of an association if it has unduly enhanced prices. For those two reasons, the Capper Volstead Act is said to provide limited immunity to anti-trust prosecution.

***Required Structure of Organizations***

The act went on to say:

*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 eight percent 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.*

The act therefore specified four restrictions on associations. The association (cooperative) must be owned by agricultural producer, it must operate for mutual benefit (distribute profits as patronage) and either use one-member one vote or limit dividends to 8%. The Capper Volstead Act requirements were integrated into many state cooperative statutes. In many cases, the states did not note the “or” requirement and included both the voting and dividend restriction in the state statue.

**Qualifying and Retaining Capper-Volstead Status**

The Capper Volstead Act states that the immunity is available one to persons “engaged in the production of agricultural products as farmers, ranchmen, dairymen, and nut or fruit growers. Courts have held that only producers may be members if the cooperative wants to maintain Capper Volstead protection. What is more, the presence of even one on-producer member disqualifies the cooperative of its Capper Volstead status. That has been term the “not even one rule”.

This principle was first articulated in Case Swayne v. Sunkist Growers, 389 U.S. 384

(1967). Sunkist, as a federated cooperative, contained both local cooperatives and also growers

as members. Over 80% of its members were growers -- natural persons, corporate farms and partnerships that were engaged in growing fruit. Five percent of its members were fruit growers who also owned their own packing facilities. The remaining 15% of Sunkist members were packing houses which contracted with Sunkist growers. The Supreme Court denied Sunkist Capper-Volstead status because it had 15% non-producer packinghouses as members,

In a separate case involving National Broiler Marketing Association, the Supreme Court denied Capper Volstead status to an association of poultry producers because some of the producer members did not own flocks but merely contracted with producers using risk sharing contracts. That court decision therefore specified that in order to be classified as a producer an individual had to take on all of the risks of production. While the case involved integrated production the courts did not comment on whether a ;producer who maintained his poultry production operation but also owned and operated a processing plant which contracted additional volume would be an eligible member. As farms have become more complex and forwardly integrated, this question has arisen more frequently. While it is clear that an individual must take on all production risk to be a producer, it is not clear whether a producer who is simultaneously operating a processing operation is still an eligible member.

**Recent Challenges to Capper Volstead**

Perhaps the biggest question raised in recent lawsuits is whether preproduction supply-management activities — such as jointly agreeing not to plant crops or to raise fewer animals is a protected “marketing” activity under the Capper-Volstead Act. The resurgence of this issue is surprising, since prior courts have already found that protected “marketing” under the Act includes direct price setting and the actual destruction of products to remove them from the marketplace. If a farmer can legally destroy products, why cannot it simply decline to produce them in the first place? However, in its “advisory opinion,” the Idaho potato court found that the Capper-Volstead Act does not protect such pre-production supply management activities. The court noted that no prior courts had explicitly approved pre-production supply management activities, that the Act itself does not expressly endorse them, and that a 1977 Federal Trade Commission statement indicated that these activities were not protected. Additionally, the court noted that farmers had an incentive to increase production if prices rise due to a cooperative’s activities, but that this incentive is missing if pre-production supply-management activities are permitted and future production is in effect “shut off.” Accordingly, the court concluded that pre-production supply management activities are not protected under the Act.

Whether the potato court will ultimately adhere to the distinction between post-production and reproduction supply-management activities remains to be seen. A similar argument is being made by plaintiffs in the Pennsylvania eggs cases, in which a cooperative’s employee allegedly made what plaintiffs argue were voluntary pre-production supply-management recommendations in the cooperative’s newsletter. Additionally, the issue is the centerpiece of California litigation involving the National Milk Producers Federation’s herd retirement program. Clearly, the issue greatly interests plaintiffs’ attorneys. Cooperatives considering engaging in pre-production supply-management efforts should closely watch these cases and plan accordingly. Caution may be warranted until the matter is decided by federal appellant courts.

**Summary**

Three laws impacted the structure of U.S. cooperatives. The Sherman Anti-Trust Act of 1890 prohibited a wide range of anti-competitive behavior. While intended to curb the activities of trusts, railroads and banks, farm association became the unintended target of the Sherman Act. Congress attempted to address the problem through the Clayton Act of 1914. The Clayton Act proved to be ineffective since it only applied to organization conducted not for mutual benefit and without capital stock. The Clayton Act did not therefore appear to apply to farm associations investing in marketing and storage infrastructure, The Clayton Act also did not explicitly describe the permitted activities of a farm association.

Drawing on the Rochdale principles, the Capper Volstead Act of 1922 became the “Magna Carta” of U.S, agricultural cooperatives. It provided cooperatives with limited exemption from anti-trust prosecution, described the organizational restrictions and also described the permitted activities. The Capper Volstead Act only applies to marketing activities and therefore marketing cooperatives. It also has strict provisions that every member must be a qualifying agricultural producer who bears the entire risk of the production. Recent challenges to Capper Volstead have centered on the question of whether a cooperative could engage in pre-production supply control in an effort to curb excess production and enhance prices.