Legal Corner

Protecting cooperatives from antitrust liability

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The Capper-Volstead Act is a powerful 1922 law that allows farmers and their cooperatives to act together for "collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce." "Marketing" includes price-setting and other conduct that would otherwise violate antitrust laws, if not for Capper-Volstead.

Large lawsuits have been filed that challenge the Capper-Volstead Act (Act) status of cooperatives of mushroom, potato, egg and milk producers. These lawsuits claim that certain cooperatives do not qualify under the Act and/or that their activities are not protected. Understanding the basics of these lawsuits can help avoid potential liability.

'Producer' membership requirement

To take advantage of the Capper-Volstead Act, a cooperative's members must be "persons engaged in the production of agricultural products." Cooperatives with non-producer members are ineligible for Capper-Volstead protection. This "producer" membership requirement has been targeted in lawsuits when a cooperative strives to make sure that all of its members are actual producers but fails to achieve perfection.

One U.S. Supreme Court case indicates that "it is not enough that a typical member qualify, or even that most of [the] members qualify." Plaintiffs argue that this language means every cooperative member must be a "producer" at all pertinent times. Some plaintiffs scour cooperative records going back many years — sometimes more than a decade — to determine whether any non-producers have ever been listed as members, even for only a brief period. Should they find such an inadvertent error, they argue that the cooperative's Capper-Volstead Act protection is forfeited.

The mushroom case in Pennsylvania provides an example of this approach. The court found a cooperative lost its Capper-Volstead status because a farmer mistakenly allowed

Farmer cooperatives should be cognizant of recent lawsuits challenging the Capper-Volstead Act status of some potato (seen during harvest, above), mushroom, egg and milk co-ops.

the wrong corporate entity to sign its cooperative membership agreement and it was not an actual producer. The court also found that the cooperative acted with two members' affiliates that were not themselves producers. The court rejected the arguments that (1) the various entities were so interrelated that they should be considered one economic unit and not separate entities, and (2) the members' good faith belief and reliance on advice of counsel that the cooperative was properly structured preserved the cooperative's Capper-Volstead status.

Should it survive any potential appeal, the foreseeable impact of the mushroom case would be immense. In the court's view, even minor membership record-keeping errors could disqualify a cooperative from being a proper Capper-Volstead entity, thereby subjecting it and its members to liability that could bankrupt the co-op. Given this uncertainty, cooperatives should have a rigorous process in place to thoroughly vet their members' producer status.

Vertically integrated producers

A related membership-qualification issue is whether vertically integrated farmers — those conducting activities beyond simply owning and raising animals or crops — are considered true "producers" under the Act. This issue has been raised in numerous recent agricultural antitrust cases. The Idaho potato case provides a good example of the opposing views on this topic.

The potato plaintiffs claimed that any type of vertical integration destroys a producer's eligibility, because it is no longer a true "pure" farmer. The producers countered that even fully integrated farmers do not destroy eligibility, as long as they all legitimately own and raise crops.

The court rejected both arguments, and in a non-binding "advisory opinion," it adopted an amorphous middle ground requiring a "factually-intense inquiry" into the economics and history of the industry, functions of the cooperatives in questions, and degree of farmer integration — all with an eye towards determining whether recognizing the exemption in each particular instance is "consistent with the legislative intent to create an environment in which farmers can compete on a level playing field." Under this standard, there is no bright line as to how far a cooperative member may deviate from simply owning and raising animals or crops and still be considered a "producer" under the Act.

If ultimately adopted, this test would require extensive factual investigation, as well as testimony from multiple experts — a very expensive proposition. Additionally, such a "factually-intense inquiry" may not be subject to resolution short of a full-blown trial. Finally, it is likely that most of today's farmers are vertically integrated to some extent. Should the trial court's "advisory-opinion" become law, it may cause many farmers to reconsider joining certain cooperatives in the first place.

Benefit of 'members' requirement

Another fundamental Capper-Volstead requirement is that the cooperative must be "operated for the mutual benefit of the members thereof." The Southeastern Milk Antitrust Litigation in Tennessee addressed this issue. Some of the plaintiffs in that case were farmers suing their cooperative for purportedly using its milk-bottling subsidiary to slash the prices the farmers received for their milk. The cooperative also allegedly attempted to force producers to sell to bottlers it controlled at reduced prices through mandatory membership in the cooperative or its subsidiaries.

Plaintiffs claimed that this benefited the cooperative financially, but reduced the prices farmers received for their milk, creating a conflict of interest. The plaintiffs further argued that because the bottling operation required an ongoing supply of low-cost milk from members, the cooperative had allegedly put its own interests first and was no longer truly operating "for the mutual benefit of its members."

Given the complex structure and nature of the activities in question, the issue would have been hotly contested at trial, had the case not been settled. A similar "benefit of members" issue will be decided in the National Milk Producers Federation herd-retirement litigation pending in California, where it will be litigated in full.

While most cooperatives operate for the general benefit of their members, they should closely examine their own business activities to determine whether they are vulnerable to the contention that they are not fully operating for the benefit of their members.

Pre-production supply management

Perhaps the biggest question raised in recent lawsuits is whether pre-production 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 pre-production 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 appellate courts.

Conclusion

While the Capper-Volstead Act is the lifeblood of antitrust protection for agricultural cooperatives, recent legal developments present a difficult needle to thread. The parameters of a nearly 100-year-old law should be well settled, but that is rarely the case where large class action lawsuits are involved. Cooperatives and their members should keep apprised of ongoing trends in the area and take preventive steps to avoid potential liability. ■