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IN THIS ISSUE:

Message from the Chairs
By John D. Shively and Ian R. Conner

Welcome to volume 2 of the Agriculture and Food Committee's e-Bulletin. We continue to see a high-level of activity in the sector, even as the year-long DOJ/USDA workshop series into competition in the agriculture sector fades into memory. This second e-Bulletin is filled with thought-provoking articles that we hope will spark further discussion in the pages of the e-Bulletin, and on our new blog, "Growing Competition."

Growing Competition Blog

We launched the Committee's Growing Competition blog at the beginning of August to provide a forum for discussion of the various developments in the agriculture and food sectors. Surprised that the DOJ brought a merger enforcement action on a $3-million dollar merger in U.S. v. George's Foods? Should Capper-Volstead immunity cover vertically integrated producers? You now have a forum for active discussion of these and other antitrust and consumer-protection issues related to agriculture and food. We hope that the blog will become a resource and forum for Committee members, antitrust lawyers and consumer-protection lawyers to discuss and debate various developments in these sectors.

Please visit the blog at http://abasalagandfood.wordpress.com/.

This Issue of the e-Bulletin

This edition looks at several very current issues in the sector and may spark discussion over the state of some long-held views in the sector.

In a thought-provoking article, Diana Moss of the American Antitrust Institute tackles arguments that have been advanced for a roll-back or repeal of the Capper-Volstead antitrust exemption for producer cooperatives. Beginning with the premise that a realignment of U.S. antitrust policy toward agriculture is needed to address serious and systemic competitive problems in parts of the agriculture supply chain, she looks at competition in production, processing and retailing, and analyzes which of those areas policy makers should focus on first in such a realignment. Her analysis considers, among other things, concerns raised during the 2010 DOJ/USDA joint public workshops on competition in agriculture, processor and retailer consolidation and concentration, non-traditional cooperatives, cooperative consolidation, the virtues and disadvantages of cooperatives, and the sectors that are winning and losing the battle for the consumer dollar at the grocery store. Her conclusions and opinions on this highly-charged policy debate are certain to spur interest.

Carrie Amezcua and Megan Morley of McDermott Will & Emery, in "Follow the Leader (or Label) . . . " delve into the hot area of FTC consumer protection enforcement against food manufacturers who advertise health claims. Their article first offers a short primer on the respective responsibilities of the FTC and FDA for regulating food health claims, the inter-agency agreements dividing those responsibilities, and the FTC's restatement of its enforcement policies after enactment of the Nutrition Labeling and Education Act of 1990. The authors then take a close look at the orders and proposed orders in four food health claim cases brought by the FTC since 2010, highlighting the convergence of FTC advertising substantiation and FDA labeling regulations apparent in those orders, but explaining why food health claim advertisers cannot assume that advertising consistent with FDA regulations will be sufficient to satisfy the FTC.

Jeane Thomas and Elliot Golding of Crowell & Moring, in "Using Price Discrimination to Define Relevant Markets: Lessons from Dean Foods," explore the role of price discrimination in the DOJ's successful challenge and settlement of the Dean/Foremost transaction. They explain how the DOJ used price discrimination to define the relevant geographic market for the merging firms around customers, rather than the suppliers. They then analyze how the recent revisions to the Horizontal Merger Guidelines' section on price discrimination played into the case. In the litigation, the court ultimately denied Dean's motion to dismiss the case. The court accepted the DOJ's allegation that Dean could successfully engage in price discrimination between the customers in the various geographic markets without the risk of losing sales to other markets through customer arbitrage. The authors then summarize the resolution of this non-reportable merger challenge.

Ian Conner of Kirkland & Ellis and Jennifer Zwagerman of Faegre & Benson complete our series on the DOJ/USDA Workshops with a report from the final Workshop, which was held on Washington, D.C. last December, and focused on margins in the agriculture supply chain, primarily at the retail level. The subject of this final

Workshop ties in with the discussion in Diana Moss's article on realignment of U.S. antitrust policy toward agriculture.

This volume of the e-Bulletin also presents three interesting updates: the status of the proposed GIPSA rules; an antitrust case to watch for in the Seventh Circuit; and a summary and analysis of *U.S. v. George's Foods*.

State of the Committee

Entering its second year, and as befitting a committee focused on crops, livestock and food, the Agriculture and Food Committee is growing. We now have nearly 160 members. In the past year, we have put out our first newsletter, sponsored or co-sponsored four committee programs, and co-sponsored two programs at the 2011 Spring Meeting. It has been quite a year for the new Committee. And it would not have been possible without your interest. We always welcome your suggestions, comments, ideas for new programs, articles or other endeavors for the Committee.

We also want to thank the Committee's vice-chairs (Les Locke, Mark Ryan and John Snyder) and Young Lawyer Representative (Lance Lange) for their work over the past eighteen months in getting the e-Bulletin together, and ensuring that we are all up to date with the most current news in the sector. John Snyder undertook the Herculean task of setting up the blog and getting it operational. Lance Lange, who next month ends his term as the Committee's founding YLR, spearheaded efforts on the agriculture sections of the Annual Review and Antitrust Law Developments VII, and worked with the consumer protection committees on our Committee's behalf. We want to thank Lance for his work for the Committee and for setting such a high bar for the future YLRs of the Committee. Frank Qi of the Justice Department will begin his term as the Committee's YLR later this month.

Upcoming for Fiscal Year 2011-12

We are hard at work on the committee programs for the new fiscal year and plan to explore recent merger challenges and litigation matters in the news with some of the players in those case. We also will be submitting proposals for Spring Meeting programs on relevant issues. If you have suggestions for committee programs or Spring Meeting programs, please contact Ian Conner at ian.conner@kirkland.com. Our goal this year is growth, so please pass this newsletter on to your colleagues and encourage them to join the Committee. With the sector the focus of so much litigation, consolidation, and political interest, the next year promises to be an interesting one.

Agricultural Cooperatives: The Antitrust Exemption and Producers' Losing Battle for the Retail Food Dollar

By Diana L. Moss,[1]
American Antitrust Institute

I. Cooperatives and the Competition Policy Dilemma

In 2010, the U.S. Department of Agriculture (USDA) and U.S. Department of Justice (DOJ) jointly conducted five workshops as part of the initiative "Agriculture and Antitrust Enforcement Issues in our 21st Century Economy." The day-long sessions in Iowa, Alabama, Wisconsin, Colorado, and Washington D.C. conveyed multiple concerns. At the broadest level, we were reminded that agriculture continues to be a critical part of the economic, social, and cultural fabric of the U.S. The workshops also punctuated concerns over consolidation and dominant firms in the concentrated food processing and retailing levels of the supply chain, and producers' precipitously declining share of the retail food dollar. It was farmers' and ranchers' stories, however, that pulled together the major themes that ran through the workshop discussions. These included, among others, failed battles with corporate giants over intellectual property, depressed prices paid for crops and animals, and the loss of multigenerational family farms and ranches.

Many observers left the USDA-DOJ workshops asking how policy can be realigned to address what are recognized now as serious and systemic competitive problems in parts of the U.S. agricultural supply chain. Ultimately, it is the consumer that bears the brunt of these problems in the form of higher prices, lower quality and reliability, lack of choice, and less innovation. Protecting the consumer, however, will require antitrust enforcers and the USDA to craft a comprehensive, multi-pronged competition policy that: (1) promotes the competitive health of the supply chain overall; (2) recognizes the nature of competitive relationships between the production, processing, and retailing levels; and (3) prioritizes competition problems at any given level in light of the severity of competitive issues elsewhere in the supply chain.

The foregoing approach to a comprehensive competition policy in U.S. agriculture will allocate valuable antitrust enforcement and regulatory resources to areas where they are most needed, and likely to produce the largest competitive benefits. This article argues that, under this approach, high priority should be given to addressing competitive problems resulting from consolidation and the exercise of buyer market power in the processing and retailing segments of the industry. Lower priority, on the other hand, should be given to calls to roll back or repeal the antitrust exemption for agricultural cooperatives under the 1922 Capper-Volstead Act.[2] In other words, the majority of competitive issues in U.S. agriculture are not tied to antitrust immunity under Capper-Volstead; they reside in the largely un-immunized, downstream segments of the supply chain.

The article consists of five parts: (1) an assessment of producers' declining share of the retail food dollar; (2) a brief analysis of the controversy over large and non-traditional agricultural cooperatives; (3) a word of caution on scaling back the antitrust exemption for cooperatives; and (4) an assessment of the antitrust tools available to combat competitive problems in agriculture, and the key challenges posed by applying them at different levels of the supply chain. A final section concludes.

II. Producers' Declining Share of the Retail Food Dollar

The role of the cooperative in U.S. agriculture was a key theme in many of the USDA-DOJ workshop discussions. Producers described multiple benefits from cooperatives, including enhanced access to capital, equity through pooling and joint ownership, farm-related supplies, services, and technology; and increased efficiency due to economies of scale in production and transportation. Cooperatives also provide strategic competitive benefits, such as aggregating producers while avoiding vertical integration and its entanglements, thereby improving farmers' bargaining position with processors.[3] In light of these benefits, it is not surprising that producers expressed concern about the possibility of scaling back or repealing the Capper-Volstead exemption for cooperatives.

Producers also recognized competitive problems at various levels of the supply chain. These include the fact that in some regional markets, producers may have little or no choice in which cooperatives to join.[4] Also cited were cooperative practices that exclude non-cooperative

[1] Vice President and Director, American Antitrust Institute.

[2] 7 U.S.C. §§ 291-292. Capper-Volstead extended the cooperative exemption in section 6 of the Clayton Act, 15 U.S.C. § 17, to capital stock agricultural cooperatives and "spelled out the broad range of activities in which cooperatives might engage." *Fairdale Farms, Inc. v. Yankee Milk, Inc*., 635 F.2d 1037, 1042 (2d Cir. 1981). Section 1 of Capper-Volstead, 7 U.S.C. § 291, provides antitrust immunity for "[p]ersons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut and fruit growers . . . act[ing] together in associations, corporate or otherwise," to collectively process, prepare for market, handle, and market "such products of persons so engaged." Section 2 of Capper-Volstead, 7 U.S.C. §292, authorizes the Secretary of Agriculture to order a cooperative to "cease and desist from monopolization or restraint of trade," if the Secretary finds that the cooperative "monopolizes or restrains trade . . . to such an extent that the price of any agricultural product is unduly enhanced. . . ."

[3] *Public Workshops Exploring Competition Issues in Agriculture*, U.S. Department of Justice and U.S. Department of Agriculture, Ankeny, Iowa (*Iowa Transcript*) (March 12, 2010), at p. 233; and *Public Workshops Exploring Competition Issues in Agriculture – Dairy Workshop*, U.S. Department of Justice and U.S. Department of Agriculture, Madison, Wisconsin (*Madison Transcript*) (June 25, 2010), at pp. 40, 59, 85, 92, and 222. Available http://www.justice.gov/atr/public/workshops/ag2010/index.html.

[4] *Madison Transcript*, at pp. 190 and 278.

(i.e., independent) producers from access to processing channels.[5] It was noted that consolidation along the supply chain has left fewer, larger processors and retailers (and cooperatives). Those retailers, in turn, want to deal with fewer, larger processors.[6]

Excessive consolidation at the processing and retailing levels of the supply chain has, in the view of some workshop participants, resulted in a diminishing producer share of the retail dollar. For example, the dairy farmer took 50 percent of the retail dollar in 1980, but only 27 percent in 2006.[7] The United Food and Commercial Workers estimate that the rancher's share of the retail beef dollar dropped from 59 percent in 1990 to 42 percent in 2009. Likewise, the hog producer's share of the pork dollar fell from 45 percent in 1990 to 25 percent in 2009.[8] These declines are pervasive enough to garner the attention of policymakers.

III. The Controversy Over Large and Non-Traditional Cooperatives

The intention of Congress in creating the Capper-Volstead antitrust exemption was to provide producers a way to countervail the monopsonistic or oligopsonistic market power of middlemen in the food marketing supply chain.[9] Whether the exemption still serves its originally-intended purpose has been challenged by (1) the emergence of complex, non-traditional new generation cooperatives (NGCs) and (2) larger traditional cooperatives. Indeed, the types of cooperatives that exist today would have been hard to envision almost 90 years ago when the Capper-Volstead exemption was created.

A. Non-traditional Cooperatives

The growing complexity of cooperatives, marked by the emergence NGCs, is clear.[10] These cooperatives raise a different set of competitive issues than their traditional counterparts and arguably push the boundaries of what types of business organization and conduct qualify for limited antitrust immunity. For example, closed (as opposed to open) membership, particularly for large NGCs that possess significant market power, creates a class of independent producers and smaller producer cooperatives that could be subject to potentially harmful exclusionary practices. An NGC's rivals in later stage processing activities could also be at risk. Exclusionary strategies could include boycotts of buyers (processors) that deal with multiple, non-cooperative sellers. Price discrimination that establishes "pool" prices for NGC shareholders and lower, "non-pool" prices for independent producers is also potentially harmful if it hampers the ability of independent producers to compete.

Profit-maximization and substantial equity contribution requirements by NGCs create incentives not found in traditional cooperatives, ranging from using capital to build brand loyalty and redistribute wealth, to engaging in potentially anticompetitive conduct. A focus on adding value, particularly in later stages of processing, also stimulates product differentiation and increases the strategic value of intellectual property, opening the door to a range of competitive issues not endemic to the more homogeneous, unbranded products produced by traditional, non-integrated cooperatives.[11]

The USDA has recognized that NGCs are fundamentally different from traditional cooperatives, prompting the agency to state about a decade ago that: "An issue of growing significance is determining where along the continua an entity crosses from a cooperative to a noncooperative."[12] This gray zone in which some cooperatives reside is defined by deviations from the traditional cooperative principles of user-ownership, control, and benefit. As noted earlier, NGCs challenge many of these tenets. At the same time, however, adding value and differentiating products is, according to the USDA, "accepted by all levels of agribusiness" and necessary to improve the effectiveness of cooperatives in "markets dominated by powerful global food and retail firms."[13]

B. Consolidation Among Cooperatives

Significant consolidation among cooperatives has also prompted calls to roll-back the Capper-Volstead exemption. For example, between 1975 and 2009, the number of cooperatives in marketing, farm supply and service fell almost 70 percent from 7,535 to 2,389.[14] The 777 mergers

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[5] *Id.*

[6] *Id.,* at pp. 85, 190, and 235.

[7] *Id.*, at p. 93.

[8] *Ending Walmart's Rural Stranglehold*, United Food and Commercial Workers (2010), at pp. 3-4. Available http://www.ufcw.org/docUploads/AG%20Consolidation%20White%20Paper2.pdf?CFID=12112536&CFTOKEN=73467741.

[9] See, e.g., *Trust Busting Down on the Farm: Narrowing the Scope of Antitrust Exemptions for Agricultural Cooperatives*, 61 Va. L. Rev. 341, 364 (1975).

[10] *See, e.g.*, Shannon L. Ferrell, *New Generation Cooperatives and the Capper-Volstead Act: Playing a New Game by the Old Rules*, 27 OKLA. CITY U.L. REV. 737, 740-41 (2002) (footnotes omitted): "At the heart of the NGC movement is the desire to revitalize rural communities by enabling local commodity producers to vertically integrate production, processing, and (in some cases) marketing of finished agricultural products. . . . Perhaps the most distinctive feature of NGCs is the means by which they simultaneously form their membership and accumulate a capital pool: the NGC sells shares in the cooperative that entitle (or require, in some cases) the buyer to deliver, and oblige the NGC to accept, a specified amount of commodity (this arrangement is commonly referred to as 'delivery rights'). The number of shares and their attendant delivery rights are calculated to provide the NGC with precisely enough raw commodity to efficiently operate its processing facilities, thus constraining the number of members the cooperative will allow."

[11] Richard T. Rogers and Bruce W. Marion, *Food Manufacturing Activities of the Largest Agricultural Cooperatives: Market Power and Strategic Behavior Implications*, 5 JOURNAL OF AGRICULTURAL COOPERATION 59 (1990), at p. 71.

[12] *Agricultural Cooperatives in the 21st Century*, U.S. Department of Agriculture, Rural Business–Cooperative Service, Cooperative Information Report 60 (November 2002), at p. 31.

[13] *Id.*, at pp. 3 and 11.

[14] *Farm Marketing, Supply and Service Cooperative Historical Statistics (Cooperative Historical Statistics)*, U.S. Department of Agriculture, Cooperative Information Report 1, Section 26 (August 2004), at p. 71 and *Cooperative Statistics – 2009*, U.S. Department of Agriculture,

and acquisitions of cooperatives between 1989 and 1997 accounted for almost 80 percent of the decline in number of cooperatives over that period.[15] In 1975, cooperatives with sales of $1 billion or more accounted for about 17 percent of total gross sales by cooperatives. By 2009, this share had increased to 43 percent.[16]

Among the more notable mergers that have contributed to the growing presence of larger cooperatives are those that formed or expanded Dairy Farmers of America, Inc. (DFA), Land O'Lakes, Inc., National Grape Co-operative Ass'n, Inc. (parent of Welch Foods, Inc.), and Riceland Foods, Inc.[17] The drivers behind cooperative consolidation are numerous. For example, mergers and acquisitions were cited by one survey as a means to streamline operations and increase scale to reduce fixed costs and remain more competitive, increase market share, diversify geographically, enhance access to distribution channels, and expand product offerings. [18] These motivations support the notion that it has been necessary for cooperatives to expand in size and scope to survive amidst increasingly powerful processors and retailers.

IV. Scaling Back the Capper-Volstead Antitrust Exemption – A Word of Caution

The Antitrust Modernization Commission (AMC) devoted considerable space in its 2007 final report to the issue of statutory and implied antitrust immunities and exemptions. In concluding that they should generally be disfavored, the AMC also makes the case for periodic reviews of exemptions.[19] This is particularly true if the exemption was originally created decades ago, where "changes in technology, competitive forces, or economic learning can render an exemption completely obsolete."[20] The AMC also set forth a set of criteria for evaluating the need for existing or new immunities and exemptions, including whether "a particular societal goal trumps the goal of consumer welfare, which is achieved through competition."[21]

While much of the AMC's reasoning in regard to immunities and exemptions is compelling, it should be applied cautiously to agriculture, for two reasons. First, there are good arguments supporting the view that competition policy in key infrastructure industries such as agriculture should recognize other goals, in addition to consumer welfare. For example, reliability factors importantly into the design and operation of electricity markets. Food safety and security likewise are important objectives that must be considered in realigning competition policy in agriculture. Such policy objectives are not always reflected in prices, but rather in consumer choice and the safety, quality, and reliability of the products and services that emerge from the agricultural supply chain.

Second, robust competition throughout the agriculture supply chain is necessary to promote the goal of consumer welfare. The USDA-DOJ workshops, however, punctuated the fact that there is a distinct lack of competition in food processing and retailing. Working first to correct that infirmity -- as opposed to scaling back the Capper-Volstead exemption -- is most likely to promote consumer welfare. The breadth and depth of structural problems in food processing and retailing markets cannot be understated. For example, the USDA characterizes consolidation at the processing, wholesale, and retail levels as "unabated" and "unprecedented."[22] This has created two major competitive problems. One is the presence of "…fewer, larger buyers that effectively control terms of trade" and which "…demand more from suppliers in specific product attributes, volume, timing, and costs."[23] A second problem is that food processors have expanded control over distribution and integrated backward into raw materials. Such developments, according to the USDA, "rob producers of decision-making authority and market choices,"[24] and limit their bargaining power.

Statistics lend some support to concerns over consolidation in the processing and retailing segments of the industry. For example, the four-firm concentration ratio for hog slaughter increased from 34 percent in 1980 to 65 percent in 2007. For cattle slaughter, the four-firm ratio increased from 36 percent in 1980 to 80 percent in 2007.[25] Equally troubling is concentration in the retail segment. The five-firm ratio increased from 24 percent in 1997 to 48 percent in 2007.[26] Walmart alone increased its share of the national grocery market from less than 5 percent in 1998 to 23 percent in 2009.[27] In light of

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Rural Development, Service Report 70 (November 2010), at p. 3.

[15] *Supra* note 14, *Cooperative Historical Statistics*, at pp. 74, 76; and *Cooperative Unification: Highlights from 1989 to Early 1999 (Cooperative Unification),* United States Department of Agriculture, Rural Business-Cooperative Service, RBS Research Report 174 (November 1999), at p. 20.

[16] *Supra* note 14, *Cooperative Historical Statistics,* at p. 71 and *Farmer Cooperative Statistics – 2009*, U.S. Department of Agriculture, Rural Development, Service Report 70 (November 2010), at p. 18.

[17] *Supra* note 15, *Cooperative Unification*, at p. iv.

[18] Darren Hudson and Cary W. Herdon, *Mergers, Acquisitions, Joint Ventures, and Strategic Alliances in Agricultural Cooperatives*, Mississippi State University, Department of Agricultural Economics, Research Report 2000-009 (September 2000), at p. 22.

[19] *Report and Recommendations*, Antitrust Modernization Commission (April 2007), at p. 349. Available http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm.

[20] *Id.*, at p. 355.

[21] *Id.*, at 350. The other two conditions are: (1) whether the conduct to which the immunity applies, or would apply, could subject actors to antitrust liability, and (2) the likely adverse impact of the existing or proposed immunity on consumer welfare.

[22] *Supra* note 12, at pp. 3 and 4.

[23] *Id.*, at p. 3.

[24] *Id.*, at p. 4.

[25] *2008 Annual Report*; Packers and Stockyards Program; USDA Grain Inspection Packers and Stockyards Administration (March 2009), at p. 46. *See also Agricultural Concentration and Agricultural Commodity and Retail Food Prices*, *Briefing for Congressional Staff*, GAO-09-746R (April 24, 2009), at p. 14.

[26] *Supra* note 8, at p. 2.

[27] *Id.*, at p. 2.

such statistics, it is not surprising that the USDA has spent less time attacking the antitrust exemption for cooperatives and more time calling for increased coordination among and within cooperatives.

V. Competition Policy Tools and Challenges

Reformulating competition policy in agriculture will require policymakers to take stock of the tools that are available to address competitive concerns along the supply chain. This exercise is important for prioritizing policies regarding cooperatives and the production level versus later-stage processing and retailing. How the antitrust agencies and the courts use enforcement tools raises important questions that should be taken up in a comprehensive review of competition policy in agriculture.

For example, we are reminded that the antitrust exemption under Capper-Volstead is a limited one. Capper-Volstead does not exempt merger and acquisition activity by cooperatives. The legality of such transactions is determined under Section 7 of the Clayton Act. The antitrust agencies have pursued a number of potential Section 7 violations against cooperatives, including transactions involving *Dairy Farmers of America/Southern Belle*, *Dairy Farmers of America/SODIAAL*, and *Dean Foods/Foremost Farms*.[28]

The application of Section 7 in regard to cooperatives nonetheless raises important questions. For example, does merger enforcement involving cooperatives sufficiently account for the risks associated with a larger (post-merger) firm that will *also* possess limited immunity from the antitrust laws? Another question is how antitrust analysis accounts for downstream competition (or lack thereof) in evaluating a merger of production cooperatives. A decision to remedy such a merger versus blocking it altogether might, for example, be affected by whether processors exert significant buyer market power over producers. Because anticompetitive outcomes in other parts of the agricultural supply chain can spill over to adjacent markets, higher levels of coordination between the FTC, which typically reviews retail grocery mergers, and the DOJ, which reviews mergers involving upstream agricultural markets, would be highly beneficial.

Capper-Volstead also does not exempt exclusionary conduct by cooperatives. In *Maryland & Virginia Milk*, for example, the Supreme Court held that Capper-Volstead did not immunize cooperatives from Section 2 of the Sherman Act.[29] A number of cases have alleged illegal monopolization by cooperatives (including for-profit, value-added entities) through exclusionary conduct ranging from foreclosure, to exclusive dealing and raising rivals' costs.[30] Despite the Supreme Court's holding in *Maryland & Virginia Milk*, however, a lack of judicial clarity on the application of Sherman Act Section 2 to cooperatives has created a legal environment that makes it unclear whether such conduct can, in fact, be prosecuted. This issue, if not resolved first by the courts, should be an important component of a comprehensive review of competition policy in agriculture.

In comparison to the competitive questions raised by cooperatives, those surrounding food processing and retailing arguably pose greater challenges for antitrust. As noted earlier, concentration in these sectors has increased, producing stronger processors and retailers that exert significant market power backward along the supply chain. Although the antitrust agencies have weighed in by challenging, among others, the mergers of meatpackers *JBS/National* and dairies *Suiza Food/Broughton*, some would argue that enforcement has not gone far enough to prevent concentration and the emergence of dominant firms in food processing and retailing.[31]

Antitrust enforcers face numerous challenges in this arena. For example, policymakers have yet to substantively address issues of buyer market power exercised by dominant firms such as Walmart, or the agreements by which large retailers extend their market power backward in the supply chain. Discussion at the fifth and final USDA-DOJ workshop in Washington D.C. highlighted the issue of whether antitrust enforcers have adequate tools to address buyer power issues.[32] Changes to rules relating to livestock and poultry marketing proposed by the Grain Inspection, Packers & Stockyards Administration under the authority of the 1921 Packers and Stockyards Act would affect the competitive landscape of the processing and retailing industries.[33] The effects of any new rules ultimately adopted would need to be reflected in antitrust analysis and enforcement decisions.

VI. Toward a Coherent Competition Policy for Agriculture

The foregoing, brief analysis reveals a number of key themes that should be central to the realignment of competition policy in U.S. agriculture. First, producers' declining share of the retail food dollar is worthy of additional investigation. The root cause(s), while not known with certainty without additional economic analysis, is (are) likely to be the result of significant consolidation and the growth of

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[28] *See, e.g.*, *U.S. and Commonwealth of Kentucky v. Dairy Farmers of America, Inc., and Southern Belle Dairy Co.*, Civil Action No. 6:03-206 (E.D. Ky.) (April 23, 2003); *U.S. v. Dairy Farmers of America, Inc., Société de Diffusion International Agro-Alimentaire Corp., and SODIAAL North American, Corp.*, Civil Action No: CN00-CV-1633 (D.C. Cir.) (March 31, 2000); and *U.S. v. Dean Foods Company*, Civil Action No. 10-C-0059 (E.D. Wis.) January 22, 2010).

[29] *Maryland and Virginia Milk Producers Assn., Inc. v. United States,* 362 U.S. 458 (1960).

[30] *See, e.g.*, *Northland Cranberries, Inc. v. Ocean Spray Cranberries, Inc.*, 382 F. Supp. 2d 221 (D. Mass. 2004).

[31] *U.S. v. JBS S.A. and National Beef Packing Company, LLC*, Case No. 08 CV 5992 (N.D. Ill.) (October 20, 2008); *U.S. v. Suiza Foods Corp., d/b/a Flav-O-Rich Dairy, Land O' Sun Dairy, Louis Trauth Dairy, and Broughton Foods Co., d/b/a Southern Belle Dairy*, Civil Action No. 99-CV-130 (E.D. Ky.) (March 18, 1999).

[32] *Public Workshops Exploring Competition Issues in Agriculture*, U.S. Department of Justice and U.S. Department of Agriculture, Washington, D.C. (December 8, 2010), at pp. 206-251.

[33] 7 U.S.C. §§ 181-229b. For a summary of the proposed GIPSA rules, *see, e.g.*, "Farm Bill Regulation – Proposed Bill Outline," Grain Inspection, Packers & Stockyards Administration. Available http://archive.gipsa.usda.gov/psp/Farm_bill_rule_outline.pdf.

dominant firms in food processing and retailing. Those downstream entities exert significant buyer market power over producers. Second, some modern cooperatives (i.e., NGCs) pose genuine questions that are worth exploring in regard to the applicability of the antitrust exemption under Capper-Volstead. As discussed earlier, however, there are compelling reasons why efforts to repeal the exemption should take a back seat to the more pressing competitive problems in food processing and retailing.

Third, there are numerous antitrust enforcement tools available to address competitive problems in agriculture, including cooperatives, which enjoy only limited antitrust immunity under Capper-Volstead. However, there are important questions regarding the use of these tools that a comprehensive realignment of competition policy should answer. This is particularly true for addressing concerns at the processing and retailing levels. Collectively, these themes illustrate that a coherent competition policy for agriculture should focus on promoting the competitive health of the entire supply chain, the practical importance of competitive interaction between its levels, and a prioritization of competitive concerns.

Using Price Discrimination to Define Relevant Markets: Lessons from *Dean Foods*

By Jeane Thomas and Elliot Golding, Crowell & Moring LLP

I. Introduction

In *United States v. Dean Foods Co.*, the Department of Justice ("DOJ") successfully challenged Dean Foods Company's ("Dean's") acquisition of the assets of the Consumer Products Division of Foremost Farms USA ("Foremost") under § 7 of the Clayton Act.[1] This purchase was completed on April 1, 2009 at a price of $35 million – significantly below the reporting threshold under the Hart-Scott-Rodino Act ("HSR") – and gave Dean complete ownership of two dairy processing plants owned by Foremost in Wisconsin ("DePere" and "Waukesha").[2] Seeking to unwind the acquisition, DOJ alleged that this would substantially lessen competition in two distinct markets: (1) the sale of "school milk" to individual school districts in Wisconsin and parts of Michigan (with each school district comprising a distinct geographic market); and (2) the sale of "fluid milk" to purchasers located in Wisconsin as well as parts of Michigan and Illinois (with this entire area constituting one relevant geographic market).[3]

In its complaint filed in January 2010, DOJ alleged that, in the fluid milk market, Dean and Foremost were the first and fourth largest milk processors, respectively, and often were the only two bidders for various supply contracts.[4] After the merger, Dean possessed a 57 percent market share in the relevant geographic area, with the top three companies comprising roughly 90 percent of the market.[5] Based on these factors, DOJ alleged that the merger would lead not only to unilateral effects through the loss of head-to-head competition, but also would facilitate collusive conduct in an already-concentrated market.[6] Arguing that DOJ had failed to allege a plausible geographic market for fluid milk, Dean on February 18, 2010 filed a Partial Motion to Dismiss or, in the Alternative, for a More Definite Statement.[7] DOJ opposed this motion in a Response dated March 11, 2010,[8] and Dean filed a Reply Memorandum on March 25, 2010.[9] On April 7, 2010, the court issued an order denying Dean's motion in its entirety.[10] After nearly a year of preliminary discovery, Dean entered into a settlement agreement with DOJ on March 29, 2011 in which it agreed to divest the Waukesha plant and report in advance to DOJ any future dairy plant acquisitions valued at $3 million or more.[11]

The dispute over the relevant geographic market for fluid milk[12] and the ultimate terms of the settlement have potentially significant implications for the agriculture sector. First, DOJ's geographic market definition arguments provide valuable insight into how the government is likely to implement the increased emphasis on price discrimination principles that are set forth in the 2010 Horizontal Merger Guidelines ("2010 HMG").[13] Second, in light of the Obama administration's stated concern with the agriculture sector's consolidation through relatively smaller transactions, DOJ's success in alleging relatively narrow geographic markets along with the settlement terms in this case may portend future challenges to other transactions falling beneath HSR thresholds in situations involving difficult market definition issues.

II. Market Definition

Quite possibly the most significant aspect of this case is DOJ's use of a price-discrimination approach to define the relevant geographic markets based on the location of customers rather than the location of suppliers. In significant updates to the Merger Guidelines ("MG") since the DOJ's 1982 Merger Guidelines, the Agencies have included two approaches to defining geographic markets: (1) the market where the merging

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[1] *United States v. Dean Foods Co.*, No. 10-CV-59, 2010 WL 1417926 (E.D. Wis. Apr. 7, 2010). Wisconsin, Illinois, and Michigan also joined the suit against Dean. For simplicity, this article will refer to all Plaintiffs collectively as "DOJ."

[2] Complaint, *United States v. Dean Foods Co.*, No. 2:10-cv-00059, 2010 WL 1251787, *available at* http://www.justice.gov/atr/cases/f254400/254455.htm, ("Compl.") at ¶¶ 1, 22.

[3] Compl. ¶¶ 2, 8.

[4] Compl. ¶¶ 3-5.

[5] Compl. ¶ 42.

[6] Compl. ¶¶ 6-7.

[7] Mem. in Support of Partial Motion to Dismiss or, in the Alternative, for a More Definite Statement, *United States v. Dean Foods Co.*, No. 2:10-cv-00059, 2010 WL 1251788 (E.D. Wis. Feb. 18, 2010) ("Dean Mem.").

[8] Pls.' Response to Def.'s Partial Motion to Dismiss or, in the Alternative, for a More Definite Statement, *United States v. Dean Foods Co.*, No. 2:10-cv-00059, 2010 WL 1251789 (E.D. Wis. Mar. 11, 2010), *available at* http://www.justice.gov/atr/cases/f256500/256522.htm ("Pls.' Resp.")

[9] Def.'s Reply in Support of Partial Motion to Dismiss or, in the Alternative, for a More Definite Statement, *United States v. Dean Foods Co.*, No. 2:10-cv-00059, 2010 WL 1251805 (E.D. Wis. Mar. 25, 2010) ("Dean Reply").

[10] *United States v. Dean Foods Co.*, No. 2:10-cv-00059, 2010 WL 1417926 (E.D. Wis. Apr. 7, 2010), *available at* http://www.justice.gov/atr/cases/f257500/257536.htm

[11] Final Judgment, 7/29/2011, *available at* http://www.justice.gov/atr/cases/f273400/273469.pdf.

[12] Dean did not challenge DOJ's definition of the relevant product markets – "school milk" and "fluid milk." Nor did Dean challenge the DOJ's geographic market definition with respect to school milk, perhaps in light of DOJ's prior track record alleging that each individual school district comprises a distinct geographic market for school milk. *See, e.g.*, Competitive Impact Statement, *United States v. Dairy Farmers of Am.*, No. 6:03-206-KSF (E.D. Ky. Oct. 2, 2006), *available at* http://www.justice.gov/atr/cases/f221700/221713.htm.

[13] The Horizontal Merger Guidelines were issued jointly by the DOJ and FTC (collectively, "the Agencies"), on August 19, 2010.

firms produce their product (i.e., a market defined by the location of the suppliers); and (2) the market where the merging firms sell their product (i.e., a market defined by the location of the customers).[14] If a hypothetical monopolist could successfully charge different prices to different customers (holding costs constant) without being constrained by arbitrage (i.e., engage in "price discrimination"), the Guidelines suggest that the latter approach is more appropriate.[15] By contrast, where a hypothetical monopolist could profitably increase prices to all customers in the geographic region where it operates without customers reaching out to more distant areas, the former approach is more appropriate.[16]

In *Dean Foods*, DOJ alleged that the fluid milk market was a "price-discrimination market." Specifically, DOJ asserted in the Complaint that a hypothetical monopolist supplying the geographic area where Dean and Foremost formerly competed would be able to engage in price discrimination without fear of arbitrage because high transportation costs and milk's limited shelf life both require processing plants to be in close proximity to delivery locations (i.e., the customers).[17] These and other factors often lead dairy processors to charge different prices to different purchasers for the same product.[18]

Dean moved to dismiss the Complaint with respect to the fluid milk market, arguing that DOJ had failed to allege facts showing that customers would be unable to obtain fluid milk from suppliers outside the proposed market or to engage in arbitrage (as opposed to the school milk market where Dean conceded that DOJ had made such allegations).[19] Dean pointed to DOJ's concessions in the Complaint that a portion of the fluid milk supplied to the relevant geographic market comes from plants located outside the alleged market and that at least some direct purchasers resell fluid milk to other customers.[20] Dean also emphasized that DOJ had improperly defined the market based on the area where the firms formerly competed rather than utilizing a "dynamic, forward-looking market definition" that included areas where customers *could* purchase fluid milk in response to a price increase.[21]

In response, DOJ asserted that "[s]uppliers located outside the region are not . . . relevant to the hypothetical monopolist test where, as here, the sale of fluid milk is a price discrimination market."[22] In such a market, the location of the customers is the relevant inquiry "because the customers' location uniquely identifies the area where the competitive harm will be realized."[23] DOJ acknowledged that the supply from distributors outside the geographic market is relevant to calculating *market shares* to the extent those suppliers sell fluid milk inside the market, but asserted that the presence of such suppliers is not relevant to the threshold determination of the geographic market itself.[24]

The court acknowledged that a proper geographic market "is not comprised of the region in which the seller attempts to sell its product, but rather is comprised of the area where his customers would look to buy such a product."[25] Nevertheless, the court denied the motion to dismiss, holding that DOJ's allegations were sufficiently plausible to support a "fluid milk" market premised on price discrimination and a lack of arbitrage.[26] Subsequently, Dean agreed to divest one of the two milk processing plants it had acquired, resulting in the DOJ's first successful merger challenge under the Obama administration.

Notably, the court accepted DOJ's threshold allegations that Dean could plausibly engage in price discrimination without being constrained by customers' arbitrage. DOJ expressly conceded that at least *some* fluid milk is sold to distributors that resell it to other customers, yet DOJ nevertheless argued that arbitrage was unlikely because such sales were insubstantial compared to direct sales. But as even the court acknowledged, the

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[14] 1982 MG § II.C; 1992 MG § 1.2; 2010 HMG § 4.2.

[15] 1992 MG § 1.22; 2010 HMG §§ 3, 4.2.2.

[16] 1992 MG § 1.21; 2010 HMG § 4.2.1.

[17] Compl. ¶¶ 14-15. Indeed, DOJ alleged that more than 90% of fluid milk sales in Wisconsin and the Upper Peninsula of Michigan were made to customers within 150 miles of the plant where the milk was processed. Compl. ¶ 15.

[18] Id. ¶ 14.

[19] Dean Mem. at 3-4. Dean also sought dismissal on the basis that DOJ had failed to identify any specific customers that a hypothetical monopolist could successfully target for price discrimination. Dean Mem. at 5.

[20] Dean Mem. at 13 (citing Compl. ¶¶ 13, 40).

[21] Dean Reply at 4; *see also id.* at 7 (arguing that DOJ's allegation that customers currently buy largely from plants located within 150 miles is insufficient because it fails to consider whether customers *would* buy milk from more distant plants in response to a price increase).

[22] Pls.' Resp. at 2, 6-7, 11.

[23] Pls.' Resp. at 7. DOJ emphasized that high transportation costs play a significant role in permitting a hypothetical monopolist to price discriminate against customers with fewer nearby alternatives outside the alleged market. Pls.' Resp. at 8 ("The commercial realities of the fluid milk business are that processors like Dean can charge more for milk in areas where its customers have few nearby processors to choose from, while charging less to customers in adjacent areas that have more competitive options."); *see also* Compl. ¶ 40 (same).

[24] Pls.' Resp. at 11-12. DOJ also argued that it had sufficiently addressed the "arbitrage issue" by alleging that fluid milk purchasers "do not resell to other purchasers in *substantial quantity*," and that milk's high transportation costs and limited shelf life rendered profitable arbitrage unlikely. Pls.' Resp. at 3, 14 (emphasis added).

[25] *Dean Foods Co.* at *3 (quoting *Tunis Bros. Co. v. Ford Motor Co.*, 952 F.2d 715, 726 (3d Cir. 1991)).

[26] *Dean Foods Co.* at *4-5. Although finding the allegations sufficient, the court made clear that the Complaint had certain shortcomings. *Id.* at *6 ("In today's world, structural issues, together with a lack of specificity in content associated with the underlying complaint, simply do not measure up to that which any court would reasonably expect in draftsmanship from an experienced litigator. That said, the court finds these shortcomings not to be of sufficient magnitude to warrant either dismissal or a more definite statement. In the end, although not well structured, all relevant factual predicates have been pled allowing Dean to reasonably respond to the complaint.")

question is not what customers *currently* do, but what they likely *would* do in response to a targeted small but significant non-transitory increase in price ("SSNIP"). Similarly, DOJ alleged that 90% of customers *currently* purchase milk from plants within 150 miles, but this says nothing about the ability of customers to purchase from more distant suppliers (or the willingness of more distant suppliers to supply fluid milk) in response to a targeted SSNIP. For example, the *Country Lake Foods*[27] court held that DOJ was unlikely to prove a market definition limited to milk processing plants within a 350 mile radius, rendering it likely that DOJ's proposed 150-mile geographic limitation would face serious scrutiny during discovery.

At the time Dean sought to dismiss the Complaint, the Agencies had not yet issued the 2010 HMG; however, DOJ's arguments reflect its increased emphasis on price discrimination in defining markets (as set forth in the 2010 HMG) rather than the much more cursory discussion of this theory set forth in the 1992 MG. Indeed, previous government attempts to define the geographic market based on the location of fluid milk purchasers had failed in the absence of a theory explicitly based on price discrimination and a lack of arbitrage.[28]

However, the 2010 HMG include an entirely new section addressing "Targeted Customers and Price Discrimination" in far greater detail.[29] This new section emphasizes that price discrimination is only possible if there is both differential pricing and limited arbitrage.[30] Although these concepts are far from new, the distinct (and early) discussion of these topics in the 2010 HMG reflects the Agencies' recognition that the possibility for the merged firm to engage in price discrimination is a critical consideration in numerous stages of a proper merger analysis.[31] Indeed, Carl Shapiro, the Deputy Assistant Attorney General for Economics in the DOJ Antitrust Division and member of the 2010 HMG working group, notes that "DOJ investigations often *begin* by asking whether there are particular types of customers who are most likely to be harmed by the merger," that is, customers who are likely price-discrimination targets.[32]

The result in *Dean Foods*, combined with the increased emphasis on price-discrimination market definition, in the 2010 HMG, seems likely to foreshadow further use of relatively narrow market definitions in similar types of transactions. For example, as in *Dean Foods*, DOJ's use of a price discrimination approach to define markets will potentially enable DOJ to allege narrower geographic markets than it could allege if those markets were defined by reference to supplier locations. This is particularly likely in markets where transportation costs are high, because customers will be less able to defeat targeted price increases by turning to more distant suppliers or engaging in arbitrage with non-targeted customers. Indeed, in the Competitive Impact Statement, DOJ made clear that its geographic market theory was directly in line with principles espoused in the 2010 HMG.[33]

III. Remedy

In addition to focusing attention on price discrimination market definition, this challenge reinforces DOJ's particular concerns in the agriculture sector. The Obama administration has clearly stated its priority to increase antitrust enforcement in the sector in response to what has been perceived as significant consolidation over the past 10 years.[34] Indeed, DOJ emphasized that the *Dean Foods* acquisition, albeit relatively small and thus not reportable under the Hart-Scott-Rodino Act, was merely one in a series of small dairy processor acquisitions completed by Dean, and that Dean had made more than 100 acquisitions in the past 15 years.[35] To remedy this – and perhaps also to send a clear message to other firms in the agriculture sector – the settlement effectively imposes HSR reporting requirements on Dean for any U.S. fluid milk processing plant acquisition of $3 million or greater, a threshold amount significantly below the HSR's "size of transaction" threshold.[36] In addition, the

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[27] *United States v. Country Lake Foods, Inc.*, 754 F. Supp. 669 (D. Minn. 1990).

[28] *See Country Lake Foods, Inc.*, 754 F. Supp. at 677 (D. Minn. 1990) ("The defendants have offered persuasive evidence that the relevant geographic market is larger than the MSP/MSA [alleged by the government] because purchasers of fluid milk in the Twin Cities could practicably turn to dairies outside the MSP/MSA should a nontransitory 5 to 10% increase in the price of fluid milk occur."). DOJ distinguished this case in *Dean Foods* not only because the proposed market was larger, but also because, unlike *Country Lake Foods*, the government in this case affirmatively alleged that it would be unlikely for more distant processors to profitably enter. Pls.' Resp. at 13 (citing Compl. ¶ 52).

[29] *Compare* 1997 Guidelines § 1.22 & n.12 *with* 2010 Guidelines § 3.

[30] 2010 HMG § 3.

[31] *See* 2010 HMG § 3 ("The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7)."). S*ee also* Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 ANTITRUST LAW JOURNAL 701, 745-46 (2010), *available at* http://faculty.haas.berkeley.edu/shapiro/hedgehog.pdf ("This new section was placed relatively early in the Guidelines because the basic principles of price discrimination articulated here are used throughout the Guidelines.").

[32] Id., at 746 (emphasis in original).

[33] Competitive Impact Statement at 3, *United States v. Dean Foods Co.*, No. 2:10-cv-00059, 2011 WL 1157025 (E.D. Wis. Mar. 29, 2011), *available at* http://www.justice.gov/atr/cases/f269000/269057.pdf ("CIS").

[34] *See, e.g.*, Christine Varney, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *Joint DOJ and USDA Agriculture Workshops: Concluding Remarks*, at 2, *available at* http://www.justice.gov/atr/public/speeches/264911.pdf ("The Department of Justice and the USDA share the strong conviction that a healthy, competitive agricultural sector is not only vitally important to our nation's economy but also a matter of national security and public health. Hearing concerns from producers about changes in the agricultural marketplace, we decided to explore competition issues affecting the agricultural sector in the 21st Century. We resolved to explore a number of different commodities and to tackle a number of important issues, including concentration in processing, buyer power, and vertical integration.").

[35] Compl. ¶ 21.

[36] CIS at 12-13.

terms of the settlement required Dean to divest the Waukesha plant, which, compared to the DePere plant, is the plant that "currently produces more milk, has a larger capacity to process milk, and is located closer to major population centers."[37] Although DOJ acknowledged that divestiture of only one plant would not effectuate complete relief from the alleged anticompetitive effects, DOJ nevertheless insisted that securing immediate relief, even if only partial, was far more likely to benefit consumers than litigating and waiting indefinitely for full relief.[38]

IV. Conclusion

Dean Foods evidences the administration's commitment to closely scrutinize further consolidation in the agriculture sector. DOJ's challenge of a relatively small merger ($35 million) and the subsequent imposition of HSR filing requirements for future smaller acquisitions ($3 million) has potentially significant implications for firms in the agriculture sector contemplating even relatively small transactions, particularly in markets where there has been a history of consolidation through a series of small transactions. Moreover, the emphasis on price-discrimination principles in the 2010 HMG, successfully applied in *Dean Foods*, likely reflects DOJ's shifting approach to defining markets and may lead to increased use of this theory in analyzing acquisitions in the agriculture sector.

[37] CIS at 10.

[38] CIS at 14-15.

"Follow the Leader" (or Label): FTC Food Health Claim Advertising Substantiation Converges with FDA Labeling Regulations

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There long has been interplay between the Federal Trade Commission ("FTC") and the Food and Drug Administration ("FDA") in protecting consumers from untrue, misleading or deceptive health claims by food and beverage makers.[1] The FTC's responsibility in this sector derives from sections 5, 12 and 15 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. §§ 45, 52, 55[2], authorizing the FTC to protect consumers from "unfair or deceptive acts or practices," including "false advertisement[s]" of foods. The FDA's responsibility over food makers' health claims derives in part from section 403 of the Federal Food, Drug, and Cosmetic Act ("FDCA"), 21 U.S.C. § 343, prohibiting among other things "misbranded food."[3]

The two agencies have carved out their respective responsibilities for policing food-related claims in inter-agency agreements. Forty years ago the FTC and FDA authored a Memorandum of Understanding that provides in substance for the FTC to take primary responsibility for regulating food advertising, and for the FDA to take primary responsibility for regulating food labeling.[4] The agencies' 1971 Memorandum of Understanding itself updated a previous FTC/FDA agreement on this subject.[5] The FTC again felt the need to clarify the boundaries of its jurisdiction over food health claims following enactment of the Nutrition Labeling and Education Act of 1990 ("NLEA") and the FDA's issuance of food labeling regulations implementing its expanded power under the NLEA.[6] The result was the FTC's 1994 "Enforcement Policy Statement on Food Advertising."[7]

The interplay between FTC and FDA regulation of health claims for food continues to evolve. Since 2010, a trend has become apparent toward convergence of FTC food health claim advertising standards with FDA food health claim labeling standards. This trend is manifested in a series of FTC orders and proposed orders that, unlike previous FTC orders on this subject, specify in greater detail the substantiation required by the FTC for various categories of health claims in the respondents' food advertising. In these recent FTC orders, that substantiation often means health claims that the FDA has endorsed.

This article first summarizes the relevant statutes and regulations that underlie the FTC/FDA regulatory "duet" on health claims for food. It then reviews the recent FTC orders and proposed orders that suggest that the FTC not only is converging its test for non-deceptive food health claims with FDA labeling regulations, but indeed seems to be pushing food manufacturers to have FDA approval for food health claims to avoid violation of sections 5 and 12 of the FTC Act.

Relevant Laws and Interpretations

Federal Trade Commission

Section 5 of the FTC Act prohibits "unfair or deceptive acts or practices in or affecting commerce."[8] For food products, Sections 12 and 15 of the FTC Act also apply. Section 12 in pertinent part prohibits the dissemination of any "false advertisement"[9] relating to food. A violation of Section 12 automatically violates Section 5.[10] Pursuant to Section 15, a false advertisement "means an advertisement, other than labeling, which is misleading in a material respect."[11] An advertisement can be misleading by explicit or implicit statements, and by omitting material facts.[12] The FTC's Enforcement Policy Statement explains that the FTC will find a food advertisement deceptive under Section 5 if it contains "a representation or omission of fact that is likely to mislead consumers acting reasonably under the circumstances, and that representation or omission is material."[13]

One key measure of whether an advertisement is deceptive is the evidence upon which the advertiser is basing its claim. In its 1983 Policy Statement Regarding Advertising Substantiation, the FTC reaffirmed its commitment to the "underlying legal requirement of advertising substantiation—that advertisers

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[1] This article will use the term "food" to refer collectively to food and beverages.

[2] Section 5(a)(1) of the Federal Trade Commission Act ("FTC Act") prohibits ". . . unfair or deceptive acts or practices in or affecting commerce." Section 12 of the FTC Act provides in pertinent part that disseminating "any false advertisement . . . for the purpose of inducing, or which is likely to induce, directly or indirectly the purchase of foods . . . shall be an unfair or deceptive practice within the meaning of section 5." Section 15 of the FTC Act defines "false advertisement" in part as "an advertisement, other than labeling, which is misleading in a material respect . . . ." Section 15 defines "food" to include "articles used for food or drink . . . ."

[3] "Misbranded food" for purposes of 21 U.S.C. § 343 includes food with "labeling [that] is false or misleading in any particular" and dietary supplements, the advertising of which is "false or misleading in a material respect" or the labeling of which violates 21 U.S.C. § 350(b)(2). 21 U.S.C. § 343(a).

[4] Memorandum of Understanding Between the Federal Trade Commission and the Federal Drug Administration, 4 Trade Reg. Rep. (CCH) ¶ 9,850.01 (1971) [hereafter, Memorandum of Understanding] (updating the "Working Agreement Between the Federal Trade Commission and the Federal Drug Administration – June 1954").

[5] *Id.*

[6] Nutrition Labeling and Education Act of 1990, Pub. L. No. 101-535, 104 Stat. 2353, codified in part at 21 U.S.C. § 343(i), (q) and (r).

[7] Federal Trade Commission, Enforcement Policy Statement on Food Advertising (1994) [hereafter, Enforcement Policy Statement], *available at* http://www.ftc.gov/bcp/policystmt/ad-food.shtm.

[8] 15 U.S.C. §45(a)(1).

[9] 15 U.S.C. §52.

[10] 15 U.S.C. §52(b).

[11] 15 U.S.C. § 55(a)(1).

[12] *Id.*

[13] ENFORCEMENT POLICY STATEMENT, *supra* note 7, at 2.

and ad agencies have a reasonable basis for advertising claims before they are disseminated."[14] The failure "to possess and rely upon a reasonable basis for objective claims constitutes an unfair and deceptive act or practice," in violation of Section 5.[15]

The FTC had previously defined a reasonable basis, in the context of nutrient content or health claims in food advertising, as competent and reliable scientific evidence to support the claim that is made.[16] Specifically, the FTC generally requires scientific evidence consisting of "tests, analyses, research, studies or other evidence conducted and evaluated in an objective manner by persons qualified to do so, using procedures generally accepted in the relevant profession to yield accurate and reliable results."[17] However, the FTC in recent orders and complaints has specified the substantiation, including, for example, two well-controlled human studies, that it requires as the supporting scientific evidence for certain health claims relating to food.[18]

Food and Drug Administration

The FDA also has jurisdiction over health claims made by manufacturers of food products pursuant to its authority in Section 403(a) of the FDCA that prohibits "misbranded food," which includes food "labeling [that] is false or misleading in any particular."[19] As mentioned previously, the FTC and the FDA have been operating under a Memorandum of Understanding since 1954 which assigns the FTC primary responsibility for regulating food product advertising and primary responsibility to the FDA for regulating food product labeling.[20]

The NLEA modified the FDCA,[21] requiring most food to bear nutrition labeling. For food labels that contain certain nutrient content claims and health claims, the NLEA mandates compliance with scientific requirements.[22]

The NLEA defines "health claim" as "any claim made on the label or in labeling of a food . . . that expressly or by implication . . . characterizes the relationship of any substance to a disease or health-related condition."[23] A substance is broadly defined as "a specific food or component of food."[24] A disease or health-related condition is "damage to an organ, part, structure, or system of the body such that it does not function properly"[25]

Before a manufacturer may label a product with a health claim, the product must meet the FDA's eligibility requirements. Only those substances that are associated with a disease or health-related condition for which the general U.S. population (or subgroup) is at risk, and for which the FDA's safety requirements are met are eligible for health claim labeling.[26] The FDA will authorize a health claim only when it determines, "based on the totality of publicly available scientific evidence (including evidence from well-designed studies conducted in a manner which is consistent with generally recognized scientific procedures and principles), that there is significant scientific agreement, among experts qualified by scientific training and experience to evaluate such claims, that the claim is supported by such evidence."[27]

Before labeling its food product with a health claim, a manufacturer must petition the FDA, and the FDA must issue a regulation authorizing the health claim. The petitioning process involves, *inter alia*, submitting to the FDA a complete explanation of how the substance meets the eligibility requirements, a list of the ingredients involved, and whether each ingredient is generally recognized as safe under the relevant C.F.R. section.[28] Most importantly, the petition must provide a summary of scientific data, the "basis upon which authorizing a health claim can be justified as providing the health benefit." The summary must establish that the health claim is supported by the standard specified by the FDA for authorizing a health claim.[29]

Only if the FDA has adopted a regulation providing for the petitioned health claim may a food manufacturer include that health claim in the labeling of its product. All labeling must be consistent with the regulation that the FDA adopted.[30] Consistent with the food-advertising requirements of the FTC, the FDA requires that a health claim on food labeling must be complete, truthful and not misleading.[31] In addition, health claims on food labeling must enable the public "to comprehend the information provided and to understand the relative significance of such information in the context of a total daily diet."[32]

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[14] FTC POLICY STATEMENT REGARDING ADVERTISING SUBSTANTIATION, at 1 (1983), *available at* http://www.ftc.gov/bcp/guides/ad3subst.htm.

[15] *Id.*

[16] ENFORCEMENT POLICY STATEMENT, *supra* note 7, at 3.

[17] *Id.*; *see also* The Dannon Co., Docket No. C-4313, at 4 (2011) (decision and order), *available at* http://www.ftc.gov/os/caselist/0823158/110204dannondo.pdf; Nestle Healthcare Nutrition, Inc., Docket No. C-4312, at 4 (2011) (decision and order), *available at* http://www.ftc.gov/os/caselist/0923087/110118nestledo.pdf; POM Wonderful, FTC Docket No. 9344, at 23 (2010) (complaint), *available at* http://www.ftc.gov/os/adjpro/d9344/100927admincmplt.pdf.

[18] *See, e.g.*, *Dannon*, *supra* note 17, at 3-4; *Nestle*, *supra* note 17, at 3.

[19] 21 U.S.C. § 343(a).

[20] MEMORANDUM OF UNDERSTANDING, *supra* note 4.

[21] 21 U.S.C. § 343.

[22] 21 U.S.C. § 343(r). Because the NLEA modified the FDCA, one must look at the implementing regulations promulgated by the FDA as published in the Code of Federal Regulations to enforce the FDCA to understand the requirements manufacturers must meet for labeling products with health claims.

[23] 21 C.F.R. §101.14(a)(1).

[24] 21 C.F.R. §101.14(a)(2).

[25] 21 C.F.R. §101.14(a)(5).

[26] 21 C.F.R. §101.14(b)(1).

[27] 21 C.F.R. §101.14(c).

[28] 21 C.F.R. §101.70(f)(A).

[29] 21 C.F.R. §101.70(f)(B). The summary standard in 21 C.F.R. §101.70(f)(B) is the same standard that is defined in 21 C.F.R. §101.14(c).

[30] 21 C.F.R. §101.14(d)(2)(i).

[31] 21 C.F.R. §101.14(d)(2)(iii).

[32] 21 C.F.R. §101.14(d)(2)(v).

FTC's Orders Converge with FDA Standards for Labeling

Starting with *Iovate*[33] and *Nestle*[34] in 2010, FTC Orders settling violations of Section 5 for false or misleading food health claim advertisements have more explicitly converged with the FDA requirements for labeling of food products with health claims and in some respects, have gone beyond what the FDA requires to substantiate health claims.

The FTC in *Iovate, Nestle* and more recent cases has described three separate categories of required substantiation for health claims in food advertising.

Disease-related claims

The first category applies to disease-related claims. In July 2010, the FTC issued separate complaints against *Iovate* and *Nestle* for deceptive acts or practices and false advertisements in violation of Sections 5 and 12 of the FTC Act. Iovate had marketed that certain of its products would prevent, protect against or reduce the duration of colds, flu and allergies. Nestle had advertised that its BOOST product would prevent or reduce the risk of upper respiratory tract infections, including colds and flu. A few months later, in September 2010, the FTC issued a complaint against POM Wonderful claiming that it had violated Sections 5 and 12 by allegedly advertising that its pomegranate-based products treat, prevent, or reduce the risk of heart disease, prostate cancer and erectile dysfunction. More recently, in January 2011, the FTC issued a complaint against Dannon for allegedly violating Sections 5 and 12 by advertising that its DanActive product reduces the likelihood of getting a cold or the flu.

In all of the proposed or stipulated Orders in *Iovate*, *Nestle*, *POM*, and *Dannon*, the FTC, with minor variations, prohibited any claim regarding cold or flu prevention or treatment, heart disease prevention or treatment, prostate cancer risk reduction, or treatment or prevention of erectile dysfunction unless (1) the claim is specifically permitted in labeling for such product promulgated in FDA regulations pursuant to the NLEA;[35] or in regard only to *Iovate* and *POM*, the product (2) is subject to a final over-the-counter (OTC) drug monograph by the FDA for such use, and conforms to the conditions of such use; (3) remains covered by a tentative final OTC drug monograph for such use and adopts the conditions of such use; or (4) is the subject of a new drug application for such use approved by FDA, and conforms to the conditions of such use.[36]

By separating out these disease-related claims and requiring that the manufacturers meet the FDA's regulations or other specific FDA authorizations, the FTC is not hiding the fact that they are deferring to the FDA's authority in labeling for such claims related to food products. That the FTC is incorporating references to FDA regulations should come as no surprise as the FTC has stated in previous policy statements that in cases where the FTC and the FDA have overlapping jurisdiction, the FTC will defer to the FDA.[37] In addition, the Director of the FTC's Bureau of Consumer Protection, David Vladeck, stated in 2009 that the FTC was making a more concerted effort to harmonize its requirements with those of the FDA.[38]

What is notable with this category is that not only is the FTC harmonizing its own Orders with the FDA testing standards, but it is requiring that manufacturers actually go through the FDA's petitioning process for health and disease claims if the manufacturer wants to advertise that its product protects against, or otherwise treats, diseases. Remembering that the FDA's process applies to labeling, not advertising, it is possible that the manufacturer specifically chose not to go through the FDA's process for labeling to avoid incurring the time and cost that goes with the petitioning process. This process can take upwards of 18 months before the FDA is required to publish a final rule regarding the health claim.[39] For *Iovate* and *POM*, requiring in the alternative that the manufacturer go through the FDA's drug approval process would be even more burdensome than the petitioning process for labeling for health claims.[40]

Some uncertainty still remains for food manufacturers notwithstanding the implicit industry guidance from the FTC in such specific Orders. First, so far, the requirement to limit food health claims to FDA-approved claims has only been applied by the FTC to the specific disease-related claims in *Iovate*, *POM*, *Nestle*, and *Dannon*. Under the NLEA, a disease is defined as "damage to an organ, part, structure, or system of the body such that it does not function properly."[41] Thus, a manufacturer could infer that if it makes advertising claims that its product prevents or otherwise treats a "disease" as it is defined in the NLEA, the FTC may file a complaint and issue a proposed order within this category. However, as products and health claims evolve, there is bound to be a gray area where a manufacturer is unsure if its health claim is

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[33] *FTC v. Iovate Health Sciences USA, Inc.*, Case No. 10-CV-587, slip. op. at 6 (W.D.N.Y. July 29, 2010), *available at* http://www.ftc.gov/os/caselist/0723187/100729iovatestip.pdf.

[34] *Nestle*, *supra* note 17, at 3. In *Nestle*, the FTC approved the final order in January 2011, but the FTC and Nestle originally reached an "Agreement Containing Consent Order" in 2010. Nestle Healthcare Nutrition, Inc., File No. 092-3087, Agreement Containing Consent Order (July 14, 2010), *available at* http://www.ftc.gov/os/caselist/0923087/100714nestleorder.pdf.

[35] *Iovate*, *supra* note 33, at 6; *Nestle*, *supra* note 17, at 3; *POM*, *supra* note 17, at 22; *Dannon*, *supra* note 17, at 3.

[36] *Iovate*, *supra* note 33, at 6; *POM*, *supra* note 17, at 22. POM was allowed also to meet the labeling requirements under the NLEA for its heart disease claims. *POM*, *supra* note 17 at 22.

[37] ENFORCEMENT POLICY STATEMENT, *supra* note 7, at 3.

[38] David Vladeck, Director FTC Bureau of Consumer Protection, Remarks at the Federal Trade Commission National Advertising Division Annual Conference (October 5, 2009), *available at* http://www.ftc.gov/speeches/vladeck/091005vladecknationaladvertising.pdf.

[39] 21 C.F.R. §101.70(j). The FDA can seek extensions throughout this process, including two 90-day extensions for cause prior to publishing a final rule. *Id.* The final rule, however, needs to be published within 540 days of receipt of the petition. 21 C.F.R. §101.70(j)(4)(ii).

[40] In a New Drug Application, the FDA requires information, such as nonclinical pharmacology and toxicology studies, human pharmacokinetics and bio-availability data, and human and non-human clinical studies, to be submitted in the petition's Technical Sections. 21 C.F.R. §314.50(d).

[41] 21 C.F.R. §101.14(a)(5).

related to a "disease" as so defined.

Second, an advertising claim, even if approved for labeling by the FDA, may still run afoul of Sections 5 and 12 "if the context of the ad renders the express message of the claim misleading."[42] In addition, an advertising claim in this disease-related category must stay within the parameters approved by the FDA for labeling. If the advertisement contextually goes beyond the scope of the approved labeling, then the FTC can still find a violation of Sections 5 and 12.

Other Specific Health Claims

The second substantiation category found in recent FTC Orders may be referred to as "other specific health claims." This category includes weight loss claims, relieving temporary irregularity, helping with slow intestinal transit time, reducing diarrhea in children, and reducing school absences due to illness.[43] For these claims, current FTC orders require "competent and reliable scientific evidence," specifically defined as two adequate and well-controlled human clinical studies of the product at issue or of an essentially equivalent product, conducted by different researchers, independent of each other, that conform to acceptable designs and protocols and whose results, when considered in light of the entire body of relevant and reliable scientific evidence are sufficient to substantiate that the representation is true.[44]

Instead of harmonizing with the FDA, the FTC's Orders for this category seem to reach beyond what the FDA requires in its regulations for health claim labeling of food. Pursuant to FDA regulations implementing the NLEA, the summary of scientific data submitted with the petition to the FDA should include "evidence of well-designed studies conducted in a manner which is consistent with generally recognized scientific procedures and principles." [45] The FDA regulations implementing the NLEA do not require a specific number of studies, nor do they even require human clinical studies in certain cases[46] in order to be granted permission to label a product with a health claim. On the other hand, the FDA regulations implementing the NLEA give the FDA room to determine whether the studies submitted in support of a labeling petition are sufficient to grant the labeling petition, and whether more studies are needed.[47]

The FTC provides some level of certainty by requiring two well-controlled human studies for non-disease related health claims. That is where the certainty ends however. As with the disease-related claims category, the FTC has called out only certain claims from *Iovate*, *Dannon* and *Nestle* that are required to be substantiated by two well-controlled human studies. The FTC has not otherwise defined what may fall into this category. There are certain to be health claims that are not disease-related but that the FTC may view as going beyond the performance or efficacy of the product, as mentioned below, in the discussion of the third category of health claims.

As with the disease-related claims category, simply having two well-controlled human studies is not a guarantee that a manufacturer's health-related claims in advertisements would not violate Sections 5 and 12. The FTC looks at a food health claim advertisement as a whole. Thus if the advertisement is misleading in context, or goes beyond what the two well-controlled human clinical studies support, even though a manufacturer has sufficient substantiation for one particular claim, other claims could be found in the context of an advertisement that cause it to violate Sections 5 and 12.

Any Other Health Claim

The third category may be referred to as "any other health claim." This category can be considered a catch-all in that there are no health claims specifically identified in this category in the FTC's recent Orders. Rather, the Orders are worded such that this category applies to claims that do not fit into either of the first two categories discussed above.[48] For this "any-other-health-claim" category, claims about the general health benefits, performance or efficacy of a food product must rely on "competent and reliable scientific evidence," defined as "tests, analyses, research, or studies that have been conducted and evaluated in an objective manner by qualified persons and are generally accepted in the profession to yield accurate and reliable results."[49]

The "competent and reliable" scientific evidence required by the FTC in this category is similar to the "well-designed" studies required by the FDA to support health claims made on the label or in labeling of a food. The FDA requires "evidence from well-designed studies conducted in a manner which is consistent with generally recognized scientific procedures and principles."[50] What constitutes a "well-designed" study is not defined in the NLEA or FDA's implementing regulations. This undefined term causes uncertainty about what evidence is sufficient to achieve FDA

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[42] ENFORCEMENT POLICY STATEMENT, *supra* note 7, at 9-10 n.10.

[43] *Iovate*, *supra* note 33, at 6-7; *Nestle*, *supra* note 17, at 3; *Dannon*, *supra* note 17, at 3-4.

[44] *Iovate*, *supra* note 33, at 7; *Nestle*, *supra* note 17, at 3; *Dannon*, *supra* note 17, at 3-4. The FTC allows the use of previous studies as substantiation of a health claim so long as the study was for an "essentially equivalent product." The FTC defines "essentially equivalent product" as "a product that contains the identical ingredients, except for inactive ingredients (*e.g.,* inactive binders, flavors, preservatives, colors, fillers, excipients), in the same form and dosage, and with the same route of administration (*e.g.,* orally, sublingually), as the covered product; provided that the covered product may contain additional ingredients or other differences in formulation to affect taste, texture, or nutritional value (so long as the other differences do not change the form of the product or involve the ingredients from which the functional benefit is derived), if reliable scientific evidence generally accepted by experts in the field demonstrates that the amount of additional ingredients, combination of additional ingredients, and any other differences in formulation are unlikely to impede or inhibit the effectiveness of the ingredients in the essentially equivalent product." *Dannon*, *supra* note 17, at 2.

[45] 21 C.F.R. §101.70(f)(B).

[46] *See* 21 C.F.R. §101.70(c) (defining the requirements for a petition that includes "nonclinical laboratory studies").

[47] 21 C.F.R. §101.14(c).

[48] *Iovate*, *supra* note 33, at 7-8; *Nestle*, *supra* note 17, at 4; *POM*, *supra* note 17, at 22-23; *Dannon*, *supra* note 17, at 3-4.

[49] *Iovate*, *supra* note 33, at 8; *Nestle*, *supra* note 17, at 4; *POM*, *supra* note 17, at 23; *Dannon*, *supra* note 17, at 3-4.

[50] 21 C.F.R. §101.14(c).

approval for health claims. It also, however, gives flexibility to the petitioning company about the evidence to include, and to the FDA about the evidence to accept, as well-designed studies, on a case-by-case basis.

Pre-Approval by FDA

Finally, there is a type of "safe harbor" in the FTC's Orders. The Orders provide in pertinent part that a health claim of any category—not merely disease-related claims—is permitted in advertising for such product if the health claim is "specifically permitted in labeling for such product by regulations promulgated by the [FDA] pursuant to the [NLEA]."[51]

The FTC is again explicitly deferring to the FDA with this category. This category allows food manufacturers who go through the FDA's petitioning process for health claims to make the claim in advertisements. However, it is important for the manufacturer to stay strictly within the scope of the grant of the FDA label for the health claim. If the advertisement, in context or otherwise, goes beyond what the FDA permits in labeling, the FTC could still claim a violation of Sections 5 and 12.

Conclusion

The FTC's proposed and stipulated Orders have become more specific in the first instance on what is required to substantiate health claims made in advertising food, and they are converging with FDA standards for health claims under the NLEA. In some cases, the FTC's Orders require more than the FDA mandates for health claim labeling of foods. The FTC's Orders may force a food manufacturer to go through the long FDA process for food health claim labeling even when the manufacturer's goal is merely to advertise a specific health claim, not to include it on a food label.

The FTC has taken to separating the content of its Orders into three categories. For disease-related claims, the FTC requires that manufacturers meet the FDA's requirements under the NLEA for these types of claims. With this category, the FTC is explicitly deferring to the FDA's authority on disease-related claims.

The second category, "other specific health claims," arguably goes beyond what even the FDA requires for labeling. The FTC has required in its last several Orders "competent and reliable scientific evidence," specifically defined as two adequate and well-controlled human clinical studies. This specific definition is not found in the FDA regulations. The third category, "any other health claim" is a catch-all for those claims that do not fall into the first two. This category requires "competent and reliable scientific evidence" similar to the FDA's requirements of having well-designed studies to support any labeling claims.

For all of these categories, if the manufacturer has already met the FDA's labeling requirements, advertising that stays within the confines of the approved labeling will more likely not be investigated for possible violation of the FTC Act. Conversely, for all of these categories, if the claim made in the advertisement goes beyond the scope of the approved labeling or study, the FTC will more likely investigate the health claim made in the advertisement for possible violation of the FTC Act.

While the FTC is converging with and deferring to the FDA, this convergence is currently a one-way street. The FTC is using the FDA's rules to guide its enforcement of Sections 5, 12 and 15; however, the FDA has not as yet changed its rules to incorporate any of the FTC's advertising standards in FDA labeling regulations.

[51] *Iovate*, *supra* note 33, at 9; *Nestle*, *supra* note 17, at 4; *POM*, *supra* note 17, at 23; *Dannon*, *supra* note 17, at 4.

Highlights from the Joint DOJ/USDA Workshop at Washington, DC, December 8, 2010

By Ian Conner (Kirkland & Ellis LLP) and Jennifer Zwagerman (Faegre & Benson LLP)

On December 8, 2010, in Washington, D.C., the U.S. Department of Justice and U.S. Department of Agriculture held their fifth and final joint public workshop on competition in agriculture industries. Although the DOJ and USDA had announced that this workshop would focus on margins at various levels of the agricultural supply chain, in fact much of the workshop focused on margins only at the retail level. Both panelists and members of the public in their comments spoke about consolidation in the grocery sector and the growing market power of Walmart. Although the proposed Grain Inspection, Packers and Stockyards Administration (GIPSA) rules were mentioned and discussed, they were mentioned far less frequently than at the Fort Collins, Colorado workshop on the livestock industries, and were not a significant part of the D.C. workshop.

The workshop began with opening comments by U.S. Secretary of Agriculture Tom Vilsack and U.S. Attorney General Eric Holder. Secretary Vilsack explained that the purpose of this workshop was to look at packer margins and margins in the retail marketplace. He said in substance that the government wanted to understand how livestock moves through the supply chain, what the margins are on livestock, dairy and poultry and how consolidation in the retail sector has affected those margins. The government wanted to explore in this workshop, as in all previous workshops, the appropriate role for antitrust in agriculture. Secretary Vilsack said that throughout the workshop series, the government has found that producers want more marketing options, transparency in pricing, and the ability to get their products to market. He noted that the share of the consumer's food dollar has shifted away from the producer and towards the packer and retailer.

Secretary Vilsack also highlighted some of the accomplishments of the workshops thus far: establishment of a joint task force between the DOJ and USDA to look at competition issues, increased enforcement of the Packers and Stockyards Act with the hiring of additional attorneys and field investigators, and the release of the proposed GIPSA rules for livestock and poultry markets. Secretary Vilsack observed that the public comment period on the proposed GIPSA rules has closed and that the USDA now would focus on drafting a workable rule that takes into account the comments that were received. He concluded by saying that the end of the workshop series should not end the dialogue on competition in agriculture.

Attorney General Holder echoed many of Secretary Vilsack's comments. AG Holder noted that antitrust enforcement will not solve every problem that plagues the agriculture sector. He underscored Secretary Vilsack's comment that the end of the workshop series does not end the dialogue on competition in agriculture. He noted that the joint task force has an online submission form to take complaints about unfair or deceptive practices in the sector.

Following General Holder's remarks, the workshop proceeded to its first panel. This panel was moderated by Secretary Vilsack, AG Holder, and U.S. Assistant Attorney General, Antitrust Division Christine Varney. The panelists included a cattle producer, and representatives from agricultural cooperatives, and from associations of meat packers, food retailers/wholesalers, and consumers.

The panel focused on changes in the food chain and consumer demand. Secretary Vilsack questioned panelists on how changes in consumer demand and the move away from home-cooked meals have affected agriculture industries. Panelists observed that there has been a shift in consumer demand to more prepared foods and in-store service. They also noted that consumers are increasingly interested in the safety of their food and knowing the source of their food. This interest, according to panelists, has led to demand for "buy-local" programs and for branded produce and livestock programs.

Looking to the future, some panelists expressed concern that the consolidation of packers has left many producers with only three or four buyer options. These panelists asserted that increasing the options for agricultural producers is necessary if the nation is to have a competitive agricultural economy. The food retailers/wholesalers association representative predicted that the retail sector is likely to see more diversification with consumers gaining more outlets for their food purchases.

This panel also discussed the shrinking farming population. Some panelists attributed this trend to packer consolidation and loss of transparent pricing. Others attributed falling farming population to low prices, which have made it difficult to profitably sustain farming. One panelist, discussing consolidation in food processing, complained that consumers now have merely the illusion of choice, since a small group of food companies market and sell a large number of products under multiple brand names.

The discussion briefly turned to retail margins. The food retailers/wholesalers association representative contended that retail margins are "razor thin." He explained that meat is typically a loss leader for groceries and price margins on meat are lower than margins on other products. He also noted that meat involves some costs that either are non-existent or lower for many other grocery items, citing transportation, refrigeration, and labor costs. He asserted that the retail sector is highly competitive, with multiple outlets and choices for consumers. This was an assertion that he made again during the day's third panel, on retailer margins.

The second panel of the day focused on margins in the dairy industry. It was moderated by Mark Tobey of the DOJ. The panel included a dairy farmer and member of the Dairy Farmers of America (DFA) milk marketing cooperative, two state university professors (economics and agribusiness) and the chief of enforcement and accounting for the Pennsylvania Milk Marketing Board. Much of this panel's discussion focused on whether, and to what extent, changes in the prices paid to dairy farmers are passed-on to consumers. All panelists agreed that milk prices have been volatile over the past few years, but this volatility has not necessarily resulted in price decreases being passed-on to consumers.

Some panelists asserted that increases in the prices paid to farmers are passed-on to consumers, but that decreases in prices paid to farmers are only partially passed-on. As a result, dairy farmers may see a relatively steeper reduction in the price paid to them for milk than in the retail price paid by consumers for that milk.

The Pennsylvania Milk Marketing Board representative noted that, in Pennsylvania, the state has set minimum price margins for sales of milk at all levels in the supply chain. He said that this ensures that everyone is receiving a fair amount of the overall price of milk.

The third panel of the day was the most lively and contentious. This panel focused on retail grocery margins. It included the president of the American Antitrust Institute (AAI), a sociology professor, two representatives of the grocery sector (including the food retailers/wholesalers association representative from the first panel), a representative of the United Food & Commercial Workers Union, two economics professors, and a consumer advocate. The panel was moderated by Sharis Pozen of the DOJ and also included Howard Shelanski, Deputy Director for Antitrust in the Bureau of Economics at the FTC.

Mr. Shelanski opened the panel by discussing the results of work done by the FTC on retail grocery consolidation. He noted that consolidation in the last 18 years has led to the top 20 grocers in the nation having a much larger share of the market. In 1992, the top 20 had 39% of the market, whereas today the top 20 grocers have 65% of the market. Walmart is the largest grocery retailer in the country and is several times larger than its next closest competitor, Kroger. However, the FTC did not find that the consolidation and increase in concentration among grocers has led to any decrease in consumer welfare.

Other panelists took issue with a singular focus on consumer welfare, which they said disregards societal or citizen welfare and does not take into account the welfare of farmers. They asserted that farmers' share of the food dollar is shrinking, and the number of small grocers and food outlets in rural areas and inner city urban areas likewise is shrinking. The primary concern of these panelists was that, although consumers may not be suffering harm, farmers are certainly being harmed by the increase in buyer power. One panelist asserted that consumers had enjoyed cheap food for too long, and that cheap food is hurting farmers. Another compared the market to an hourglass, with retailers and packers in the middle squeezing the farmers.

The topic of buyer power at the retail grocer level came to dominate the third panel's discussion. Bert Foer of the AAI encouraged the government to challenge Walmart due to its buying power. When Mr. Shelanski asserted that it would be difficult under the antitrust laws to sue Walmart for gaining its market share through organic growth, Mr. Foer responded that the DOJ challenges buyer cartels for depressing prices. Mr. Shelanski suggested that regulating Walmart's buying power would be better left to regulatory instruments, rather than the antitrust laws.

Mr. Foer noted, and Mr. Shelanski agreed, that monopsony is not a mirror image of monopoly. Mr. Foer argued that a buyer could have a much greater effect with 30% of the buyer's market than it would have with the same share in the seller's market. This opinion was echoed by the union representative on the panel, who recounted the story of Vlasic's unsuccessful attempt to restructure its pricing to Walmart, which Vlasic ended after Walmart threatened to drop Vlasic products completely. Mr. Shelanski noted that use of buyer power to lower prices and then pass those lower prices on to consumers is not typically an antitrust issue. He observed that buyer power is an antitrust issue when buyer power is used to raise prices and exclude competitors.

Following this dialogue, Mr. Shelanski and Ms. Pozen briefly commented on theories of raising rivals' costs and the action that the DOJ has brought against Blue Cross & Blue Shield of Michigan regarding most-favored-nations (MFN) clauses in BCBS's agreements with hospitals.

The panel concluded with each panelist offering his recommendation for antitrust enforcement in the retail arena. Mr. Foer advocated the creation of a blue ribbon panel to discuss the issue of buyer power. Other panelists argued for retrospective review of all agriculture mergers consummated in the last decade, a legal policy framework that would focus on citizen welfare rather than consumer welfare, and increased monopsony challenges. The representatives from the grocery sector said that they wanted the enforcement agencies to acknowledge the growing diversification of outlets in the retail sector. They also applauded the DOJ's action against credit card issuers on interchange fees.

The fourth and final panel of the day considered livestock and poultry margins. This panel focused on a number of issues identified in previous workshops, including contracting and pricing practices in the poultry industry, with little specific focus given to issues surrounding price margins. Economists on the panel discussed the difficulty of using currently available public data to support livestock producer concerns regarding packer concentration. The economists said in substance that the available data do not support claims that the marketing practices of beef and pork processors are reducing competition. However, it was noted, economists are constrained by the information available to them and that in certain areas, particularly the poultry industry, the information is limited.

Comments by members of the public at the workshop focused on an array of issues. Many expressed concern over food safety in light of recent salmonella outbreaks. Others voiced concern over the safety of genetically modified foods and the dominance of Monsanto in genetically modified seeds. Several supported the proposed GIPSA rules and encouraged the USDA to do more to encourage price transparency. Many argued that Walmart's buyer power drove down prices to suppliers and hurt competition.

This final workshop in the series echoed many of the concerns heard from farmers and ranchers at prior workshops. But, the buyer power issue had not been explored in depth at any of the prior workshops. Its prominent place in this workshop was a fitting, albeit inconclusive, end to the USDA/DOJ joint public workshop series. In her closing remarks AAG Varney stated that:

> The Antitrust Division emerges from these workshops better equipped to ensure that our nation's farmers, processors, and consumers

> reap the benefits of competitive agricultural markets. It is our role to enforce the antitrust laws and advocate for competition in the agricultural sector, and the stories we heard at the workshops confirmed the importance of these efforts.

She also offered the DOJ's assistance as the USDA crafts the final GIPSA rules. She concluded her remarks by stating that although government does not have all the answers, it can play an important role in addressing the challenges facing rural America. There was no indication that the workshop series would result in a report or other publication by the DOJ or USDA on the findings of the series.

Updates:

What Happened to the GIPSA Proposed Rules?

In 2010, GIPSA's controversial proposed rules were a major focus in agricultural antitrust. The rules' attempts to eliminate the need for proof of anti-competitive impact to establish a violation of the Packers and Stockyards Act ("PSA") and to radically change the structure of the meatpacking and poultry processing industries generated much heated debate. The series of USDA-DOJ joint industry workshops provided a venue for those debates. In mid-2011 – a little over a year after the rules were proposed – they appear to be "off the radar" of the antitrust world. What has happened since November 2010?

By the November 22, 2010 close of the public comment period on the proposed rules, over 64,000 comments were received. A number of those comments attacked the economic impact analysis that GIPSA submitted with the proposed rules and some provided independent economic analyses. For example, the American Meat Institute comment pointed out that Executive Order 1266 and the Regulatory Flexibility Act required GIPSA to submit an economic impact analysis with a number of specific assessments, and that the GIPSA proposed rules had failed to do so. AMI submitted its own economic analysis showing that implementation of the rules would cause the loss of approximately 104,000 jobs and adversely affect domestic GDP by $14 billion.

In December 2010, Secretary of Agriculture Vilsack stated in a conference call with industry stakeholders that GIPSA would conduct a new, thorough cost-benefit analysis before issuing final rules. It is currently unclear exactly what economic impact analysis GIPSA is doing, what the results will be, or whether the results will be issued for public comment before the final rules are issued.

In January 2011, the U.S. Supreme Court denied certiorari on plaintiffs' appeal of the 6th Circuit Court of Appeals' decision in *Terry v. Tyson Farms, Inc.*, 604 F.3d 272 (6th Cir. 2010), *cert denied*, No. 10-542, 131 S. Ct. 1044 (2011). This action removed any possibility that the established law requiring a showing of adverse impact on competition to prove a violation of the PSA might be changed to comport more closely with the approach taken in GIPSA's proposed rules. Since the GIPSA proposed rules attempted to change this law, the Supreme Court's conclusion appears to bolster the position of the rules' opponents.

As the Fiscal Year 2012 Agricultural Appropriations Bill wound its way through Congress during June and July 2011, the GIPSA rulemaking was subjected to further attack. The House version of the bill defunds the GIPSA proposed rules. It states that "None of the funds made available by this or any other Act may be used to write, prepare, develop, or publish a final rule or an interim final rule in furtherance of, or otherwise to implement . . ." the GIPSA proposed rules. The Senate version of the bill contains no such prohibition. It remains unclear (1) how this issue will be resolved in the final bill and (2) if defunding is enacted, the extent to which GIPSA could issue a final rule out of funds "made available" in earlier, or other, appropriations.

One additional development is that John Farrell, Deputy Secretary of Marketing and Regulatory Affairs at USDA (which oversees GIPSA) and one of the chief organizers of the USDA-DOJ industry workshops, who was likely heavily involved in the GIPSA proposed rules, is leaving USDA this August.

In summary, the proposed GIPSA rules have suffered a number of blows, but they are clearly alive and being retooled in the GIPSA workshop. At some point, they will reemerge in some new final form with a more extensive economic impact analysis. The extent to which GIPSA will modify its proposed rules to meet industry concerns and the concerns of producers opposed to the rules is unclear. All parties are awaiting GIPSA's action. When GIPSA issues final rules, it will ring the bell for the next round of the fight, and the antitrust issues surrounding the PSA will soar back into prominence.

Case to Watch for: *Minn-Chem, Inc. v. Agrium, Inc.* (7th Cir., No. 10-1712)

Judges Richard Posner and Frank Easterbrook of the Seventh Circuit are widely associated with the "Chicago School" approach to antitrust law. Given its emphasis on the resiliency of free markets, its skepticism for the notion that entrenched monopoly power is a true problem in the modern U.S. economy, and its embrace of economics over legal precedent as a driver of antitrust law in the courtroom, many lawyers associate the "Chicago School" with a pro-defendant tilt to antitrust. Perhaps; but in light of the Supreme Court's recent decisions in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), it would be a mistake to conclude from that alone that the Seventh Circuit is necessarily unfriendly to plaintiffs in circumstantial price fixing cases. To the contrary, readers of the now-familiar High Fructose Corn Syrup and Text Messaging cases might conclude that the Seventh Circuit is one of the more pro-plaintiff forums among the Courts of Appeals. One pending case in particular may shed some light on the question whether the Seventh Circuit is, in fact, going its own way.

Minn-Chem, Inc. v. Agrium, Inc. (7th Cir., No. 10-1712), is a class action involving allegations of an international conspiracy to reduce output and raise the price of potash, a key ingredient in most fertilizers. The plaintiffs allege that the conspiracy involved price-fixing for potash sales in overseas markets, as well as parallel cuts in foreign potash production, which they claim had an anticompetitive impact on potash prices in the United States.

The case is particularly notable because the defendants moved to dismiss the complaint on two independent grounds, both of which remain unsettled in the Seventh Circuit. *First*, they argued that the claim was barred by the Foreign Trade Antitrust Improvements Act ("FTAIA"), which provides that the Sherman Act does not extend to foreign commerce unless the challenged conduct either "involv[es]" U.S. import commerce or "direct[ly] . . . [a]ffects" U.S. domestic markets. *See* 15 U.S.C. § 6a. They contended that the complaint alleged anticompetitive conduct taking place entirely outside the United States and directed exclusively at foreign markets, and that the impact of that alleged conduct on the United States (if there was any at all) was indirect and tangential. The plaintiffs argued otherwise; in their view, because each defendant was simultaneously participating in foreign markets and domestic markets, their conduct in fixing prices abroad necessarily "involved" U.S. import commerce.

Second, the defendants argued that, in alleging nothing more than follow-the-leader behavior in a concentrated industry,

the allegations were fully consistent with independent conduct, and thus should be dismissed under *Twombly* and *Iqbal*. Plaintiffs responded that allegedly coordinated price increases and capacity reductions with respect to a fungible product in a concentrated market, taken together with alleged trade association meetings, raised a plausible inference of conspiracy.

Judge Castillo of the Northern District of Illinois denied the defendants' motion to dismiss on both scores, but certified his order for interlocutory review under 28 U.S.C. § 1292(b). The Seventh Circuit subsequently granted interlocutory review of both questions. It is unclear whether the court will decide the appeal on the basis of the FTAIA question, the *Twombly* question, or both. But the fact that the appeal remains pending more than one year after it was argued (on June 3, 2010) suggests that the judges view the case as a hard one—and one that may reshape how the court approaches antitrust cases in the coming years.

The Agriculture and Food Committee plans to sponsor a webinar when the decision in *Minn-Chem* comes down.

U.S. v. George's Foods

The government's May 10, 2011 Clayton Act § 7 challenge to a consummated $3 million chicken processing facility acquisition in *United States v. George's Foods, LLC,* 5:11-cv-00043 (W.D. Va.) is noteworthy by several measures: the genesis of the action; the acquisition's size; the product market; the competitive harm alleged by the government; the swiftness of the proceedings and the agreed relief.

Genesis of the action; size of the acquisition. On March 18, 2011, competing chicken processors George's[1] and Tyson Foods, Inc. ("Tyson") – two of the three processors of broiler[2] chickens located in the Shenandoah Valley of Virginia and West Virginia -- publicly announced George's intent to acquire Tyson's Harrisonburg, Virginia chicken processing facility. It was a very small transaction; the purchase price for the facility was only $3 million. Given the $3 million purchase price, the transaction was non-reportable and thus the parties were not required to wait for HSR clearance to close the deal. The DOJ opened an investigation into the non-reportable transaction and issued Civil Investigative Demands (CIDs). On May 7, 2011, before complying with these CIDs, the parties closed the transaction.

Three days later the DOJ filed a complaint to unwind the transaction. Although the Complaint criticized the parties for closing their deal without notice to the government and before complying with the CIDs (Complaint ¶ 1), a motion filed by George's a few days after the Complaint filing suggests that the parties made this move to push the government to swift resolution in a case where the parties believed the facts refuted the government's theory of competitive harm and the wisdom of the requested divestiture. George's May 16, 2011 motion asked the court to expedite the proceedings. George's argued in its supporting brief that delay threatened its "turn around" of the "financially distress[ed]" plant, which it asserted was losing approximately $140,000 a week and had lost more than $10 million over the last three years. George's argued that it bought the facility because of its ability to share costs with its nearby facility, which would enable George's to substantially increase production at the Harrisonburg plant to the benefit of the growers, employees and consumers. In many ways, the parties were effectively asserting a failing firm defense.

Product market; competitive harm. The government's alleged product market and theory of competitive harm evoked the buyer power concerns often voiced by producers during the 2010 USDA/DOJ joint public workshops on competition in agriculture. The relevant market was described as "[t]he *purchase* of broiler grower services [by processors] from chicken farmers in the Shenandoah Valley" of Virginia and West Virginia. Complaint ¶ 20 (emphasis added). According to the Complaint, the parties vigorously competed for the services of farmers, called "growers," who raise the chickens until they are ready for slaughter. *Id.* ¶ 2. Raising chickens is the only significant operation contracted out by the parties. *Id.* ¶ 12.

The Complaint alleged that farmers who want to raise broilers "must contract with a nearby integrator [vertically integrated processor] to raise chicks owned by that integrator." *Id.* ¶ 15. There is no cash market for the purchase of broilers (*Id.* ¶ 15), and due to transportation costs and storage constraints poultry processors typically contract with growers who are located close to their processing facilities. *Id.* ¶ 22.

The DOJ alleged that George's acquisition of Tyson's plant would facilitate monopsony by lessening competition for purchases of grower services in the Shenandoah Valley, with the "likely effects including *depressed prices* paid and less attractive contract terms offered to farmers." Complaint ¶ 24 (emphasis added). In support of this conclusion, the DOJ pointed to the impact of George's acquisition on: (1) market concentration as measured by the Herfindahl-Hirschman Index ("HHI"); (2) the ability of Shenandoah Valley growers to switch to another processor; and (3) the ease and durability of coordinated interaction between George's and its only remaining competitor, Pilgrim's Pride.

Citing the Horizontal Merger Guidelines § 5.3, the DOJ alleged that the acquisition is "presumed likely to enhance market power," since it increased George's control of Shenandoah Valley chicken processing capacity to approximately 43%, increased HHI by 700 points, and resulted in a post-acquisition HHI of over 5,000 points. Complaint ¶ 24. The Complaint did not elaborate on the DOJ's coordinated-interaction allegation.

The most fascinating allegations focused on grower-switching, in which the DOJ outlined an economic theory of how George's enhanced market power would harm competition. The DOJ alleged that a grower's ability to switch or threaten to switch to another integrator was the grower's "primary source of bargaining power when negotiating [contract terms] with integrators" and "the grower's only practicable recourse in the face of unfavorable contract terms," since there is no cash market and turning to processors outside the Shenandoah Valley is not feasible. Complaint ¶¶ 19, 27. Because growers have significant investments that

[1] The defendants were George's Foods, LLC; George's Family Farms, LLC; and George's, Inc. (collectively, "George's").

[2] "Broilers" are chickens that are raised for meat products. Complaint ¶ 2.

are highly specific to broiler production ($100,000 - $300,000 for a chicken house), often financed by substantial loans, and converting chicken houses to other suitable use also involves substantial additional expense, a grower who cannot colorably threaten to switch would likely choose to accept inferior terms rather than no terms at all. *Id.* ¶¶ 21, 29. For these reasons, the DOJ alleged, George's acquisition of Tyson's Harrisonburg facility was "likely to enhance George's incentive and ability to force growers to accept lower prices and less favorable contractual terms for grower services." *Id.* ¶ 29.

Swiftness of the proceedings; agreed relief.

Less than two months after filing its complaint, the DOJ announced a settlement of the case that left the disputed Harrisonburg processing facility in George's control. Instead of requiring a divestiture, the "settlement requires George's to make capital improvements to the Harrisonburg chicken processing plant that will lead to a significant increase in the number of chickens that will be processed at the facility." DOJ Press Release, 6/23/11. The DOJ in its press release explained that these improvements will enhance George's "incentive and ability to increase local poultry production, thereby increasing the demand for grower services and averting the likely adverse competitive effects arising from the acquisition." *Id.*

The DOJ's press release did not explain how the settlement addressed the competitive concerns raised by George's enhanced buyer power. The DOJ may have expected that the increased production capacity would lead to an expansion in George's demand for grower services in the Shenandoah Valley, with resulting upward pressure on prices for grower services and more bargaining leverage for growers. But, the ultimate resolution of the case left George's with control over the Harrisonburg plant.

Possibly, the explanation for this settlement may be gleaned from the section of the DOJ's press release that refers to "significant concerns [about] the viability of the Harrisonburg processing plant." With the ability to further assess the competitive dynamics in the market following its filing of the complaint, the DOJ may have taken into account the elements of the failing firm analysis and determined that the likely harm from preventing the rescue of the Harrisonburg facility outweighed the potential harm from the acquisition.

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