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Antitrust Implications of Contemporary Food Production and Marketing Issues

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Discusses current antitrust cases and lists implications for the food industry.

Structural change involving cooperative mergers, integration into farm production and food processing, and conglomerates signals a new set of antitrust regulatory issues for the food industry. But the current swell of antitrust activity in the food industry is more complex. It occurs at a time when there is great concern about rising food costs. The current activism of consumer groups and proponents of stronger antitrust regulation have brought marketing management strategies including advertising, product cycles, product and package modification, planned obsolescence, and shelf space management under direct antitrust scrutiny. The exemption of farm level food prices from the economic stabilization policies has again raised the question of a conflict between agricultural policies designed to raise producer prices through price supports, marketing orders, and cooperative activity, and antitrust policies designed to promote decentralized structures and competitive prices. Producers are, on the other hand, calling for enactment of legislation which would give them greater equality of bargaining power in dealing with the larger firms who buy their products. These firms, which constitute what is commonly referred to as agribusiness are, at the same time, viewed by some as a direct threat to takeover of agriculture by ownership and contractual integration. (1)

The focus of this paper shall be upon specific regulatory cases being litigated in the food industries. Since these cases are in litigation, this discussion suffers from lack of finality. Yet the issues are so pervasive with research, management, and policy implications that they should hardly be ignored.

The Cereal Cases: Concentration, Growth, and Market Strategies

The cereal cases have been heralded by some as the most important antitrust actions in the history of the antitrust laws. (2) In a sense they might be interpreted as an attempt by the Federal Trade Commission to enforce the provisions of the Concentrated Industries Act (3) before it is enacted. In another sense they cut at the heart of many of the marketing strategies that have become a part of our Madison Avenue oriented marketing system.

The ready to eat (RTE) cereal industry is composed of six firms. The four largest firms -- Kellogg, General Mills, General Foods, and Quaker Oats -- accounted for over 90 percent of RTE cereal sales in 1970. Since 1950 these concerns consistently accounted for over 84 percent of sales. This high level of concentration was maintained despite more than a fourfold expansion in the value of cereal sold. High concentration in the cereal industry combines high levels of advertising -- an average 13 percent of sales -- with extensive brand proliferation -- 150 brands being marketed from 1950 to 1970. (4)

The charges brought under Section 5 of the Federal Trade Commission Act in these cases are extensive. They boil down to an alleged maintenance of high levels of concentration of market sales in the hands of the four largest firms by artificial and nonproductive brand proliferation, product differentiation, and trademark promotion. A system of supermarket shelf space allocation used by the cereal companies has also come under scrutiny.

Two aspects of this case appear to be particularly important for those interested in marketing and antitrust policy. First, this is one of the first attempts to deconcentrate an industry where high levels of concentration were attained and maintained largely by means of internal growth. While three acquisitions are mentioned in the complaint, they represent what must be considered a relatively insignificant factor in the current high level of concentration. Previous to this action, the major thrust of the antitrust laws from a structural standpoint was the prohibition of mergers where the effect is to substantially lessen competition under the Clayton Act. Highly concentrated market structures were attacked by the Justice Department under the Sherman Act only when there was evidence of predatory or conspiratorial practices.

Internal growth resulting in high levels of market concentration has not easily been reached by the Sherman Act. The largest firm must generally have over two-thirds of the market combined with a finding of intent to monopolize, or there must be evidence of predatory or conspiratorial activities among firms. This policy was recently confirmed when the Supreme Court refused to review a Court of Appeals decision. This decision held that the construction of a milk processing plant by Kroger in the St. Louis market had not violated the Sherman Act. (5)

Action under Section 5 of the Federal Trade Com-

mission Act was previously applied largely to anti-competitive and deceptive practices. The cereal cases are being used to attack a structural situation where high levels of concentration give firms discretionary power to engage in unfair methods of competition proscribed by Section 5. In the future, such a theory could be applied to: (1) horizontal structures where high levels of market concentration result from either internal growth or mergers, (2) vertical structures such as where a food chain builds its own processing facility, or a processor buys land for agricultural production purposes, or (3) conglomerate structures where power relationships among products or markets result.

The second important aspect of the cereal cases involves the charges relating to high barriers to entry created by high levels of advertising directed to a vulnerable child audience and the FTC charge that the ... 'Respondents artificially differentiate their RTE cereals.' To do this the 'Respondents produce basically similar RTE cereals and then emphasize and exaggerate trivial variations such as color and shape.' (6) Trademarks and premiums are then, according to the FTC, used to conceal basic similarities. The National Commission of Food Marketing study of grocery manufacturing tends to support these allegations when it found 27 new products were introduced between 1955 and 1964, the vast majority of which were minor variations of existing products. (7)

These charges should be recognized as a direct attack by the FTC on modern marketing management strategies designed to take advantage of product cycles and planned obsolescence. New product introduction combined with high levels of advertising followed by new improved product or package, and another dose of advertising, has become an integral part of our marketing strategies.

Such strategies are seldom analysed in terms of the costs they impose or replace in the marketing system. The FTC complaint charges that the costs are high -- artificially inflated prices, high profits, lack of product innovation, lack of meaningful competition, and blocked entry to potential competition. (8) market strategies retort that nonprice competition benefits consumer by increasing sales and reducing costs, increasing variety available to consumers, reducing the size of the needed sales force and distribution network. They argue such benefits outweigh the costs as set forth in the FTC complaint against the benefits as set forth by market strategists. (9) If anything, the wealth of empirical studies of the relationship between structure and performance, -- even considering the large unexplained portion of variation in profits -- economic theory, and legal precedence tend to support the FTC and place the burden of proof on the defendant corporations and market strategists.

If the cereal cases are successfully litigated, it goes without saying that major changes in market management theory and practice will be required.

Agribusiness Integration Strategies

The entrance of agribusiness into food production has

come under increasing scrutiny and criticism during the past year. The charge is that agribusiness corporations such as Tenneco, United Brands, Gates Rubber, Del Monte, and Ralston Purina are converting agriculture from a competitive industry to one dominated by conglomerates. In the process, these are said to be driving family farmers off the land. The intensity of the issue is evidenced by the controversy surrounding the nomination of the Secretary of Agriculture (10) and the introduction in Congress of the Nelson Family Farm Act (11) which would prohibit much of the contractual and vertical integration existing in agriculture today. Exaggeration of the extent of vertical integration tends to be commonplace. For example, it is estimated that only 4.5 percent of total agricultural production is vertically integrated. However, 15 - 17 percent of total production is produced under production contract arrangements with agribusiness firms. (12)

The introduction of the Family Farm Act and similar proposals has tended to overshadow antitrust remedies to problems of integration. There is currently in the FTC litigation a very interesting case in point. It challenges the acquisition of at least nine small growers of lettuce and celery by United Brands -- a 1.5 billion dollar food industry conglomerate. Of even greater significance, it challenges leasing, joint ventures, and full supply arrangements between United and many otherwise independent producers. These arrangements give United control of approximately 11 percent of the Nation's lettuce production.

Among other things, it is alleged by the FTC that these arrangements have anticompetitive effects by transforming the structure of the fresh lettuce, and celery industries '...from small independent profitable concerns selling in a competitive market into an industry dominated by large conglomerate companies selling at stable prices arrived at outside the competitive market...' (13)

Two facets of this case appear to be particularly important. First, it points up the antitrust alternative to the Nelson Family Farm Act as a means of curtailing integration in agriculture if such is a desired policy. Antitrust would appear to have some advantages in this respect. It is more flexible in that it could be applied only in those cases where substantial anticompetitive effects, relative to efficiency gains, are likely. And the same standards would be applied to structural questions in agriculture as in the remainder of the economy resulting in, among other things, fewer economic distortions.

Second, the United Brands case is more than an ownership integration case. In fact, the proportion of production controlled by ownership of land is small relative to that controlled by leasing, joint venture, and full supply arrangements. If this case is litigated successfully, it would, accordingly, appear to be a relatively small step to applying the antitrust laws to agricultural commodities where contract integration is extensive -- broilers, turkeys, processing vegetables, and sugar beets for example. (14)

Cooperative Growth and Market Strategies

Producer efforts to organize bargaining activities are currently being questioned by the Justice Department. The 1960's saw a major consolidation of cooperative activity in the milk industry particularly in the Central and Southeast United States by four major cooperatives and two federations encompassed nearly 100,000 producers of 34.4 billion pounds of milk. This represents over 30 percent of the Nation's milk production and over 75 percent of the production in many Central and Southeast United States Federal order milk markets. (15)

There are at least 14 suits pending against one or more of these cooperatives alleging violations of the antitrust laws since these organizations and their predecessors were formed. The plaintiffs in these suits include such parties as the Department of Justice, the State of Illinois, other cooperatives, handlers, and consumers. All of the suits contain nearly the same basic allegations. These allegations generally involve diverse forms of market conduct with the alleged effect of coercing producers who were not cooperative members into the cooperative, foreclosing markets to noncooperative members, forcing handlers into full supply arrangements, acquiring competitors, and raising prices above competitive levels. (16)

The allegations are pervasive in their coverage. If successfully litigated, they have multidimensional implications for cooperative activity. Two aspects of the case merit comment. First the cases raise a basic question of the extent and means by which cooperatives can, under the Capper-Volstead Act, increase control over the markets for which they produce. Assessment of the appropriateness of various forms of cooperative activity is an important aspect of answering this question. Two basic alternatives appear to exist: (1) The cooperative may be viewed as one of many participants in competitive agricultural markets. If viewed in this manner, the antitrust laws and Capper-Volstead Act may be interpreted as having the role of maintaining a competitive balance between the various segments, but not allowing the balance of market power to swing one way or the other. (2) Producers may be viewed by some as being in such an inferior bargaining position that cooperative activity, even to the extent that it achieves a monopoly position for producers, should not be restrained.

Consistent with the latter position, the dairy cooperative cases bring into focus a conflict between: (1) programs of the Department of Agriculture promoting cooperative group action that are, in part, designed to raise farm prices by the exercise of market power thereby enhancing producer returns, and (2) antitrust policies designed to maintain a competitive market environment. The implications for enactment of proposals, such as the Sisk Bill, (17) which create an obligation for handlers to bargain with qualified cooperatives, should not be overlooked. The basic questions raised include the appropriate limits on bargaining and the extent to which Government supported self-help programs, as opposed to Federal revenues and/or decisions, should be used to

raise producer returns. In answering these questions, clarification and recognition of a legitimate expansive role for cooperative activity in the public and producer interest is needed.

Second, certain questions of import to the development of cooperative structures (18) will likely not be answered by the current dairy cooperative cases. A specific question involves the extent and conditions under which cooperatives can combine with noncooperatives in various types of joint ventures and bargaining activities. The Courts have consistently held that cooperatives cannot maintain Capper Volstead immunity from antitrust prosecution when they combine with noncooperative firms. (19) The unanswered question is whether a basis for distinction exists in cases where joint ventures between cooperatives and noncooperatives result from a legitimate market need which has no direct competition suppressing effects. Another question arises as to whether financing and profit sharing arrangements can be worked out that are within Capper-Volstead legal requirements. (20)

Some insight into the attitude of the Justice Department toward these questions was provided by a recent advisory opinion. (21) This resulted from an application by Holly Farms, one of the Nation's largest broiler contractors, to become a member of the National Broiler Marketing Association (NBMA), a Capper-Volstead broiler marketing cooperative.

The opinion stated that NBMA's exempt status under the Capper-Volstead Act may be jeopardized if Holly Farms became a member. Justice indicated it would consider Holly's contract as productive nonmember production which cannot under the Capper-Volstead Act exceed 50 percent of the cooperative's volume. The rationale Justice used was that Holly's contracts did not make it a producer because it did not "... assume substantially all the risk typically inherent in the role of a farmer." (22) Regardless of the merits of this particular rationale, a more basic question can be raised as to whether Congress ever intended or even envisioned agribusiness entering into contract production and forming cooperative corporate combines for the purpose of raising prices.

Issues in Supermarket Strategies and Control

The merchandising and purchasing strategies of supermarkets also appear to be coming under increasing scrutiny. The concerns of the regulators and consumer activists cover a wide range of supermarket decisions - shelf space allocation, private label differentials, unit pricing, open dating, grade, and nutritional labeling, supermarket processing pricing, and procurement strategies.

Retailer shelf space allocation policies will likely be looked at closely in the cereal cases. The concern is that barriers to the entry of new products and food processors may be created by supermarket shelf space allocation procedures. Such procedures may either be developed and operate by a supermarket chain for its

stores or by a food processor for the product line which it manufactures. They are generally operated on a volume turnover basis. However, such procedures can impose substantial barriers to the entry of new products if strict volume allocation procedure is used.

Barriers to entry can also be imposed by the not particularly uncommon practice of allocating a large proportion of the shelf to private labels, or completely excluding brands other than the supermarket's own label. The interesting question is also posed of the obligation of the chain to provide the consumer with a choice of available products. If such an obligation does not exist, if for example all chains baked their own bread, proprietary firms could be excluded from a market and consumers limited to a single brand within a store. If the obligation does exist, is it an inherent obligation, or does it only exist when there are physical or quality differences in the products? Who determines whether there is a quality difference?

An initially plausible alternative to allocating shelf space on the basis of volume, is allocating it to maximize profits. Space then becomes a function of both volume turnover and margins. This procedure also has pitfalls in terms of imposing barriers to entry. Private labels frequently have wider margins than packer labels. The private label would thus receive favored treatment over packer labels. Packers labels could conceivably not be allocated any shelf space if other products could generate higher profit levels.

Logical extensions of this barrier to entry shelf space allocation theory can be made to pricing, procurement, and integration policies which have the effect of denying particular processors shelf space or artificially disadvantaging them in terms of price. The legal concept and precedent to be applied may be that of a chain store discriminating in favor of itself. (23)

The procurement strategies of chains have also come under scrutiny as the powers of the long dormant Section 2(f) of the Robinson-Patman Act have come to life. The pace of FTC activity appears to be steadily increasing (24) following the landmark *Automatic Canteen* decision holding that the Commission's trade experience evidence could be used to show that the buyer knowingly induced a discriminatory price within the meaning of Section 2(f). (25) Thus, in the recent *Kroger* case the Court of Appeals upheld an FTC decision that Kroger knowingly induced a discriminatory price concession when its milk purchasing agent gave false competitive bid information to Beatrice. (26) The Commission's trade experience evidence included the findings that the discount as large as the one ultimately induced was unheard of in the market, was substantially below average discounts for the market, and was not, in fact, responsive to an actual lower offer by a competitor in the market.

The Court of Appeals inferred injury to competition from: (1) the substantial price advantage afforded Kroger, (2) the fact that Kroger labeled milk was received at cheaper prices than Beatrice labeled milk, and (3) while

this price differential existed Kroger "... did not reduce the retail price of its private label milk and, thereby, pass on lower prices to the consumer, but reaped higher profits for itself. (27) The Commission inferred competitive injury since the higher profits could be used by Kroger to adversely affect its competitors. Pass-through of price differences might also be required to prevent multi-product margin discrimination which adversely affects the demand for high margin products and thereby injures particular firms. In an era of consumerism, pass-through might be required under Section 5 of the FTC Act to prevent consumer injury.

Problems, however, result from the high degree of regulation implied by the application of such pass-through concepts. At the extreme is the question of pass-through requirements for those products processed by chains. A more likely solution to this problem is the application of the antitrust laws to provide a sufficiently decentralized structure to insure competitive forces to encourage pass-through and render high margins on particular items no more than temporary phenomena.

Implications

Antitrust enforcement in the food industry appears to be rising to a new level of sophistication. The problems being litigated are not purely those of structure, conspiracy, and predatory behavior. The implications of of this higher level of sophistication are fourfold.

- (1) More intensive analysis of the tacit and consciously parallel forms of firm behavior can be expected in the future. These are the means by which oligopolists can allegedly accomplish the same degree of market control as monopoly and collusive oligopoly. In the process, many of the management strategies that are alleged to enable oligopolists to maintain protected markets will be attacked.
- (2) A renewed emphasis is being placed on the vertical market relationships by which firms at one market level influence and control market activity at a second level. The emphasis will increasingly shift from vertical acquisitions, resale price maintenance, and restrictions on distribution channels to buyers who control market access. The resurrection of the long dormant Section 2(f) will result in greater buyer responsibility in sales negotiation. The conditions under which agribusiness firms purchase products from producers will be scrutinized more carefully.

As a result of these changes, researchers and management efforts to develop better vertical market relationships in a system or subsector configuration must carefully consider the antitrust constraints and implications of their actions and advice. At the same time, the regulators

must be careful to enforce their policies in a way that does not unduly impede the development of cost reducing means of vertical coordination.

- (3) Attempts will be made to bring increased rationality to apparently conflicting laws. The lines of demarcation between the Capper-Volstead and Sherman Act will be brought into better focus by the cooperative case. At the same time, pressures are building for enactment of laws which raise additional questions of conflict. The proposal to create obligations on the part of processors to bargain with producers, or to exempt soft drink bottlers from antitrust limitations on the allocation of territorial franchises (28) are illustrations.
- (4) More weight will likely be given to the ultimate effect of market structure and firm behavior upon the consumer. The cereal complaints charges of inflated prices, high profits, and product imitation rather than innovation are illustrative. They do not differ substantially from the finding that Kroger failed to pass-through a price difference or the charges in the cooperatives case that consumers have been deprived of an opportunity to buy milk at competitive prices. In the offing may be a new antitrust standard of legality which places greater emphasis on revealed consumer benefits

and costs. The implications of such a development for marketing analysts are obvious. We have for too long drawn our implications for performance from structure. But there is the danger of taking too narrow a view of the concept of consumer benefits. Emphasis needs to be placed on the development of a multidimensional approach to performance. Such an approach would, in addition to measuring the degree of monopolistic pricing, evaluate the contributions of firms in dimensions such as realization of technical efficiency, opportunities and restrictions placed on other firms at the same as well as other levels in the market channel, adoption of technology, innovation in products, variety, the quantity and quality of information provided for decision-making, and the responsiveness of the industry to changes in consumer demand and customer complaints. This is a big task. Industrial organization specialists have spent too much time counting firms and calculating concentration ratios while marketing specialists have been rationalizing market strategies on the grounds that success of their use signifies consumer acceptance and satisfaction. While this has been happening, public confidence in both antitrust policy and business has declined perceptibly.

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