CHAMPAGNE VS. GRAPE JUICE: DEFENDING, ADDING, OR DISCOVERING VALUE AT THE FARM-GATE: NEW STRATEGIES FOR THE CALIFORNIA COOPERATIVE

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I. INTRODUCTION

This article is an analysis of the challenges faced by the American farmer at the opening of the twenty-first century.[1] These challenges are unique to agriculture when contrasted with other industries but they are not new. Thus, a historical review of legislative efforts to remedy these difficulties follows a description of the challenges, with particular focus on the cooperative as a market-oriented solution.[2] The article concludes with a suggestion for the development of a system of regional marketing that could be implemented through existing and new cooperatives with the necessary legislative framework in place.[3]

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1. *See* discussion *infra* Parts II.-VII.
2. *See* discussion *infra* Part IV.
3. *See* discussion *infra* Parts V.-VII.

II. "NO ESCAPE THROUGH RUTHLESS COMPETITION:"[4] THE CHALLENGE OF ABUNDANCE

Food security requires the continuous production of excess to insure adequate supplies. The twenty to thirty percent variance in annual per acre yield of most commodity crops and California's specialty crops necessitates a chronic, structural surplus of production to satisfy our need for adequate food.[5] This bias towards overproduction is market-distorting in the sense of creating surplus supply and driving the farm-gate down.

Market distortions, or imbalance between supply and demand create economic hardship for farmers to benefit the rest of society.[6] The interplay between a necessary overproduction of food, farmer income, and the market prices for food should inspire us to craft a legislative balance which produces adequate income levels for farmers and fair consumer food prices. The 1933 Agricultural Adjustment "Act" balanced food security for society and economic security for farmers by imposing discipline on our agricultural abundance.[7]

In 1933, Franklin D. Roosevelt commented: "If I were asked to state the great objective which Church and State are both demanding for the sake of every man and woman and child in this country, I would say that great objective is a 'more abundant life.'"[8] In 1933, more than a quarter of all American citizens were involved in agriculture,[9] a marked contrast to the less than one percent of our population that produces our food today.[10] To give these individuals "a more abundant life," in financial terms, something had to be done to alleviate the downward price pressure generated by the extreme abundance of agricultural production.[11]

Henry Wallace, then Secretary of Agriculture, evaluated the success of the 1933 Act in the title of his 1935 Report to the President: "Toward a Balanced Abundance."[12] He began his report by describing the approaching end of the

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4. Henry A. Wallace, *The Year in Agriculture: The Secretary's Report to the President, in* YEARBOOK OF AGRICULTURE 1935 1, 7 (Milton S. Eisenhower ed.).

5. *See* NATIONAL AGRIC. STATISTICS SERV., USDA, TRACK RECORDS: U.S. CROP PROD. 12, 52, 79, 124, 144, 159, 183-184, 201 (1999) (authors own computation of sampled percentage differences in yield for the following crops: barley, cotton, flaxseed, oats, peanuts, rice, sorghum, and soybeans) (on file with author).

6. *See* Wallace, *supra* note 4, at 1.

7. *See id.*

8. Franklin D. Roosevelt, Address to the Federal Council of Churches of Christ (Apr. 29, 1938), *in* FAMILIAR QUOTATIONS 648-49 (Justin Kaplan ed., Little, Brown & Co. 16th ed. 1992) (1855).

9. *See* USDA, *Farm Business and Related Statistics, in* YEARBOOK OF AGRICULTURE 1935 666, 674 (Milton S. Eisenhower ed., 1938) (statistics submitted by the Bureau of Agricultural Economics).

10. *See* OFFICE OF COMMUNICATIONS, USDA, AGRICULTURAL FACT BOOK 1998 29, *available in* <http://www.usda.gov/news/pubs/fbook98/content.htm>.

11. *See* Wallace, *supra* note 4, at 2-3.

12. *See generally id.* at 1-109 (relaying annual report on the successes of the past year in agriculture under the Agricultural Adjustment Act of 1933).

emergency measures of drastic reductions of farm output and continued by explaining the need for permanent control.[13]

> Essentially, agriculture needs production control to prevent the mass swings that lead to recurring cycles of over and under production. . . .[R]ecurring cycles in production blocked steady farm prosperity. Adjustment to demand through blind competition caused farmers to rush in and out of different enterprises. Whenever any crop showed a profit, the producers grew more until the profit had been stamped into the ground. . . .Cooperative adjustments offer a means of correcting this normal handicap, as well as of [sic] dealing with abnormal surpluses.[14]

The alternative to this course, according to Mr. Wallace, is the competitive elimination of acres and jobs, resulting in endless distress for urban and rural communities.[15]

Although the present article focuses on the use of market responsive mechanisms, such as the cooperative, to attain adequate income for the dwindling number of family farmers in the United States, the non-farming sector of society also gains when farmers are able to make a fair living. Special treatment of the agricultural sector in the economy advances the interests of non-farmer consumers.[16] These attendant social benefits have come into focus recently under the term "multifunctionality," used by members of the European Union (E.U.) to defend the continuation of several of the E.U.'s farm programs.[17]

Domestically, the 1933 Act used the concept of "parity" between farm and non-farm spending power as a measure of the farmer's well-being.[18] Under the 1933 Act, the sales price of agricultural goods gave the sellers the same purchasing power in terms of goods and services which the same sale of commodities generated during the so-called "golden years" of American agriculture: 1910-1914.[19] The measure of parity has been adjusted several times since 1933, however, its use underscores society's recognition that food security should not be bought at the farmer's expense.

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13. *See id.* at 1-4.
14. *Id.* at 2-3.
15. *See id.* at 7.
16. *See generally* THE HARTMAN GROUP, THE HARTMAN REPORT: FOOD AND THE ENVIRONMENT: A CONSUMERS PERSPECTIVE 13-26 (1996) (discussing consumers attitudes toward environmental issues regarding foods). Examples of these benefits include greater product choices through the ability to select more highly perishable products which require local production because of their inability to be transported great distances. *See id.* at 22-23. Ready, local, food availability and reliable information regarding the manner of production in the use of pesticides, herbicides, and labor practices are also desirable product attributes sought out by increasing numbers of consumers as indicated in the Hartman Report. *See id.* at 13-26.
17. *See* Elizabeth Olson, *Global Trade Harmony? Yeah, Right*, N.Y. TIMES, Nov. 13, 1999, at C2.
18. *See* Wallace, *supra* note 4, at 6-7.
19. *See id.* at 30.

This recognition meant that the drafters of the Act developed several mechanisms for partially insulating the farmer from the brutal swings of supply and demand.[20] Without any means of coordinating farmers' individual, rational decisions to maximize production, or of controlling Mother Nature's whims, farmers are required to take on very high levels of market risk, compared to the production of other, non-perishable goods.[21] The Act sought to equalize those market risks by giving agricultural products an inherent or guaranteed value relative to other goods and services in society.[22] In essence, "parity" is a way of retaining some form of base value within an agricultural product, despite fluctuations of supply and demand.[23]

Insuring a base or parity value in agricultural production also serves the consumers' interest in a steady, reasonably priced food supply.[24] It allocates the price penalty for overproduction, a social good, across a broader array of market participants than the farmer alone.[25] In a modern world, however, the notion of calibrating farm income to a seemingly arbitrary, that is non-market, measure seems to find less and less favor amongst the general public.[26]

The 1933 Act delineated three mechanisms for achieving parity:

1. Price Supports[27]
2. Demand Expansion programs[28]
3. Market Responsive techniques (these include surplus control, marketing orders and cooperatives.)[29]

This article focuses on the last of these three mechanisms for achieving value.

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20. *See* USDA, *What's New in Agriculture, in* YEARBOOK OF AGRICULTURE 1935 111, 113 (Milton S. Eisenhower ed., 1935) (report prepared and submitted to the USDA by H.R. Tolley of the Agricultural Adjustment Administration).

21. *See* Wallace, *supra* note 4, at 34.

22. *See id.* at 30-32.

23. *See generally id.* at 1-109 (discussing the need for permanent control in establishing a more stable commodity price through narrowing the gap between actual and parity prices).

24. Some commentators have argued that the increasing levels of imported foods and the decline in the number of individuals with the technical expertise to produce food is a natural outcome of a developed economy and nothing to be overly concerned about. *See, e.g.*, Steven Blank, *The End of the American Farm?*, FUTURIST, Apr. 1999, at 22, 22-24. Other commentators point to global food insecurity because of the declining land mass available for production, and environmental degradation, and events such as the recent grain shortages of the 70s and 90s to call for caution and the preservation of the ability to produce food in this country. *See, e.g.*, Lester Brown, *Food Scarcity: An Environmental Wakeup Call*, FUTURIST, Jan.-Feb. 1998, at 34, 34.

25. *See* Brown, *supra* note 25, at 38.

26. *See id.*

27. *See* Agricultural Adjustment Act, Pub. L. No. 73-10, 48 Stat. 31, 32 (1933) (codified as amended at 7 U.S.C. § 602 (1994)).

28. *See id.*

29. *See id.*

The 1996 Farm Bill phases out the traditional price support programs by 2002.[30] In addition, virtually all support programs and demand expansion programs are vulnerable to challenge under our trade obligations through our membership in the WTO.[31] More importantly, however, dependence on volatile, spot market, export markets has proven to be unreliable as a secure source of value.[32]

Export dependence, often advocated as a technique for enhancing farmer income, in fact, is a tremendous market burden to place on farmers through governmental policy mandates. Farmers must also be provided a means to "opt out" if government forecasters prove to be mistaken. How can farmers alone hedge against hot money currency speculation, exchange rate devaluations, and prolonged recessions and depressions in the economies of their foreign trading partners?

Market responsive techniques for enhancing farm income, by contrast, are those mechanisms that enable farmers to overcome the inherent aspects of agricultural production, e.g. fluctuations and excesses, which deprive the producer of the ability to attain sufficient market power to keep successive generations on America's family farms.[33]

These aspects of production, which minimize producer market power, might be summarized as follows:

1. Perishability of production;[34]
2. Large numbers of independent, non-cooperating producers—a.k.a. the free-rider problem;[35]
3. Long periods of time required for production—inability to respond quickly to market signals;[36]
4. Large land areas needed for production; and
5. Vulnerability to weather.

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30. *See* Agricultural Market Transaction Act, Pub. L. No. 104-127, 110 Stat. 899, 900 (1996).

31. *See* General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 187 [hereinafter GATT]; Transfer Agreement Between GATT 1947, ICITO and the WTO, Dec. 8, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1A, *available in* <http://www.wto.org/wto/ddf/ep/public.html>.

32. *See, e.g.*, *Harvest of Risk* (visited Feb. 16, 2000) <http://www.agweek.com/harvest> (linking to numerous web site stories examining the hard times in the farm crisis).

33. *See* DAVID BESANKO ET AL., ECONOMICS OF STRATEGY 101-104 (John Wiley & Sons, Inc. ed. 1996). The average age of farmers in the United States is fifty-four years old. *See Census of Agriculture News Release* (visited Mar. 31, 2000) <http://www.nass.usda.gov/ny/01jan/cen90128.htm>. Anecdotally, less than thirty-two percent of midwest grain growers would encourage their children, to go into farming. *See* ROCKWOOD RESEARCH CORP., FARM JOURNAL, INC., U.S. FARM BILL STUDY 10 (1998) (on file with author).

34. *See* G.C. Wood, *Marketing from a Lawyer's Standpoint*, CAL. COUNTRYMAN, Jan. 1922, at 15.

35. *See id.*

36. *See id.*

Several market responsive techniques have been developed to counterbalance the farmer's weak position in the marketplace. These include: voluntary acreage reductions,[37] marketing orders and agreements,[38] and regulated marketing through voluntary agreements with handlers, processors, and cooperative associations.[39]

Perfect competition at the farm level makes voluntary surplus control schemes such as acreage reductions, cow culling programs, and even voluntary agreements, within the context of a cooperative, largely ineffective.[40] In a perfectly competitive environment, game theory postulates that each rational player will seek to maximize his personal benefit at the expense of the community even though all might be better off if the community worked in a coordinated or cooperative manner.[41] Thus, none wish to cooperate where the benefits, however short-term they might be, accruing to the "free-riders" outweigh the benefits to those who are participants in a voluntary program of surplus control.

Marketing orders alleviate this problem by requiring the participation of all producers of a particular commodity.[42] The Agricultural Marketing Agreement Act of 1937 provides for marketing orders that are administered at the federal level.[43] The 1937 Act provided for orders for milk, fresh fruits and vegetables, nuts, tobacco, hops, and honeybees.[44] Some states, like California, have their own marketing order legislation patterned after the federal statutes.[45]

The orders were instituted to provide orderly marketing through coordination of both quality and quantity.[46] Although "quantity" is usually controlled through diversion of excess supplies from a primary to a secondary market, producer and market quota systems are also employed.[47] This feature of marketing orders has

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37. *See* 7 U.S.C. § 7211(a) (Supp. IV 1999).

38. *See id.* § 1421 (1994).

39. *See id.* § 608b(a).

40. *See* JOHN KENNETH GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER 154 (1956).

> In both the markets in which he sells and those in which he buys, the individual farmer's market power in the typical case is intrinsically nil. In each case he is one among hundreds of thousands. As an individual he can withdraw from the market entirely, and there will be no effect on price—his action will, indeed, have no consequence for anyone but himself and his dependents.

Id.

41. *See* John M. Staatz, *The Cooperative as a Coalition: A Game-Theoretic Approach*, AM. J. AGRIC. ECON. 1084, 1087 (1983). This paradox is further complicated by the increasingly divergent interests of members in the same cooperative; members are becoming less homogeneous in size and needs serviced by the cooperatives. *See id.* This creates the need for coalition building. *See id.*

42. *See* Jonathan Rauch, *Hidden in the Grocery Bag*, 19 NAT'L J. 2479, 2479 (1987).

43. *See* Agricultural Marketing Agreement Act of 1937, 7 U.S.C. § 608b (1994).

44. *See id.* § 608c.

45. *See* ALYCE LOWRIE JEWETT & EDWIN C. VOORHIES, AGRICULTURAL COOPERATIVES: STRENGTH IN UNITY 64-65 (Agric. Council of Cal. ed., 1963).

46. *See id.* at 63.

47. *See* Daniel I. Padberg & Charles Hall, *The Economic Rationale for Marketing Orders*, 5

proven a source of controversy and consequently, not all orders contain explicit quantity control provisions.[48] "Quality" control can have substantial impact on supply and producer revenue as well, since size and other quality standards can be changed periodically to restrict or enlarge the quantity available in the marketplace.[49]

In recent years, some producers have expressed dissatisfaction with the marketing orders by challenging them legally or seeking to "vote them out."[50] Some producers, especially larger scale producers, feel thwarted by the order restrictions and believe that they should be able to maximize their profitability either in spite of or at the expense of other producers.[51] They have rallied under the banner "Get the Government Out of Agriculture!"[52] One of the principal reasons that producers became disenchanted with the marketing orders is the "free rider" problem described earlier in the context of voluntary agreements and cooperation.[53] This problem is especially acute for states such as California that suffer as foreign production makes its way into the domestic market.[54]

Our membership in the World Trade Organization (WTO) has required a relaxing of both tariff and non-tariff barriers to imported production.[55] Marketing order grades and standards do, however, apply to both domestic and imported production at least during the domestic production season.[56]

Unfortunately, as Thompson and Wilson point out in their article, *The Organizational Structure of the North American Fresh Tomato Market: Implications for Seasonal Trade Disputes*, "firms, not states, regions or countries produce tomatoes and firms compete with one another within and across political boundaries."[57] This insight is of key importance. With farmers at less than one percent of our population,[58] how can trade representatives effectively negotiate to the benefit of American farmers where agricultural products are important exports of the

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SAN JOAQUIN AGRIC. L. REV. 73, 78 (1995).

48. *See id.* at 77. Table 1 lists twenty percent of marketing orders in 1989 as containing provisions to control total quantity or surplus. *See id.* at 77 tbl.1.

49. *See id.* at 79.

50. *See* Leon Garoyan, *Marketing Orders*, 23 U.C. DAVIS L. REV. 707-12 (1990) (listing actions filed through 1990); *A Good Deal for All or a Rip-Off?*, 19 NAT'L. J. 2481, 2481 (1987).

51. *See* OSHA GRAY DAVIDSON, BROKEN HEARTLAND: THE RISE OF AMERICA'S RURAL GHETTO, 27-28 (1990).

52. *Id.* at 28.

53. *See infra* p. 6.

54. *See* Ronald W. Cotterill, *The Competitive Yardstick School of Cooperative Thought, in* AMERICAN COOPERATION 1984 50-51 (Mary Kay Overholt ed., American Institute of Cooperation).

55. *See* Kevin J. Brosch, *The Uruguay Round Agreement on Agriculture, in* THE GATT, THE WTO AND THE URUGUAY ROUND AGREEMENTS 865, 874-875 (1995).

56. *See* 7 U.S.C. § 608e-1(a) (1994).

57. Gary D. Thompson & Paul N. Wilson, *The Organization Structure of the North American Fresh Tomato Market: Implications for Seasonal Trade Disputes*, 13 AGRIBUSINESS 533, 542 (1997) (emphasis omitted).

58. *See* OFFICE OF COMMUNICATIONS, *supra* note 10, at 29.

countries to which American firms wish to export more profitable products such as financial services? A question further complicated by the investment of agri-business firms in production opportunities abroad.

The United States imports approximately $370 million worth of tomatoes produced in Mexico.[59] This has stimulated larger U.S. producers and cooperatives to invest in production and processing opportunities in other countries such as Mexico.[60] The majority of farmers, however, are reluctant to shift their livelihoods entirely from the physical production of their own soil to the financial production of foreign investment opportunities. Certainly, as far as investments go, others are more lucrative.

Because the orders can apply to imported production, as well as domestic production, they might be deemed a non-tariff trade barrier under the WTO Agreement.[61] The assessments paid by domestic producers and the fact that domestic producers must share their market to greater and greater degrees with imported production, raises a question of whether one of the primary objectives of the order system—to achieve parity prices for American producers—is being diluted through the enlargement of the total pool of production, to include foreign production.

In sum, voluntary schemes, such as acreage reduction programs, and non-voluntary schemes, such as marketing orders, have proven ineffective as long as they indirectly penalize participants by creating profit opportunities for the "free rider." This is because farmers operate in a perfectly competitive environment at the farm-gate level, and have difficulty with programs that seem to operate in opposition to the laws of their market environment.[62]

III. COOPERATIVES: DEFENDING AND/OR ADDING VALUE

The mechanisms with the greatest chance of success for achieving economic abundance for men, women, and children engaged in agriculture in the United States are those mechanisms which work within the marketplace to discover or add value to agricultural products at the farm-gate level. Since the late 1800s, several notable theorists and many farmers have worked to realize the dream of aligning economic abundance with the natural abundance of the farm, through the formation of cooperatives.[63] Cooperatives should function as a mechanism for transformation of the raw product value into economic value with minimal or no loss in the process.[64]

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59. See GARY CLYDE HUFBAUER & JEFFERY J. SCHOTT, NORTH AMERICAN FREE TRADE: ISSUES AND RECOMMENDATIONS 291 (Institute for Int'l Econs. ed., 1992).

60. *See id.* at 296-98.

61. *See* Robert G. Chambers & Daniel H. Pick, *Marketing Orders as Nontariff Trade Barriers*, 76 AMER. J. AGR. ECON. 47, 47-54 (1994).

62. *See* Jon G. Filipek, *Agriculture in a World of Comparative Advantage: The Prospects for Farm Trade Liberalization in the Uruguay Round of GATT Negotiations*, 30 HARV. INT'L L. J. 123, 130-31 (1999). The perfectly competitive environment is defined as an environment in which the behavior of any particular individual market participant makes no differences on prices. *See id.* at 130.

63. *See* JEWETT & VOORHIES, *supra* note 46, at 36. The first farmer cooperatives organized in

As noted above, the farmer, as a small seller in a global marketplace, negotiating with a few substantially larger buyers, has difficulty defending the value in his product.[65] Cooperatives, first and foremost were designed to *defend* farm gate value, through equipping producers with sufficient countervailing power to bargain effectively.[66] With a few notable exceptions, what I term "defensive" cooperatives have failed to guard the value within their members' production.

This failure to defend the value inherent within the raw product, has led farmers and theorists to hail the development of the new "value-added" cooperative as a means of imbuing the sometimes near worthless commodity with some small value in the marketplace.[67] "New wave" or "value-added" cooperatives seek to increase farmer returns by engaging in further processing of the farm product before the farmer sells it.[68] Often cooperatively owned facilities do the additional processing.[69] Yet, this begs the question: why invest in the production of the worthless commodity (at the farm level) when the farmer could invest in the production of value at the processing level? For example, why would a farmer invest in the production of catfish at zero return, when he could let someone else produce the fish while investing in the production of fish sticks at a profit?[70]

California occurred in the 1860s with the development of the California Wool Growers Association and the California Wine Growers Association. *See id.* Although "[n]either of these early organizations could be properly classified as *marketing* cooperatives . . .[t]hey are historically significant because they exemplify early recognition on the part of farmers of the need to impose quality standards on their products." *Id.*

64. *See id.* at 37.

65. *See id.* at 25.

66. *See id.* at 37. Interestingly, in Russia the development of cooperative theory also included the need to defend the peasant, or individual family farm within the marketplace. *See* ALEXANDER CHAYANOV, THE THEORY OF PEASANT CO-OPERATIVES XIX (David Wedgwood Benn trans., 1991). Unlike the later "collectives," early agricultural cooperative theory in Russia was based on principles developed in Italy and Belgium. *See id.* The "defensive" component appears to be virtually universal.

67. *See, e.g.*, Nick Coleman, *The Uprooted Family Farm*, ST. PAUL PIONEER PRESS, June 27, 1999, at 1A (illustrating how the failure to defend is present in our current farm crisis). In three years time (1996-1998), farm prices and farm export values have slid from extreme highs to unimagined lows as large supplies of crops around the world, Asian financial problems, and Russian depression have slowed U.S. farm trade. *See* Michael Zielenziger, *How Global Fallout Hurt Farmers*, ST. PAUL PIONEER PRESS, June 27, 1999, at 1D.

68. *See* LEE EGERSTROM, MAKE NO SMALL PLANS: A COOPERATIVE REVIVAL FOR RURAL AMERICA 115 (1994). In California, the "new" value-added cooperative is not "new." *See id.* at 229. (1994). Even the transferability of delivery rights, which some point to as the key distinguishing feature of the new cooperatives vs. the old, has been undertaken in California.

69. *See id.* at 115.

70. A farmer friend told me that the answer to this is simple: Because farmers love to farm. Unfortunately, their children are pursuing other careers. The "greying" of the productive farming population is another significant concern from the perspective of food security and raises the issue of who will be producing our food. Will it be land owning individuals or will it revert to a system of share-cropping dependent on extremely cheap labor?

Nevertheless, the idea of farmers cooperatively creating food rather than commodities and developing closer relationships with consumers is the most promising development for small farmers since the organization of California cooperatives of the late 1800s, a development popularized nationally by Aaron Sapiro in the early 1920s.[71] Success for these new "value-added" cooperatives, however, requires an examination of the historical development of cooperatives and a closer look at the twin issues of defending and adding value.

IV. EARLY MODELS OF COOPERATION: NOURSE AND SAPIRO

A. *The Cooperative as an Economic Organization*

As Dr. Richard Sexton points out in a review of the factors contributing to the success or failure of new farmer cooperatives: "Cooperatives are oftentimes misunderstood. In part, confusion has been caused by people's desire to impart social or political connotations to cooperatives. However, the overriding significance of cooperatives, especially to American farmers struggling to succeed in today's economy, is as an economic organization."[72] This misunderstanding stems from the social role historically played by cooperatives and their manner of organization.[73]

Indeed, E.G. Nourse in *The Legal Status of Agricultural Cooperation* (1928), suggested that the socioeconomic environment at the time of the formation of many of the early cooperatives as an explanation for why both farmers and legislators wished to include social, non-economic values within an economic organization.[74] Early cooperative law often bore the imprint of a scheme of social reform.[75] In particular, the California laws of 1895 and 1909 (thought to have been drafted by the Farmers Alliance with the assistance of David Lubin) included the following:

> In such association the rights and interests of all members are equal, and no member can have or acquire a greater interest therein than any other member has. At every election held pursuant to the bylaws each member

71. *See* Wood, *supra* note 35, at 15.

72. RICHARD SEXTON & JULIE ISKOW, GIANNINI FOUNDATION, INFORMATION SERIES NO. 88-3, FACTORS CRITICAL TO THE SUCCESS OR FAILURE OF EMERGING AGRICULTURAL COOPERATIVES 2 (1988).

73. *See id.*

74. *See* EDWIN G. NOURSE, THE LEGAL STATUS OF AGRICULTURAL COOPERATION 13-14 (1928).

> The manner in which the corporation meets the needs of industrial, mercantile, transportation and mining enterprises has caused it during recent years to approach rapidly to a position of dominance in these fields . . . . In the early days of this development, resistance took the form of a frontal attack on the whole system of corporate capitalism and efforts to substitute in its place some form of industrial democracy, socialism, communism, or what was styled "co-operation."

Id. at 9.

75. *See id.* at 27.

> must be entitled to cast one vote and no more. All persons above the age of eighteen years, regardless of sex, are eligible for membership.[76]

Similarly, the Alabama law of 1909 grants farmers the right to become a "body-corporate" when they "wish to form an association or corporation, not for pecuniary profit in the sense of paying interest or dividends on stock, but for mutual benefit."[77]

At the federal level, in 1914, the passage of the Clayton Act containing the following clause cemented this concept as a defining characteristic of the cooperative:

> Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of . . . agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit . . . nor shall such organizations . . . be held or construed to be illegal combinations or conspiracies in restraint of trade, under the anti-trust laws.[78]

The passage of this act, which based exemption from the purview of anti-trust laws on whether the cooperative was organized for "mutual benefit" and had no capital stock, prompted the enactment of many state laws conforming to this "California" type statute.

Cooperative enterprises' inability to issue stock greatly restricted their ability to accumulate capital from their patrons or outside sources.[79] Commercial banks hesitated to lend to a corporate body that had no issued stock.[80] This represented a significant disadvantage vis-à-vis the advantages enjoyed by the entities with which the cooperative had to do business.[81] Thus, the stock cooperative in Wisconsin and Nebraska developed beside the non-stock, fraternal model, popular in California.[82]

These cooperatives were organized around the English Equitable Pioneers' Society "Rochdale Principles" and had as their objective: to put the individual members of our agricultural sector in an economic position compatible with the economic demands of modern life both as to productive efficiency and as to distributive justice.[83] Despite their ability to issue stock, these cooperatives remained

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76. *Id.* at 59.

77. *Id.* at 67.

78. Antitrust Act of 1914, ch. 323, 38 Stat. 730, 731 (codified as amended at 15 U.S.C. § 17 (1994)).

79. *See* David L. Baumer & Robert T. Masson, *Curdling the Competition: An Economics and Legal Analysis of the Antitrust Exemption for Agriculture*, 31 VILL. L. REV. 183, 190 (1986).

80. *See* William H. Simon, *Social-Republican Property*, 38 UCLA L. REV. 1335, 1347-48 (1991).

81. *See id.*

82. *See* NEB. REV. STAT. § 21-1401 (1999); WIS. STAT. ANN. § 185.01 (West 1999).

83. *See* DAVID J. THOMPSON, WEAVERS OF DREAMS: FOUNDERS OF THE MODERN COOPERATIVE

smaller local units dedicated to achieving benefits for their patrons through market efficiencies.[84]

As the principal theorist and organizer in the Mid-West and East, Nourse was greatly concerned with public perception that farmer cooperatives might be seen as abusing their market power.[85]

> No one has yet succeeded in determining just when a position of bargaining skill and significance as a factor in the marketplace passes over to one of control in such a degree as to deserve the title 'monopolistic.' It is clearly evident, however, that when a cooperative pool acquires the power and claims the right to withhold a product from the market, either temporarily or permanently it begins to move out of the clearly lighted area of distributive efficiency into a twilight zone of market control in which public opinion is pretty sure to assert its right to examine, and possibly restrict, market adjustment or manipulative activities.[86]

Thus, the legal forms advocated by Nourse were defensive in character, rather than aggressive or assertive expressions of market power.

The Nourse-style of a "defensive" cooperative functions as a "competitive yardstick" by which to measure the performance of investor-oriented firms (IOFs).[87] Leon Garoyan uses the following three characteristics to describe this type of cooperative:

> 1. It is integrated to the first handler, and perhaps the processor level, but its further vertical integration is undesirable.
> 2. Possession of a modest market share, and therefore, devoid of market (monopoly) power.
> 3. Striving for technical and economic efficiency in operations, so that comparisons can be made with performance of non-cooperative firms.[88]

B. *Sapiro and the Development of the "New" California Cooperative*

In contrast to the "defensive" variant of cooperative, the Sapiro model transformed the California cooperative from a fraternal, non-stock organization into an economic organization that went beyond merely defending the value of the farmers' production.[89] His model was an entity that could actually confer value onto

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MOVEMENT 142-44 app. (1994).

84. *See* Cotterill, *supra* note 55, at 44-45.

85. *See* NOURSE, *supra* note 75, at 163-64.

86. *Id.*

87. *See* Cotterill, *supra* note 55, at 42.

88. Leon Garoyan, Aaron Sapiro's Contributions to Cooperative Philosophy and Development 22 (July 19, 1982) (presented at Graduate Institute of Cooperative Leadership, University of Missouri, Columbia) (on file with author).

89. *See* Cotterill, *supra* note 55, at 46-47.

the farmers' production.[90] Again, law and theory developed in response to the economic environment of the time, save that in this case, the environment had so gravely tilted against the farmer that more drastic responses were required.[91] As Eric Thor paints the scene: The economic climate of the 1920s was one of severe depression.[92] "The depression resulted from a combination of overexpansion and loss of export markets. . . . In 1920 farm prices fell drastically, from an index of 228 in 1919 to 128 in 1921."[93]

In 1922 Sapiro wrote: "The grain growers of the Middle West copied the English "Rochdale System" of cooperation, which was a consumer's rather than a producer's organization, and failed. . .They marketed by locality, and not by commodity."[94] Sapiro's model had eight essential characteristics:

1. Organization of the cooperative on a commodity basis.[95]
2. Long-term legally binding contracts with grower members.[96]
3. Centralized organization.[97]
4. Pooling products according to grade.[98]
5. Controlling a large enough proportion of the crop to be a dominant market factor. (typically seventy-five percent).[99]
6. Democratic control of cooperatives by members.[100]
7. Use of experts in technical positions.[101]
8. Limitation of membership to growers.[102]

In addition, there were four other "principles of successful merchandising:"

1. Grading and standardizing products to improve quality;[103]
2. Packaging products for effective shipment and to attract buyers;[104]

90. *See* Grace H. Larsen, *Cooperative Evangelist: Aaron Sapiro, in* GREAT AMERICAN COOPERATORS 446, 452 (Joseph G. Knapp & Assoc. eds., 1967).
91. *See id.* at 453.
92. *See* Eric Thor, Proceedings of the National Symposium on Cooperatives and the Law 81 (Apr. 23-25, 1974) (University Center for Cooperatives, University of Wisconsin-Extension) (on file with author).
93. *Id.*
94. Wood, supra note 35, at 15.
95. *See* Cotterill, *supra* note 55, at 46.
96. *See id.*
97. *See id.*
98. *See id.*
99. *See id.*
100. *See id.*
101. *See id.*
102. *See id.*
103. *See* Wood, *supra* note 35, at 15.
104. *See id.*

3. Extending markets by time, place and increased use;[105]
4. Earning profits by matching market supply with demand.[106]

Each of these elements played a key part in the "California Plan," which Sapiro promoted in the early 1920s.[107] This plan was also known as the "Commodity Method of Cooperative Marketing."[108] The objective of the plan, according to Sapiro, was "to control flow of supply as to time, place, and quantity so that you have something to say about the conditions that affect price values."[109] Sapiro was extremely popular and "by 1922 he had organized or represented at least fifty-five associations in nineteen states, including California. By the following year . . . he had organized, or served as counsel, cooperative groups whose membership totaled over half a million persons."[110]

As a result of his critique of the Rochdale model and the development of the California Plan, Sapiro advocated the need for a uniform cooperative marketing act—which he drafted.[111] Between 1920 and 1928 most states adopted a version of the standard cooperative marketing act.[112] The Bingham Cooperative Marketing Act of Kentucky is generally considered the representative example of the standard act.[113] Mr. Sapiro defended that legislation before the U.S. Supreme Court.[114]

Although by 1926 many of Sapiro's cooperatives had failed, some were successful.[115] The primary reason for the success of these cooperatives was the decision to organize around "commodity rather than locality" as Sapiro put it in 1922.[116] Control over sufficient volume of production to represent a significant block of bargaining power moved the cooperative from the defensive position of the Nourse/Rochdale model into an offensive position, more in the nature of a cartel.[117] In fact, Sapiro's cooperatives' contracts with producers would not be implemented until a sufficient number of producers had signed on.[118]

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105. *See id.*
106. *See id.* at 17.
107. *See* Larsen, *supra* note 91, at 450.
108. *Id.* at 450-51.
109. *Id.*
110. *Id.* at 451-52.
111. *See id.* at 452.
112. *See id.*
113. *See id.*
114. *See id.*
115. *See id.* at 453. Some examples of successful Sapiro cooperatives: Sunsweet Growers, Nulaid, Milk Producers Association of Central California, California Pear Growers Association. *See, e.g.*, Cotterill, *supra* note 55, at 46-47.
116. Larsen, *supra* note 91, at 450-51.
117. *See id.* at 450-52.
118. *See* Sun-Maid Raisin Growers v. Papazian, 240 P. 47, 48 (Cal. 1925).

C. *The Market Power of Cooperatives*

As John Kenneth Galbraith and others have pointed out, the difficulty for American farmers has been in developing and retaining sufficient countervailing market power to make farming financially viable.[119] The Nourse-style cooperative created market power through competition, where farmer-owned firms could operate at highest efficiency they pressured other firms to meet their prices.[120] They served as the "competitive yardstick."[121] The challenge today is that the competitive yardstick for agricultural production cannot be maintained in a global trading environment without incurring substantial changes in the structure of our food production and distribution system to the decided detriment of American family farmers.

American farmers, as individual small businessmen, should not be called upon to compete with multinational firms or foreign governments unless they are given equivalent market advantages. The transferability of technology and capital removes most barriers to investment in agricultural opportunities in countries which have fewer internalized costs in agricultural production.[122] That is, both investment and technology will migrate to areas of comparative advantage, even when those advantages are not inherent to the place but are merely the product of a more lax regulatory backdrop, e.g. non-existent or non-enforced environmental and/or labor laws.[123] Thus, the Nourse-style of cooperative is ineffective in a global marketplace.

In contrast to the Nourse-style of cooperative, the Sapiro model created market power through supply management.[124] Volume-based commodity marketing can be very successful where it has the effect of creating offensive, rather than merely defensive, market power.[125] Indeed, the success of Sapiro's commodity-based model is evident from the suits brought by the FTC during the 1970s and 1980s, testing the scope of the Capper-Volstead exemption from the purview of the Sherman Anti-trust Act.[126] The cooperatives under examination had attained sufficient market power to attract attention, but in the final analysis none had true

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119. *See* GALBRAITH, *supra* note 41, at 155.

120. *See* Cotterill, *supra* note 55, at 42.

121. *See id.*

122. *See* WILLIAM J. BAMMOL & ALAN S. BLINDER, ECONOMICS: PRINCIPLES AND POLICIES 613-16 (5th ed. 1991).

123. Agriculture is the final sector in America to experience this shift to production in other areas, tracking multinational investments. Interestingly, Adam Smith's original conception of "comparative advantage" did not anticipate capital mobility. *See* Robert W. Benson, Free Trade as an Extremist Ideology: The Case of NAFTA 2 (Nov. 5, 1993) (unpublished paper prepared for the Symposium on Pacific Rim Trade, University of Puget Sound School of Law) (on file with author). It is unlikely that he would have endorsed the present system thought to be based on his theory. *See id.*

124. *See* Orion Ulrey, *Pioneer in Cooperative Theory and Education: Edwin Griswold Nourse, in* GREAT AMERICAN COOPERATORS 366, 375 (Joseph G. Knapp & Assoc. eds., 1967).

125. *See* Larsen, *supra* note 91, at 450-51.

126. *See, e.g.*, Sunkist Growers, Inc. v. FTC, 464 F. Supp. 302, 307-08 (C.D. Cal. 1979).

monopoly power.[127] At a minimum, the cooperative's market power must be sufficiently strong to defend the value of the farmers' cost of production in the product. Where the cooperative's market power falls below this defensive minimum, it fails its purpose.

If the fundamental strength of the Sapiro model (volume control) is no longer possible because of foreign competition, Nourse's vision of local or regional cooperatives matching or bettering the efficiency of large scale IOFs may deserve a second look. What has prevented these cooperatives from retaining their efficiency advantage?

1. Patron's production is tied to one geographic area. This defining locale prevents global, lower-cost raw product sourcing and may constrain the continuing flexibility, enjoyed by non-farmer owned firms, to shift sourcing areas.
2. Cooperative's financial and governance structure is not designed to foster the accumulation of capital needed for expansion and for R&D or innovation required to remain on the cutting edge.
    a. Membership is limited to agricultural producers and the one-member/one-vote rule is reinforced by anti-trust exemptions in the Clayton and Capper-Volstead Acts.
    b. Capital accumulation is difficult because producers view themselves as producers rather than investors and prefer to receive a higher price at the farm-gate than a less certain, higher patronage refund.
    c. A limited return on investment discourages both farm and non-farm investors.
3. Unwillingness to cross-subsidize products to retain market share. This is the classic "putting all one's eggs in one basket," where firms can survive on limited profits from one product while developing marketplace dominance for another. Nourse-style cooperatives remain focused on single products.[128]

As the Nourse-style cooperative became less successful at the local level it sought to achieve the market power associated with the volume control of the Sapiro model.[129] This led to many mergers and consolidations of local cooperatives into larger units.[130] Unlike California's specialty crop cooperatives that deal in the production of a limited geographic area by relatively few producers, dairy and grain cooperatives have never been able to achieve the same level of market power as their

127. *See e.g.*, *id.* at 304.

128. This list represents the author's own opinions on why Nourse's cooperatives have not remained efficient.

129. *See* EGERSTROM, *supra* note 69, at 145-46, 234-36.

130. *See id.* at 235.

successful specialty crop counterparts.[131] Neither have they been able to effectively countervail the market power of those with whom they must bargain.[132]

Contrast, for example, the Canadian Wheat Board that retains two of the three characteristics of the Nourse model: (1) it is not engaged beyond the first handler level; and (2) it strives for technical and economic efficiencies.[133] Because it also integrates the benefits of a marketing order through control over the entirety of Canadian production, it has sufficient market power to potentially engage in cross-subsidization,[134] and to effectively service increasingly decentralized foreign purchases.[135] Thus, the Canadian Wheat Board represents a complete and successful integration of the police power of the state (like our marketing orders) with the Nourse model and the Sapiro-model.[136]

It may be that the mergers and consolidations of the local cooperatives, organized around the Nourse model, were based on incomplete economic reasoning. Because they were unable to ever attain the market power needed to have greater control over price, they disregarded the opportunity to continue in the Nourse tradition, and to create greater efficiencies at the local level without the need for attaining near monopoly market power.[137] The hoped for efficiencies from greater economies of scale were only sufficient to buy a little time.

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131. *See* Cotterill, *supra* note 55, at 46-48.

132. *See id.* at 48-49.

133. *See* Canadian Wheat Board, *About the Canadian Wheat Board* (visited March 4, 2000) <http://www.cwb.ca/publicat/about/about.htm>.

134. *See* Stephanie Nall & Courtney Tower, *Canadian Wheat Dumping Charged, But Nation Dismisses North Dakota Claims*, J. COM., Aug. 15, 1997, at 3A. Cross-subsidization is the ability of a firm to sell one item at cost or below because it is making sufficient profits on other items. *See* BAMMOL & BLINDER, *supra* note 123, at 658. This is a source of great concern and vulnerability to commodity producers who are engaged in the production of a single commodity.

135. *See Canada-U.S. Trade Goes Both Ways*, GRAIN MATTERS, May-June 1994, at 5 (published by the Canadian Wheat Board).

> Decentralization provides the CWB with the opportunity to capitalize on what the Canadian grain industry does best-produce grain that is distinguished on the basis of quality. Not only does Canada have a reputation as a supplier of quality grain, but it also produces a wide range of products which give the industry flexibility in meeting customers, needs. There is a co-ordinated [sic] effort between the CWB and the Canadian Grain Commission (CGC) to maintain quality and consistency. Individual mills tend to be more concerned about these aspects than government buying agencies.

Id.

136. *See generally* Julian M. Alston & Richard Gray, *Export Subsidies and State Trading: Theory and Application to Canadian Wheat*, *in* WORLD AG TRADE 281 (Tulay Yildrim et al. eds., 1998) (comparing the American and Canadian systems to determine which maximized total social benefit). Total social benefit is defined as the most "efficient " mechanism for supporting producers. *See id.* at 295. The authors conclude, "[i]t was shown in our simulation results that, compared with targeted export subsidies (and even more so when compared with flat export subsidies) the CWB is a more efficient mechanism for supporting Canadian wheat producers." *Id.*

137. *See* Cotterill, *supra* note 55, at 44.

Recognizing these impediments has stimulated development of new value-added cooperatives and has led to the assertion by many authors that the cooperative must be run on sound business principles. This pragmatism may require the abandonment of some of the fraternal or social objectives in order for cooperatives to remain competitive.[138] The new value-added cooperatives look to closed membership and the transferability of delivery rights as two innovations designed to assist cooperatives to attain the same competitive edge as IOFs.[139] Neither of these attributes will create sufficient countervailing power over the long term to make the new cooperative truly competitive because neither of these powers address the lack of inherent value in the commodity produced.

V. LOCALITY NOT COMMODITY: DISCOVERING VALUE AT THE FARM-GATE

As has been shown, each new phase in the development of agricultural cooperatives has arisen in response to crisis.[140] Today, we are in a period of deepening malaise in the agricultural sector.[141] The "new-value-added cooperatives" might be seen as the latest response to the crisis in agriculture. Unless they are able to operate to defend a product's farm gate value or are able to confer added value on the product itself, they do not represent any new development in cooperative theory. They merely represent an alternative investment strategy. To be truly effective, value-added cooperatives must discover some new method of transforming nature's abundance into an abundance of capital for the family farm.

I suggest an inversion of Sapiro's commodity-centered cooperative to the creation of a locality-centered cooperative. This new, locality-centered cooperative would be able to achieve many of the benefits associated with increased farmer income while successfully surmounting the challenges associated with the modern cooperative functioning in a global economy. It would, in fact, be able to achieve many of the desired benefits of the older California cooperative with its fraternal and social attributes. At the same time, the legislative framework could be designed to conform with the strictures demanded by our participation in the World Trade Organization (WTO).

While the market power inherent in the control of a significant quantity of product holds great attraction, it is no longer possible for America's farmers. As mentioned above, global sourcing of products from areas of least cost production has

138. For example, the new "Madison Principles" developed by the Network of Rural Cooperative Development Centers lists as Principle #7: "Cooperatives only work when they are market driven; the development practitioner seeks to ensure that accurate market projections precede other development steps." NETWORK OF RURAL COOP. DEV. CTRS., THE MADISON PRINCIPLES (1994) (handout published by Wisconsin's Center for Cooperatives in Madison, Wisconsin) (on file with author).

139. *See* Dennis A. Johnson, *Surfing the New-Wave Cooperatives*, FARMER COOPERATIVES, Oct. 1995, at 10.

140. *See supra* Part IV.

141. *See generally* Zielenziger, *supra* note 65, at 1D, 5D (describing the farm crisis).

deprived both the marketing order and the large scale, volume-based commodity cooperative of their market power.[142]

As Lee Egerstrom points out in his book *Make No Small Plans*, cooperatives have attempted to address this problem through becoming more like their IOF counterparts.[143] These cooperatives have developed the following strategies for coping with global competition:

1. Flexible financial instruments.[144]
2. Joint ventures and development of subsidiaries with IOFs.[145]
3. Global sourcing of products.[146]
4. Product diversification to permit cross-subsidization.[147]

Despite these adjustments and efforts to behave like the competition, none have attained the level of a Fortune 500 company.[148] And even the most successful are unable to provide their member/patrons with the same level of return (even including the value of providing a guaranteed home for members' entire production) as is provided to the investors in an IOF.

The failure of cooperatives to perform at the level of an IOF is attributable in the final analysis to the lack of value in the commodity products in which they are forced to deal.[149] The cooperative *must* deal in the products of its members, whereas the agile, rootless IOF can select the points on the production and distribution value chain that are profitable.[150]

If large-scale cooperatives are unable to serve their members by raising the commodity prices of their products through surplus control and effective countervailing power in the market, or through competitive efficiency, or as a pure economic investment, then a genuine new analysis must be undertaken.

At first blush, the idea of locality-centered cooperatives appears to fly in the face of the prevailing model of high efficiency, lowest cost commodity production. However, the approach I advocate is not intended to be a substitute for the high-efficiency, mass-market, transportation-intensive, fungible commodity model that characterizes today's food production and distribution system. Instead, it is an

142. *See infra* p. 18.
143. *See* EGERSTROM, *supra* note 69, at 240-41.
144. *See id.* at 223-24.
145. *See id.* at 234-36.
146. *See id.* at 230.
147. *See id.* at 240-41.
148. *See id.* at 128-29.
149. *See generally* MICHAEL E. PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE 36 (1985) (discussing sector-wide value chains as being too broad and obscuring sources of competitive advantage which the author contrasts with an investor-oriented firm).
150. *See* Johnson, *supra* note 140, at 10; PORTER, *supra* note 147, at 38.

approach intended to operate in tandem with the large-scale model at a local level to provide greater marketing and income opportunities to farmers. I believe this approach will better meet the more individually tailored wants and needs of tomorrow's consumers.

Revival of a smaller scale, locality-based cooperative system, could achieve many of the goals which large scale cooperatives have difficulty in achieving such as the following.

A. *Effective Brand Development*

This is an obvious distinction between the Nourse-model and the Sapiro-model. The Nourse-model, though initially characterized by greater local individuation, was not integrated to the consumer level and thus was unable to capitalize on locality based branding.[151] Large cooperatives such as Land O' Lakes, have been able to capture a brand premium, but where there is no inherent difference in the product when compared with a generic brand;[152] large expenditures in advertising are required to defend the brand's market share.[153]

B. *Rewarding Diversity*

By its nature, commodity-based marketing seeks the production of fungible (that is, legally substitutable) goods. Uniform quality standards create market efficiency and facilitate large-scale commercial transactions.[154] It has been argued that the uniform quality standards of commodity marketing are necessary to keep food plentiful and reasonably priced for consumers.[155] This argument makes some flawed assumptions about the market preferences of today's consumers and the effect of near monopolistic control by processors and retailers on product differentiation.

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151. *See* Cotterill, *supra* note 55, at 43. Nourse states that cooperatives should only be used to "bring industry performance back to the competitive norm" and not to "exact the largest possible return for a special interest" on a larger scale. *Id.*

152. For example, identical milk and butter from the same creamery are used for a store's generic brand and the Land O' Lakes brand.

153. *See* GALBRAITH, *supra* note 41, at 46-47.

> With price competition ruled out, competitive energies are normally concentrated on persuasion and, especially in consumers' goods, on salesmanship and advertising. . . . This is competition but no longer the kind of competition that is eligible for the liberal's defense. On the contrary, the very instrument which once rewarded the community with lower prices and greater efficiency now turns up assailing its ear with rhymed commercials and soap opera and rendering the countryside hideous with commercial art.

Id.

154. *See* Padberg & Hall, *supra* note 48, at 78.

155. *See id.* at 81.

For example, even Padberg and Hall, in their effort to distinguish marketing order control from monopoly control are missing an important distinction.[156] They state:

> We have another concern with the criticism of marketing orders on anti-monopoly grounds. The classic monopoly model relates to historic conditions of very low levels of living where the household obtains food by the direct purchases of a few food commodities. . . . Today, manufacturers buy those commodities and create thousands of products. . . . The classic monopolistic behavior is a persuasive conceptual argument, but it is not descriptive of the behavior of firms in the food market place.[157]

While it is true that we enjoy a tremendous variety of processed food products, we enjoy fewer and fewer choices of non-processed food products. Contrast the hundreds of varieties of tomatoes available to the European consumers or the home gardener with the meager array available at the supermarket. In the case of processed foods made with tomatoes, e.g. tomato sauces, frozen pizza, frozen entrees, the number of varieties shrinks even further. While it may be true that the consumer has a greater choice of processed foods, we tend to forget that the "low level of living" that characterized much of rural America in earlier times, featured high levels of in-home food production through the garden and the work of the family in food preparation and processing.[158] At the local level, which is after all, the only place where an individual can eat, there is the potential for a far greater diversity of farm and food products than where retail sales are concentrated in national and international firms.[159]

The present consolidation of international and national firms in food processing and retailing is antithetical to the ability of farmers to enjoy locality premiums in their local markets because those markets are increasingly controlled by firms sourcing fungible commodities from around the world.[160] Furthermore, the

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156. *See id.*

157. *Id.*

158. *See generally* BETTY FUSSELL, I HEAR AMERICA COOKING (1986) (discussing a definitive sociological cooking reference, illustrating the vast array of delicious, complex, regional specialties produced by the local genius of families using the wide varieties of wild, indigenous plants and their own garden cultivations).

159. *See generally* NEIL D. HAMILTON, THE LEGAL GUIDE FOR DIRECT FARM MARKETING (1999) (describing the benefits of direct farm marketing at the local level).

160. *See* Dr. William Heffernan, *Report to the National Farmers Union: Consolidation in the Food and Agriculture System* (visited Jan. 24, 2000) <http://www.nfu.org/whstudy.html>.

> The term "alliance" is frequently used to suggest the "seamless system" which describes the emerging, fully vertically integrated food system from gene to shelf . . . . The only time the public will ever know the "price" of animal protein is when it arrives in the meat case. As this system evolves, even the price of livestock feed and its ingredients, such as corn, will not be known to the public, because like today's broilers the product will not be sold. The firm owns the chick and sends it to their

preference of multinational firms for fungible goods discourages farmers from experimenting with new varieties or cultivating a more diverse array of specific, locality sensitive varieties. In fact, the increasing lack of diversity, and therefore, effective market risk protection, in today's farming operations is amply demonstrated by the growing evidence of poverty, malnutrition, and hunger in America's grain belt.[161] Diversification of production at the farm level, with a focus on local markets, would provide the farmer with a natural hedge against the fluctuations of international markets.[162]

To benefit from the greater spending power and discrimination of today's American consumer in the food sector, farmers must be able to address that sector directly. Consumers value greater variety, taste, smell, and texture attributes in food, not to mention consumers' preferences for food produced in an environmentally sound or labor-benefiting manner.[163] As shown in the Hartman Report, consumers are also willing to pay a premium for these attributes.[164] Variety, taste, environmental stewardship, and sound labor practices are all components of small, family farm agriculture in the United States.[165] Unfortunately, rather than directly engaging the consumer in the sale of their production, farmers must deal with processors who want fewer product distinctions and lower prices.

> processing facility from which it emerges, perhaps in a TV dinner. However, the prices along the line of production are never discovered until the chicken is sold to the consumer.

Id.

161. *See* DAVIDSON, *supra* note 52, at 77.

> The very idea of hunger in rural areas, and especially in the Midwest, surprises many, and for obvious reasons. It is simply hard to reconcile malnutrition with an area that boasts the world's most fertile land. But of the country's 150 worst "Hunger Counties" (as identified by the Harvard group,) 97% are in rural areas.

Id.

162. Greater diversification also helps to insure adequate food supplies in the future. *See* JOHN TUXILL, *The Biodiversity that People Made*, in WORLD WATCH (May/June 2000). Around 1900

> U.S. farmers were cultivating hundreds if not thousands of corn varieties; by 1969, the U.S. corn crop was dominated by just six. All over the world this scenario is repeating itself, as ancient, traditional crop varieties yield to modern commercial ones. But commercial crops require regular genetic infusions from their older relatives in order to maintain their vigor. Modern agriculture is replacing the genetic wealth on which it depends.

Id.

163. *See* THE HARTMAN GROUP, *supra* note 17, at 11.

164. *See id.* at 9.

165. *See* NATIONAL COMM'N ON SMALL FARMS, USDA, A TIME TO ACT: A REPORT OF THE USDA NATIONAL COMMISSION ON SMALL FARMS 20-22 (Jan. 1998).

C. *Shifting the Focus of Competition from Price to Quality: Tangible and Intangible*

For example, Guernsey milk was formerly marketed by highlighting its naturally occurring beta-carotene, a pre-cursor to vitamin A.[166] Milk produced by other breeds of cows lacks this feature.[167] When the milk pooling system was instituted in California, many Golden Guernsey producers switched to cows with higher yields because they could no longer recoup the consumer premium for this attribute of their milk.[168]

Today, with the growing interest in preventative health care, so called "phyto-pharmacological" values are being recognized in food products. At the international chain level this is evidenced by ADM's claims for soy products.[169] At the locality level, however, milk produced by cows grazing on certain herbs, such as Echinacea, may also have marketable, region-specific health attributes.[170] Consumer interest is growing in so-called "functional foods" of all kinds.[171]

D. *Heightened Grades and Standards: Champagne vs. Grape Juice*

Although some foreign producers of perishable products complain about the marketing orders' "grades and standards" as being too restrictive and constituting unfair barriers to trade, one might argue from the local level, that they are not sufficiently detailed and restrictive because they lump the entire production of a particular commodity and prevent differentiation.[172]

Indeed, the Agricultural Marketing Agreement Act (AMAA) specifies that marketing orders should be designed around the smallest geographic area possible.[173] In our zeal to service the mass market preference for uniform production and to enhance bureaucratic efficiencies, we have overlooked the opportunity to capitalize on regional variations, which could be complimented by creating varietal orders. One method of creating this value for the farmer would be to enhance the marketing order system to create orders with regionally or varietally specific attributes. The

166. *See Guernsey* (visited Apr. 4, 2000) <http://www.ansi.okstate.edu/BREEDS/cattle/GUERNSEY/index.htm>.

167. *See id.*

168. *See, e.g., id.*

169. *See* ARCHER DANIELS MIDLAND CO., *A Primer on Soybean Isoflavones*, ADM NUTRITION & HEALTH UPDATE, (visited Jan. 24, 2000) <http://www.admworld.com/home/update/1.htm> (on file with author).

170. *See, e.g., Echinacea* (visited Apr. 4, 2000) <http://www.go-symmetry.com/echinacea.htm>. Echinacea grows wild as forage in some parts of the United States. *See Herbal Information Center* (visited Apr. 4, 2000) <http://www.kcweb.com/herb/echin.htm>.

171. *See Functional Foods . . . Are We Ready?* (visited Apr. 4, 2000) <http://ificinfo.health.org/press/funcfood.htm>.

172. *See* Chambers & Pick, *supra* note 62, at 47.

173. *See* 7 U.S.C. § 608c(11)(B) (1994).

marketing order system might also serve as the framework for a regional food security system if it were redesigned around smaller geographic areas. This would employ a different legal mechanism for achieving the same objectives achieved through the federal system of regional appellation protection utilized by wine grape growers, discussed in more depth below.

Because there are no federal country-of-origin labeling requirements for food products sold at the retail level, consumers are unable to base any purchasing decisions based on conditions of production.[174] Although there are pending bills at the state and federal level, there has been significant opposition by retailers to the concept.[175] Suppose, for example, some consumers would prefer not to buy beef imported from Brazil because they believe that the beef was produced by the unsustainable practice of burning or clear-cutting rainforest for short-term grazing opportunities on land which is quickly depleted and unsuited for range production.[176] These consumers can not distinguish this Brazilian beef from other beef produced in a location where range production is sustainable and desirable. This is a lost profit opportunity for producers in the location deemed desirable enough, by the consumer, to pay a premium.

VI. LOCATION, LOCATION, LOCATION . . .

As mentioned previously, the two characterizing features of the new value-added cooperatives: closed membership and transferable delivery rights, cannot in themselves fully empower farmer-investors to succeed in these new ventures.[177] However, these two attributes will work if combined with a third: promotion of localism of production.[178] In the book entitled, *Competitive Advantage: Creating and Sustaining Superior Performance*, Michael E. Porter describes what he calls "differentiation strategy," as the means by which a firm is able to create "buyer value" and enjoy premiums in the marketplace.[179] Commodity production, which is so undifferentiated as to set the standard for the legal concept of "fungibility," prevents producers from ever realizing these premiums.[180]

One way to signal differentiation, employed with varying degrees of success by some large cooperatives, has been to establish a brand.[181] Thus, "Sunkist," is able

174. *See* Harmonization Alert, *Food Safety: Hearing on Country-of-Origin Labeling Bills* (visited Apr. 4, 2000) <http://www.harmonizationalert.org/may99/label.htm>.

175. *See id. See also Issue: Country of Origin Meat Labeling* (visited Apr. 4, 2000) <http://www.nlpa.org/Country%20of%20Origin.htm>.

176. *See* Bryan Ness, *Saving Tropical Forests Profitably* (visited Apr. 4, 2000) <http://botany.about.com/education/botany/library/weekly/aa051798.htm?rnk=r&terms=braxilian+beef>.

177. *See* Johnson, *supra* note 140, at 10.

178. *See id.*

179. *See* PORTER, *supra* note 150, at 150.

180. *See id.* at 149.

181. *See id.* at 142.

to derive a consistent premium over time in the marketplace.[182] When a firm, however, is processing or marketing large volumes of a commodity such as grains, this type of branded differentiation becomes far more difficult.[183] Sunkist may have had a preliminary advantage in establishing its brand because of its early entry, however, to retain this brand advantage in the face of international competition without inherent qualitative differences will require increasing levels of advertising expenditures.[184]

Localism or regionalism lends itself naturally to differentiation either through pure locational branding (rarely successful on its own) or through its ability to create protectable, real product differences based on locality.[185] This strategy has been employed for many years in Europe with the development of the system of "Appellation d'Origine Controlee" or "A.O.C." for wines and cheeses and other agricultural product.[186] These appellations create value in the locality of production for the farmers producing in those regions.[187] Thus, true "champagne" can only be produced in the Champagne area of France and all other production, even if derived from the same grape variety, may only be described by method of production, for example, the production of Spanish Champagne is labeled "*methode champenoise*," rather than "Champagne."[188]

In addition to wines, cheeses such as "*parmigiano reggiano*," the famous authentic parmesan of Italy's Emilia Romagna region enjoy similar protections.[189] These regional differentiation schemes have been very successful methods for farmers to get and to sustain product differentiation in the marketplace.[190] As Porter explains, "[d]ifferentiation will not lead to a premium price in the long run unless its sources remain valuable to the buyer and cannot be imitated by competitors. Thus a firm must find durable sources of uniqueness that are protected barriers to imitation."[191]

In this era of global, low cost sourcing we have overlooked great marketing and income opportunities for our farmers in food while concentrating on raw

182. *See* Wood, *supra* note 35, at 15.

183. *See generally* PORTER, *supra* note 150, at 130-62 (discussing the various methods employed in differentiating products to increase value and the problems associated where products suffer from ready substitution in the marketplace).

184. *See, e.g.*, Wood, *supra* note 35, at 15.

185. A good example of this is the use of appellations in wine production. *See* Carolyn Dempsey, *Wine 102: Appellations* (visited Mar. 4, 2000) <http://bayarea.citysearch.com/E/F/SFOCA/0000/12/27/>.

186. *See Appellation d'Origine Contrôlée (A.O.C.)* (visited Apr. 4, 2000) <http://secure.catalog.com/fromages/usa/aoc.htm>.

187. *See* Dempsey, *supra* note 185.

188. *See, e.g., id.*

189. *See* Italian Trade Commission, *Parmigiano-Reggiano*® (visited Apr. 4, 2000) <http://www.italianmade.com/parmigiano/default.htm>.

190. *See* PORTER, *supra* note 150, at 153.

191. *Id.*

material production alone.[192] Most of the commentators who have made this point have suggested the development and production of processed "value added" food products as the mode of capitalizing on this shift in consumer behavior.[193] This idea will only work over the long term if additional value is discovered in the raw product not just the processed product.

Value can be discovered in the raw farm production, insuring the durable source of uniqueness described by Porter, only if farmers have the ability to address consumers who esteem the unique, local product attributes rather than being forced to address buyers for multinational firms.[194] This approach requires the development of independent or interdependent regional cooperatives to provide marketing and possibly processing services to producers. The system will also require a legal framework such as a new, regional or varietal marketing order system, or an appellation system as is already in place for wines.[195]

The economic feasibility of investment in regional food production cooperatives requires that the regional differentiation remains sustainable and lucrative for farmers. To that end, I propose the development of a Uniform Farm Products Appellation Code (UFPAC) to be introduced and passed as protective legislation in each state. This body of law would serve to provide a long term identity differentiation and protection for farmers across the country and would provide a low-cost, uniform means of signaling to consumers the products' genuineness and other attributes (such as those listed above) which are not, at present, fully exploited by farmers or their cooperatives.

In addition to wines and cheeses, for which there is the obvious European precedent, there are an almost infinite number of regional food varietals that contribute to different cuisines. As an example, Mexican cuisine recognizes at least these two variants of corn meal: *Chaquegue* (from white corn), and *Atole* (from blue corn).[196] Because many immigrants are unable to find the wide range of varieties

192. *See* Michael Boehlje, *Industrialization of Agriculture: Implications for Cooperatives, in* AMERICAN COOPERATION 6, 6 (Lisa L. Keller et al. eds., 1997) (pointing out the need to move away from commodity production and into "food" production).

193. *See id.*

194. *See* PORTER, *supra* note 150, at 153.

195. *See* Dempsey, *supra* note 185.

196. *See Ingredients of Mexican and Southwestern Cooking-1* (visited Apr. 4, 2000) <http://soar.berkeley.edu/recipes/hints/mexican-sw-cooking1.html>. *See also* George W. Dickerson, *Specialty Corns: Guide H-232* (visited Apr. 4, 2000) <http://www.cahe.nmsu.edu/pubs/_h/h-232.html>. Another excellent example is the "Radicchio rosso a Chioggia." *See id.* Kyle Phillips, *Radicchio Rosso: The Marvel from Treviso* (visited Apr. 4, 2000) <http://italianfood.miningco.com/food/italianfood/library/weekly/aa091698.htm>. This is the radicchio which is commonly available in American supermarkets. *See id.* It has a firm, round head and resembles red ice-berg lettuce or cabbage. *See id.* Like iceberg lettuce, it has a long shelf-life and in Italy began to displace other, more fragile varieties, such as the radicchio of Treviso and Castelfranco. *See id.* This phenomena was noted as a negative in a history of Italian cuisine. *See* GUISEPPE MAFFIOLI, LA CUCINA VENEZIANA 427 (Franco Muzzio ed., 1982). These more fragile, regional varieties are significant elements of local cuisine which become increasingly difficult to find. *See id.*

demanded by their cuisines in our supermarkets, we are missing a tremendous opportunity. Today's consumers are interested in higher levels of differentiation in foods that are not being provided by the older style cooperatives.

As ethnic diversity with corresponding food diversity of our country intensifies, new immigrant farmers are presented with unique opportunities.[197] These new farmers must not fall into the same mistakes of undifferentiated production for a fast food market that the traditional farmers of this country have embraced. Furthermore, many of these new foods have production characteristics at the farm level that are only known by producers from that culture.[198] Food production for a culturally diverse market is a hugely lucrative market whose parameters are, as of yet, largely untapped, and which also serves to achieve the social and environmental goals not successfully integrated into today's firm or today's cooperative.

Already, at both the state and federal levels there is a body of regulations for appellation protection of wines.[199] Part 9 of Title 27 of the Code of Federal Regulations provides for the establishment of a viticultural area appellation of origin.[200] Similarly, California's Business and Professions Code provides penalties associated with the mislabeling of wines.[201] These laws provide a useful model for how such a regional system might function for other products.

The success of regional appellation for wine grapes is indisputable.[202] In fact, the success of regional labeling creates pressure to infiltrate the region's production with lower-value grapes, produced outside of the region.[203] Such deceptive strategies were at issue in a 1981 case brought to clarify "misleading" varietal and geographic labeling requirements promulgated by the Bureau of Alcohol, Tobacco, and Firearms.[204] In this case both the percentage of grapes of a particular variety and the percentage of grapes from a particular region required to satisfy the appellation requirements were at issue.[205] Basing its reasoning on the objective of not misleading the consumer, the court held for the Bureau's determination that no more than twenty-five percent of the volume could be of a

197. For example, Baby Bok Choy, grown in China and shipped to the United States is now grown in California year round. *See* Karen Levin, *Baby Bok Choy* (visited Feb 29, 2000) <http://pgonline.webpoint.com/food/is20000105.htm>.

198. *See The History: Parmigiano-Reggiano: The Only Cheese of its Kind in the World* (visited Jan. 24, 2000) <http://www.parmigiano-reggiano.it/estoria.htm>. "Parmigiano-Reggiano is called the great cheese of eight centuries' because the ancient formula has remained unchanged throughout 800 years of history." *Id.*

199. *See* CAL. BUS. & PROF. § 25239 (West 1997); 27 C.F.R. pt. 9 (1999).

200. *See* 27 C.F.R. pt. 9 (1999).

201. *See* CAL. BUS. & PROF. § 25239 (West 1997).

202. *See, e.g.*, Melinda Warner, *Controversial Coastal Appellation Rejected, BATF Denies Petition Led by Kendall-Jackson*, GRAPE GROWER MAGAZINE, Feb. 1999, at 19, 19-20.

203. *See* Wawszkiewicz v. Department of Treasury, 670 F.2d 296, 298 (D.C. Cir. 1981).

204. *See id.* at 299.

205. *See id.* at 298.

variety undisclosed on the label.[206] The question of geographic percentages was returned to the Bureau to institute regulations that sufficiently guarded the consumer against misleading labeling.[207]

This issue will be faced by producers of any regional product in defending the value discovered through local appellation. It will be important to create law and regulation that is sufficiently precise to prohibit the exploitation of this discovered value by other than local family farmers, the group this legislative framework would be designed to assist.

VII. CONCLUSION

A historical review of the agricultural cooperative in the United States recognizes two main theoretical schools of cooperative thought: the "Nourse model," prevalent in the Midwest and East, and the "Sapiro model," originating in California.[208] The principle difference between the two models is the degree to which the cooperative controls the total volume of production.[209] The Nourse model does not control a large volume of the overall production, but functions as a "competitive yardstick" by eliminating inefficiencies.[210] These cooperatives serve a "defensive" function for their members.[211] By contrast, in the Sapiro model, a member's "iron-clad" contract with the cooperative only became operative when a certain minimum number of producers (usually seventy-five percent) joined.[212] This gave the cooperative cartel-like "offensive" market power through control of supply.[213]

Two features of today's economy: 1) high levels of market concentration in the firms with which the farmer or his cooperative must negotiate, and 2) the global sourcing of agricultural production, create an atmosphere in which it is virtually impossible for the cooperative to compete without evolving new survival techniques.

Some cooperatives blame the social and fraternal aspirations incorporated by law in their governance and operational structures for their failure to effectively compete. These cooperatives have sought to become more like their IOF counterparts by eliminating or modifying the one member/one vote requirements and by developing novel methods of capital accumulation.[214] At a fundamental level, however, what hinders the success of the American agricultural cooperative, is that it

206. *See id.* at 303.
207. *See id.* at 304.
208. *See* Cotterill, *supra* note 55, at 42, 45.
209. *See generally* Cotterill, *supra* note 55 (comparing and contrasting the differences between the Nourse and Sapiro models of cooperatives).
210. *See id.* at 42.
211. *See* EGERSTROM, *supra* note 69, at 229.
212. *See* Cotterill, *supra* note 55, at 46.
213. *See* Larsen, *supra* note 91, at 450-51.
214. *See* discussion *supra* Parts IV.-V.

must deal in the production of its members; and that production, in a global trading environment, is frequently no longer the lowest cost production.

Recognition that there is little value in the farmer's raw commodity production has prompted the development of new "value-added" cooperatives.[215] Although these cooperatives are generally modified to operate more like IOFs, they often fail to "discover" or confer value on the farmers' raw product, instead they add value through processing and achieving efficiencies through vertical integration and scale economies.[216]

This article suggests that locality of production is an untapped source of value that might be "discovered" within the raw product itself.[217] It identifies two potential legal strategies for insuring that the discovered value remains with the farmer: first, through an enhancement of the marketing order system, or alternatively, through a system of regional and varietal appellation, such as that employed for wine grapes in the United States.[218]

There are many additional benefits to the utilization of regional values by farmers. First, it ensures local food security, making it permissible within the context of our WTO agreements.[219] Second, it enhances food quality to the consumer by providing consumers with fresher food and greater varieties.[220] Third, where there is a local premium, as farmers marketing through the farmers' market have discovered, there is the potential for disintermediation as farmers deal directly with consumers.[221] As a further step the advent of the internet promises to create very direct and coordinated farmer-consumer marketing. Fourth, in rural areas surrounded by farms producing locality specific food products there is great potential for "agri-tourism" as it is known in Europe.[222] One could imagine seasonal food tours coinciding with the emergence of a regional variety of asparagus, blueberries, or peaches.[223] Many rural towns in California have annual local fairs based around a local farm commodity (e.g. Kelseyville Pear Festival, Gilroy Garlic Festival). This regional diversification would enhance the entire rural social fabric and reincarnate our rural communities as locations with an identity rather than as homogeneous service centers strategically placed along the interstate.

Thus, with the requisite legal framework—a modified marketing order system and a Unified Farm Products Appellation Code (UFPAC)—a return to smaller, locality based cooperatives providing high quality, differentiated food

215. *See* discussion *supra* Part V.
216. *See* discussion *supra* Part V.
217. *See* discussion *supra* Part V.
218. *See* discussion *supra* Part V.
219. *See* discussion *supra* Part V.
220. *See* discussion *supra* Part V.
221. *See* discussion *supra* Part V.
222. *See* discussion *supra* Part V.
223. *See* discussion *supra* Part V.

products directly to the consumer, is our best opportunity for "discovering," at the farm level, the great value inherent in our nation's agricultural abundance.[224]

224. *See* discussion *supra* Part V.