Judge Denies Motion to Dismiss *Sitts vs. DFA/DMS* Antitrust Case

by Pete Hardin

Origins of DFA's Northeast Anti-Competitive Actions …

The sordid history of thug-like, anti-competitive deeds by Dairy Farmers of America committed against Northeast dairy farmers and cooperatives stretch back more than 20 years … to events that occurred even before DFA was formed.

Documents revealed in the Southeast antitrust case revealed a 1997-98 conspiracy involving, Gary Hanman (DFA's President/CEO) and Gregg Engles (then CEO and board chairman of Suiza Foods – the firm that eventually merged to create the "new" Dean Foods). That pair agreed to have Suiza Foods turn over its independent dairy producers to DFA's control … and the co-op guaranteed that the milk processor would have lower raw product costs than any competitor.

On September 18, 2000, Hanman bragged at a meeting of DFA personnel about how the co-op would lasso independent Northeast dairy producers into DFA membership. DFA sent out an audiotape the following comments by Hanman, which were printed in *The Milkweed* in late 2000. On that tape, Hanman said:

"We've got some stress going on in New York and in New England. One of our joint ventures is in the country trying to maintain a non-member milk supply that they've had. And yet our leadership up there says, I thought we had an understanding …. that these producers would become DFA members."

"…(W)e've pretty much got the rest of it where the milk supply is coming from DFA members, but we haven't integrated fully the milk supply function for these affiliates, primarily Suiza and affiliates, thee in the Northeast and the Mid-East Council.

"We will get that done, given time. This fall is probably not the time to put the pressure on this membership. But we'll get that done over time … plus the oversight of Justice today, which is very severe, very significant."

Thus, the roots of DFA's conspiracy track back two decades – the length of time that DFA's management (Hanman and Rick Smith) have brought Northeast independent dairy producers under DFA's thumb.

Call it: "Northeast Dairy Antitrust Case, Version 2.0."

On September 27, federal judge Christina Reiss of the United States District Court for the District of Vermont issued a stinging denial of all significant portions of defendants' request for summary dismissal of all charges in the ongoing Northeast dairy antitrust class action.

That legal action is titled *Sitts et al. vs. Dairy Farmers of America, Inc. and Dairy Marketing Services, LLC*. (The case reference is CV-2:16: 287.) This class action was brought by present and former Northeast dairy farmers who dissented from the settlement of an earlier antitrust case brought against the same defendants.

Reiss's fact-charged decision laid bare many facts in the *Sitts* case that have previously been sealed from public view. Reiss' ruling opens the door for the *Sitts* case to proceed towards trial. Her decision raises serious questions regarding whether blatant, anti-competitive actions by defendants DFA and DMS will be protected by from charges brought by plaintiffs' attorneys under Sections 1 and 2 of the federal Sherman Antitrust Act.

Looking ahead, defendants could possibly forfeit their protections provided to cooperatives under the federal Capper-Volstead Act – the so-called "Magna Carta" for agricultural cooperatives. That 1922 federal law provides legal protections from antitrust activities that might otherwise be deemed illegal. However, Capper-Volstead DOES NOT protect agricultural cooperatives from blatant illegal activities.

Two razor-sharp statements in Reiss' decision cut to the bone of plaintiffs' allegations against DFA and DMS:

DFA violated 1977 Consent Decree with federal antitrust officials.

Reiss stated that defendants had violated the 1977 Consent Decree that DFA's predecessor cooperative – Mid-America Dairymen, Inc. (Mid-Am) – had forged with the Antitrust Division of the United States Justice Department. DFA and all of its subsidiaries, joint venture parties, and related organizations inherited the 1977 Consent Decree from Mid-Am, when DFA was formed in 1997. Still current portions of that document specify that DFA may not restrict producers' access to markets.

Violations of the 2016 Allen case settlement

In 2015 the first Northeast class action antitrust case was settled in Judge Reiss' court: *Allen et al. vs. Dairy Farmers of America et al*. Reiss is thoroughly familiar with allegations by defendants in the *Sitts* case that DFA has violated terms of the *Allen* settlement. Judge Reiss' September 27 ruling noted:

> "They [plaintiffs' attorneys] have proffered admissible evidence from which a rational jury could conclude that the full supply agreements in question violated a 1977 Consent Decree, Defendants' own Antitrust Policy, and in the case of Dean's Lansdale, Pennsylvania processing plants, the *Allen* settlement agreement." (p. 47 of the 9/27/19 decision).

DFA practices benefited processing subsidiaries, not member producers.

Two key quotes from Judge Reiss' September 27, 2019 ruling clearly detailed motives behind DFA's business practices – control large volumes of producer milk while low-balling payments to members' for their milk. Those lower milk prices enhanced the profits of DFA's subsidiaries — milk processing dairy plants. Judge Reiss wrote:

> "Plaintiffs proffer admissible evidence from which a rational jury could conclude that DFA management favored growth of its commercial operations and empire building over the interests of its farmer-members, including through executive compensation and benefits which were not fully disclosed to DFA members and improper payments to DFA Board Members and Area Council Members.(13)" (p. 29)

And further, Reiss' decision detailed DFA's operating strategies and then quotes plaintiff's expert witness:

> "Recognizing that it ordinarily would make no economic sense for a cooperative such as DFA to inflict this harm on its own members, Professor Elhauge opines that DFA makes it profits based on milk volume and reaps profits in other sectors of its business when milk prices paid to dairy farmers are suppressed. He explains that:
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> "… reducing raw milk prices [paid to dairy farmers] directly increases DFA's profit per unit as a processor. Accordingly, DFA as an entity financially benefits from reducing raw milk prices (which increases its profits per unit as [a] processor without affect[ing] its profits per unit as a cooperative raw milk seller), while maintaining as much raw milk volumes possible (by driving farmers to have to sell through DFA)."

(Note: Plainiffs' expert antitrust witness referenced in the above paragraph is Einar Elhauge, perhaps the top antitrust authority at the Harvard Law School. This guy *really* did his homework.)

Background on the *Sitts* case …

The original Northeast antitrust case vs. DFA and other named defendants focused on DFA's coercing Northeast dairy producers to sell their milk through DFA or DMS (a subsidiary operated by DFA). DFA coerced many formerly independent Northeast dairy producers into selling their raw milk to DFA or DMS through a long list of exclusive milk supply agreements that DFA forged with many of the Northeast's biggest fluid milk processors – including Dean Foods, HP Hood, and Farmland Dairies … as well as smaller fluid processors in the region. The *Allen* case also alleged that DFA/DMS had restricted access to markets for Northeast producers, as well as underpaying farmers for their milk sold through DFA/DMS.

Lead plaintiffs Garret and Ralph Sitts (dairy farmers from Franklin, New York) had served as class representatives in the *Allen* dairy antitrust case brought against defendants DFA, DMS, Dean Foods and HP Hood. (Same for plaintiff Richard Swantak.) Dean Foods settled fairly early in the case, for $30 million – a settlement figure labeled by *The Milkweed* as "peanuts" (about two cents per hundredweight). HP Hood was curiously dismissed as a defendant in the *Allen* case by Judge Reiss.

Defendants DFA and DMS eventually settled the *Allen* case for $50 million. A majority of original plaintiffs (including Garrett Sitts, Ralph Sitts, Jonathan and Claudia Haar, and Richard Swantak) opposed that $50 million settlement. To end-run those dissidents' objections, plaintiffs' attorneys imported a handful of additional class representatives, who then (along with lead plaintiffs Alice and Lawrence Allen) swung the vote among class representatives to approve the $50 million settlement with DFA. (More peanuts.)

Disgusted with terms of the $50 million settlement vs. DFA/DMS, Garret and Ralph Sitts, along with Richard Swantak, resigned as Class Representatives in the *Allen* case and refused to accept their compensation as Class Repre, and also refused to take any settlement payments. Their objections to the *Allen* case settlement included the paltry pay-out, as well as failure to release a promised, vast trove of documents.

Instead, Garret and Ralph Sitts helped lead over 100 Northeast dairy producers to dissent from the *Allen* case. In 2016, those 100-plus dissenters filed a separate but similar class action challenge against defendants DFA/DMS in Judge Reiss' court – the *Sitts* case. During the discovery process, the *Sitts* attorneys have dug deep into the financial practices of DFA/DMS, DFA's dairy processing operations, salaries paid to DFA executives, and, in a few cases, illegal compensations paid to certain DFA farmer-directors.

(Editor's note: Judge Reiss' 9/27/19 decision noted how, about a decade ago, an illegal $1 million payment to DFA's former corporate board chairman, Herman Brubaker was unearthed. The payment came from DFA's processing subsidiary – National Dairy Holdings. Then CEO/President Gary Hanman was reportedly dunned to compensate that illegal payment. However, *The Milkweed* must observe DFA's internal investigators somehow missed the "gift" of a Chevy Suburban to Brubaker, apparently also *gratis* of NDH. Brubaker's $1 million "bonus" apparently stemmed from his championing before DFA's corporate board of directors a $6 million bonus paid in the early 2000s to Hanman for Hanman's role in the Dean Foods merger. Also worth noting: An antitrust case on behalf of dairy producers in the Southeast against DFA, DMS, Dean Foods and others resulted in DFA and Dean Foods engineering pre-trial settlements for $140 million each.)

"… A rational jury …"

As noted earlier, Judge Reiss' 9/27/19 ruling against most of defendants' motions to dismiss the *Sitts* case unveiled facts that had previously been sealed from the public. Further, Reiss either opined, or cited, plaintiffs' expert witness statements that DFA had violated the 1977 Consent Decree as well as certain terms of the *Allen* settlement in her own courtroom.

Ultimately, questions must arise about whether DFA's antics in the Northeast will be partially protected by the Capper-Volstead Act. If not, that could open up DFA to far wider exposure and liabilities to a variety of matters, from antitrust to income tax questions.

Judge Reiss' decision cited expert witness Elhauge's multiple regression analyses that plaintiffs had individually suffered damages of roughly $.78 per hundredweight of milk marketed over several years – a total calculated at $26.9 million to date — due to defendants' anti-competitive actions. That's a far better, potential pay-out than the few peanuts harvested from the *Allen* case. But those hard-headed plaintiffs in the *Sitts* case are dug in for more than just the money. Indications are that they want to *Sitts* case to go to trial, so that critical documents detailing DFA's dirty games in the Northeast are finally made public. Such documents might range from specific details of DFA's executives' salaries … to many tens of millions of sweetheart payments by DFA/DMS to fluid processors (such as Dean Foods, Farmland Dairies) that dumped their independent producers into DFA's grubby mitts.

Judge Reiss' decision must leave DFA's leadership running scared. Potential disintegration of a Capper-Volstead defense could lead to decisions against the defendants involving violations of Sections 1 and 2 of the Sherman Antitrust Act.

A pre-trial hearing is scheduled for November 14.

DFA: Two Enterprises – Both Squeezing Farmers' Milk Checks

by Pete Hardin

The September 27, 2019 ruling by federal judge Christina Reiss explicitly details Dairy Farmers of America's core operations. DFA controls two distinct operations:

• "Milk Marketing" – i.e., marketing members' raw milk, and

• "Commercial Investments" – direct ownership of more than 40 processing plants with over 6,000 employees nationwide, as well as numerous joint ventures and affiliate relationships.

Cynically, DFA's business model appears to be to low-ball milk prices it pays to members. Devaluing members' milk prices effectively boosts the profits of DFA-owned and controlled dairy processing plants.

Milk marketing

To extend DFA's control of milk supplies in the Northeast, the cooperative entered into numerous exclusive (or near-exclusive) raw milk supply deals with several major fluid processors. In those deals, DFA and its subsidiary, Dairy Marketing Services (DMS), would assume control of processors' independent producers milk marketing (testing, hauling, payments). Further, DFA guaranteed those processors what Judge Reiss refers to as "Most Favored Nation Status" – in other words, guaranteed lowest costs for raw milk purchases. Thus, these arrangements tended to minimize the value of members' milk – boosting processors profits (including those of DFA-owned plants). Fluid processors with which DFA struck deals in the Northeast include: Suiza Foods (Dean Foods' predecessor), Dean Foods, HP Hood, Crowley Foods (later acquired by HP Hood), Farmland Dairies and Turkey Hill (among others).

Worse yet, covenants involving DFA/DMS and other cooperatives participating in DMS contractually disallowed soliciting each others' producers. … those co-ops all shared their monthly pay prices – so no co-op strayed too far from DMS (actually DFA) price dictates. Even non-DMS member cooperatives were pulled into this conspiracy, including Agri-Mark.

Meanwhile, DFA also used exclusive (or near exclusive) agreements with manufacturing milk processors to limit access to those plants. Examples include: Great Lakes Cheese, Kraft Foods, Euphrates, and Agro-Farma (Chobani), and others.

DFA backed up these exclusive milk supply agreements with outright payola. Judge Reiss' opinion cited plaintiffs' attorneys documenting $70 million in payments to two dairy processors that turned over "independent" producers to DMS' control – Dean Foods and Farmland Dairies.

The DocuWare scam …

DFA turned a lemon – growing demand for rbGH/rbST-free milk — into lemonade. DFA/DMS crafted an exclusive computer software titled "DocuWare." That program allowed participating processors to track the status of producers who had signed agreements not to inject their cows with the controversial biotech hormone – recombinant bovine growth hormone – then produced and marketed by Monsanto.

The DocuWare trap was the following: Firms with access to DocuWare could not solicit producers from other marketers participating in DocuWare. Thus, DFA/DMS converted consumers' growing demand for rbGH/rbST-free milk into a contractual agreement limiting many milk buyers from soliciting other DocuWare participants' producers.

Worse yet, covenants involving DFA/DMS and other cooperatives participating in DMS contractually disallowed soliciting each others' producers. Within the DMS tent, those co-ops all shared their monthly pay prices – so no co-op strayed too far from DMS (actually DFA) price dictates. Even non-DMS member cooperatives were pulled into this conspiracy, including Agri-Mark. Here's what Judge Reiss revealed about Agri-Mark:

> "For example, a May 8, 2007 agreement with Agri-Mark (which is not a member of DMS, but which sometimes markets its milk with DFA) provides in relevant part that:
>
> "COVENANT NOT TO SOLICIT
>
> "Agri-Mark will not either directly or indirectly, whether as an individual, owner, partner, operator, joint venturer, contractor, employee of, or consultant to, any person or entity, solicit a milk marketing relationship with or perform milk marketing services for any of the producers in the DocuWare Data. This covenant shall remain in effect for so long as Agri-Mark has access to DocuWare Data and for a period of 24 months after such access is terminated." (p. 10 of Judge Reiss' 9/27/19 decision).

One month later, Judge Reiss' decision notes that DFA/DMS entered into a similar agreement with the St. Albans co-op – based in Vermont. Thus, by tying up Agri-Mark and St. Albans literally into no-compete/no solicitation agreements regarding producers connected to DFA/DMS, DFA effectively pulled the two major competitors in the New England market into a conspiracy to restrict producers' access to milk markets.

2016-2017: Wiping out "independent" producers & co-ops …

Once independent producers' milk was shoved under DMS' control, it was a mere matter of time before DFA embarked on its final solution – wiping out independent dairy producers and cooperatives in the Northeast. In 2016-2017, DFA embarked on a strategic elimination of independent producers and small dairy co-operatives. Starting in 2016, DFA ordered a succession of smaller dairy co-ops in the Northeast to disband and turn over their members to DFA's control, or else their milk markets with DFA would be terminated. (Examples: Cortland Bulk Milk Producers, Oneida-Madison Co-op, and the South New Berlin Co-op).

In early 2017, DFA notified the remaining 794 independent producers selling milk to DMS that those producers had to join DFA as direct members, or seek other markets. (Judge Reiss' decision cites DFA officials admitting there were no other available markets at that time.) Some 630 of those producers joined.

***"Commercial Investments" —boosting7 plants' profits by devaluing members' raw milk.**

DFA's "Commercial Investments" include over 40 dairy processing plants across the United States, as well as numerous joint ventures and subsidiaries involved in dairy and food processing. Profits from those businesses are credited to the cooperative, but DFA members do not directly share in the profits of the "Commercial Investments."

Thus, DFA members' equity investments in the cooperative have helped to bankroll acquisitions under the "Commercial Investments" side of the co-op, but members do not directly share in those ventures' profits.

The Milkweed will quote from a portion of Judge Reiss' recent decision to best describe the conflict of interest DFA entered when, as a processor of farm milk, the co-op's profits were enhanced by devaluing the price of milk paid to its member-producers (and other producers under DFA/DMS control):

United States District Court
For The District Of Vermont, Plaintiffs
v.
Dairy Farmeres Of America, Inc
and Dairy Mardketing Servies, LLC, Defendants.
(Pages 27-29)

"Claiming Defendants' reasons for doing so were pretextual, Plaintiffs cite Professor Elhauge's explanation of Defendants' economic motive for driving the independent milk supply to sell through DFA and for paying DFA's members lower prices for their milk:

"Generally, a cooperative that only makes its money from marketing the raw milk of its farmers, and engages in no other lines of business, will be motivated to secure the highest practical price for its members' milk. However, DF A is also heavily invested in the dairy process business: ... DFA's "Milk Marketing" segment is distinct from its "Commercial Investments" segment, with the latter involved in an array of dairy processing operations. . . . [T]hese dairy processing activities benefit from lower raw milk prices, because those dairy processing operations utilize raw milk as an input. This creates an inherent conflict and motivation for DFA to suppress milk prices. (Page 27)

"…

"In an October 2000 memo, Rick Smith (then-Dairylea-CEO and current DFA CEO) wrote to Gary Hanman (then-DFA-CEO) that "just like in operating fluid plants, there is a conflict of interest in selling your own milk to your own manufacturing facilities." Rick Smith explained the conflict ... during a lawsuit against DF A in the Southeast Order [wherein] he testified that when operating a fluid milk plant that is its own processor, one wants to buy raw milk at the cheapest price, but a cooperative acting on behalf of farmers selling raw milk wants to sell that raw milk at the highest price. Similarly, Alan Bernon (former owner and operator of milk processor Garelick Farms, former President of milk processor Dean Foods Group, and current DFA Senior Advisor of Mergers and Acquisitions) testified that a processor always wants to pay the lowest possible price for the best quality milk. Bernon was also asked about multiple DF A acquisitions from 20 IO to 2017, including Kemps, Cass Clay, Guida, DairyMaid, Oakhurst, and Cumberland Dairy (all of which are milk processors); for each of these acquisitions, Bernon admitted that it was in the best interest of these DFA entities to pay the lowest price for the best quality of raw milk. He further stated that: "I think that's true of all these transactions that are processing milk." Thus, DFA's "Commercial Investments" segment will be more profitable when raw milk prices are lower.

"A reduction in the raw milk prices that D FA receives as a seller of raw milk also does not reduce DFA's net income from selling raw milk less than it could benefit DFA's net income as a processor of raw milk. This is because DFA's income statements show that its net income from the sale of members' raw milk has been a fixed [redacted] cents per cwt for at least the last ten years, even though the raw milk prices paid to its members have ranged from $13.05 to $24.17 per cwt during this period. Thus, any decreases in raw milk prices paid by processors are passed through to members, and DFA's financial performance as a raw milk cooperative depends only on the volume of raw milk sold by DF A members, not the raw milk prices. In contrast, reducing raw milk prices directly increases DFA's profit per unit as a processor. Accordingly, DF A as an entity financially benefits from reducing raw milk prices (which increases its profits per unit as [a] processor without affect[ing] its profits per unit as a cooperative raw milk seller), while maintaining as much raw milk volume as possible (by driving farmers to have to sell through DFA). (Page 28)

"Plaintiffs' SDF ,r 99, Ex. Z (Elhauge Rep. at ,r,r 129-30, 133)12 (footnotes omitted); see also Plaintiffs' SDF ,r 98, Ex. KKK at 77 (DFA's 2015 Financial Report stating: "Lower milk and other dairy commodity prices during 2015 led to an increase in net income from our commercial investments ... over the prior year."). DFA's Antitrust Guidelines caution:

> "Do not agree to more favorable terms for processing plants which are partially owned by DF A which are not justified by market conditions. In other words, do not favor processor profitability over raising or maintaining producer milk prices.
>
> "Plaintiffs' SDF ,r 100, Ex. B, Tab 2 at 95.

"Plaintiffs proffer admissible evidence from which a rational jury could conclude that DF A management favored growth of its commercial operations and empire building over the interests of its farmer-members, including through executive compensation and benefits which were not fully disclosed to DF A members and improper payments to DF A Board Members and Area Council Members.[13]"

Get the picture?