Cooperatives and Corporations: The Sun-Maid Antitrust Case and the Legal Status of Agricultural Cooperation, 1890-1943

Victoria Saker Woeste[1]
Amherst College

This study brings to light a long-ignored episode in the history of regulation: the legal transformation that created modern agricultural marketing organizations. My dissertation relates the history of the cooperative movement from the demise of the Populists in the mid-1890s to the Second World War. By the 1920s, the success of the "California model" of cooperation precipitated nationwide imitation. Its influence during the decade before the Great Depression led to important and lasting changes in the legal structure of the corporation, antitrust law, and public policy pertaining to government's role in the market.

My thesis is that cooperation established the pretext of a private self-help initiative under which farmers controlled supply and administered prices. In effect, government delegated the task of safeguarding the public interest in efficient agricultural markets to quasi-public corporations rendered distinctive in form, function, and philosophy. Cooperation's ideological heritage of democratic capitalism was institutionalized in the modern cooperative practices of profit-sharing, patronage dividends, and limited capital investment. These limits on cooperatives' economic powers provided assurance that they would not abuse their privileged market position, at least in theory.

The development of a cooperative organization that avoided the evils of business corporations called for a different public policy response to agriculture's initiative. Associationalism blurred the distinction between private and public that substantive due process strictly maintained. Similarly, cooperation provided a model of private enterprise that recognized the vital public interests in efficient agricultural marketing. Since cooperation held out the possibility of stabilizing markets without extending government's regulatory activities, farmers were able to obtain legal protections and privileges that far exceeded the demands of other groups such as organized labor. For a time,

---

[1]This essay is drawn from my dissertation, "Benevolent Monopoly: The Legal Transformation of Agricultural Cooperation, 1890-1943" (University of California at Berkeley, 1990), supervised by Harry N. Scheiber and Morton Rothstein. Research was supported by a U.S. Department of Agriculture Cooperative Agreement.

BUSINESS AND ECONOMIC HISTORY, Volume Twenty-two, no. 1, Fall 1993.
 ISSN 0849-6825.

cooperation's legislative achievements even outstripped the gains that corporations and trade associations had acquired by the 1920s. I argue that cooperation's ideological tradition and agriculture's symbolic importance to American culture bolstered farmers' claim that they could make capitalism safe for a democratic society.

This was possible because of two factors, one economic, the other legal. Horticultural cooperatives achieved productive and allocative efficiencies through vertical and horizontal integration. And farming's relationship to national prosperity made the stability of agricultural markets a high priority in public policy. Cooperation supplied the ideological rationale and the organizational tools that enabled farmers to control their commodity markets without violating the strictures of substantive due process. The result was a far-reaching legal revolution that instituted the gospel of cooperation in federal law and in the laws of thirty-eight states by 1928. Ultimately, cooperation supplied the regulatory model for the New Deal's agricultural recovery program.

My case study is a legal and economic history of the organization now known as the Sun-Maid Raisin Growers of California. Sun-Maid exemplifies both the promises and the paradoxes of the agricultural cooperation movement. In the Sun-Maid case, the growers' instrumental use of corporation law transformed the legal status of cooperation and, in so doing, redefined the place of farmers in industrial society. The rest of this presentation will focus on what I see as the most important feature of this history: the raisin growers' reformulation of the business corporation to suit their marketing needs. This recasting of the corporation was shaped and limited by the ideological heritage of cooperation as well as the legal constraints imposed by existing antitrust law and corporation law.

Traditional nineteenth-century cooperation aspired to reform the emerging industrial system by decentralizing and democratizing market power. In the 1840s, English consumer cooperatives began rewarding participation in proportion to contribution of goods or patronage rather than investment of capital. And only those with shared economic interests could belong to the cooperative. Limits on dividends and on the amount of capital any individual could contribute were designed to prevent internal factions from gaining control of the organization. The restriction of membership to those similarly situated--workers, artisans, or consumers--was intended to keep hostile outside interests from destroying the cooperative.

For American farmers, these safeguards against hostile competitors filled a need left unmet by post-Civil War agrarian protest movements. But they needed laws to create marketing organizations that would prevent middle merchants from encroaching on farmers' profits. The Grangers and Populists spurred the passage of separate incorporation laws for cooperatives. This move carved out a space in corporation law for organizations conforming to traditional cooperative practices.

These separate incorporation statutes proceeded on the premise that the elements of the business corporation took on a different legal character when employed by farmers cooperatively organized. They limited the amount of capital stock to a nominal sum or sometimes banned capital stock entirely;

they restricted membership to farmers; and they instituted the principle of "one person, one vote," meaning that each member had the same measure of influence in the management of the organization's affairs. By 1920, nineteen states had enacted versions of Massachusetts's 1866 capital stock law and California's 1895 non-stock law. But farmers' decided preference for capital stock organizations meant that the most salient feature of the regular corporation was present in most cooperatives. Although cooperatives distributed voting power and dividends according to patronage rather than capital stock shareholding, Progressive-Era judges believed that the mere presence of capital stock was incompatible with true cooperative purposes. Any farmers' organization that issued capital stock was no different from a business corporation. As a result, neither the separate incorporation statutes nor statutory exemptions in state antitrust laws protected farmers' organizations from private lawsuits alleging that price-fixing, production pools, and preferential trading constituted anticompetitive practices. Ironically, cooperation's philosophical commitment to democratic capitalism was used against farmers whose pressing need for capital was seen as inimical to free markets.

The raisin growers' organization arose out of this vortex of legal confusion over the legal and philosophical nature of cooperation. Due to soil, rainfall, and climate conditions, the production of fruit and nut crops was confined to specific geographic areas of California. These natural monopolies facilitated cooperatives' horizontal control over growers, commodity supply, and marketing. But no industry so brazenly transgressed the line separating cooperative and corporation as did Sun-Maid. In 1912, after a series of cooperative organizations had failed to stabilize the industry, a new organization was founded that merged cooperative principles with corporate trust devices. Sun-Maid's organizers spurned the non-stock law and organized under the state's corporation law. They set its capital stock at one million dollars. And they did not limit membership to growers alone but permitted any interested person to purchase stock. To ensure that the stock would be controlled by friendly interests, however, a voting trust arrangement was set up. Under the voting trust, twenty-five trustees held and voted the stock on behalf of all shareholders. By April, 1913, Sun-Maid had seventy-six percent of the growers under contract, and it had raised eight hundred thousand dollars in capital stock. The intimate democracy of traditional cooperation had been replaced by an impersonal corporate structure. While regular incorporation and capital stock were typical of American cooperatives, Sun-Maid's voting trust definitely departed from the norm. But the membership of three-quarters of the growers enabled Sun-Maid's officers to claim that in spirit, if not in form, theirs was a true cooperative.

Sun-Maid's ensuing economic behavior belied that claim. Since stockholding served the purpose of raising capital rather than tying members to the organization, Sun-Maid had to secure control over the crop through grower contracts. These contracts guaranteed a minimum price to growers and ensured distribution of net proceeds according to grower contribution. But before paying the growers, Sun-Maid first met its own expenses, including six-percent dividends on capital stock. Sun-Maid also broke an early pledge that it would serve only as the growers' marketing agent with private commercial

raisin packers and processors. Instead, Sun-Maid integrated vertically in the processing industry by constructing its own packing plants and setting up its own marketing system to sell its own brand of raisins. Packers who refused to pack raisins for Sun-Maid soon found themselves without raisins to process; wholesalers and jobbers expecting to deal with the cooperative found themselves the unwitting dupes of a marketing end-run. Sun-Maid also maintained its horizontal monopoly with strict measures. An "iron-clad" crop contract ran with the land; this meant that growers could either sell to Sun-Maid or leave the industry. And free-riders were swiftly punished. Night-riders routinely and with impunity terrorized anyone who tried to remain independent; racial and ethnic hostilities fueled this extra-legal violence. By 1918, Sun-Maid's membership stood at 9,200 growers (88 percent of the industry); it held $3.5 million in capital stock; and it performed almost all of the industry's packing operations. In short, Sun-Maid achieved a degree of horizontal and vertical integration that was unprecedented in American agriculture.

The federal government was powerless to stop Sun-Maid's expansion. Section 6 of the Clayton Act of 1914 exempted non-stock agricultural cooperatives from the federal antitrust laws. A rider attached to the Justice Department's appropriations bills every year from 1913 to 1928 forbade the expenditure of any funds for the prosecution of agricultural organizations seeking to "obtain and maintain a fair and reasonable price for their products." In 1919, at the height of post-World War I inflation and profiteering, Sun-Maid finally gave the government legal grounds to prosecute. Citing soaring labor costs, Sun-Maid hiked retail prices by 100 percent. The act led eastern trade papers to brand the cooperative as "the Raisin Trust." But its leaders confidently claimed that their monopoly was a "benevolent trust" that protected the interests of farmers and consumers alike.

The bitter public quarrels over Sun-Maid were an accurate measure of the high stakes involved in the antitrust suit. The commercial packers who opposed Sun-Maid argued that as a capital-stock cooperative, Sun-Maid did not merit Clayton Act protection. This argument raised the larger question of cooperation's legal status. As it turned out, however, in the context of rule of reason antitrust jurisprudence and enforcement politics, what mattered was the effect on price, rather than the corporate form of the market actor. The government moved against Sun-Maid only when its flagrant price-fixing resulted in increases so egregious as to constitute a *per se* violation of the law -- the only circumstance under which prosecution of an agricultural organization was possible. The government's conduct of the case indicates that what underlay cooperation and antitrust policy during this time was a conception of market freedom defined by the price function. Administered prices that constituted egregious profiteering overran the reasonableness standard of the appropriations rider. The litigation's theory and timing revealed that the law tolerated a cooperative organization that flouted legal convention, refused to conform to established cooperative practices, and held excessive control of the market only as long as it had no unreasonable impact on price.

The lawsuit settled few of the questions it raised. Unable to establish federal jurisdiction under the Sherman Act, the government agreed to a settle-

ment that enjoined Sun-Maid from employing market practices prohibited by the Sherman Act. In effect, Sun-Maid's monopoly was left intact, but it was barred from further vertical and horizontal integration and explicitly forbidden to engage in price-fixing, preferential trading, or controlling production. The settlement said nothing, however, about the legal form that agricultural cooperatives should take under federal antitrust law. That issue was resolved by the Capper-Volstead Act of 1922. Known as "agriculture's Magna Charta," the Capper-Volstead Act immunized all cooperatives regardless of their capital stock holdings from the antitrust laws, as long as they conducted no more business with non-members than with members. In addition, cooperatives either had to limit dividends on capital stock to eight percent or adhere to the "one person, one vote" principle. The law put to rest all outstanding questions about the organic structure of cooperatives and scuttled the threat of antitrust prosecution against farmers' organizations.

The Capper-Volstead Act recognized the hybrid of cooperative and corporation resulting from Sun-Maid's legal experimentation. In making this form of business organization accessible to farmers as a matter of federal law, it sent an important signal to state legislatures. In the following six years, thirty-eight states enacted versions of a uniform cooperative marketing statute that immunized Capper-Volstead cooperatives from state antitrust prosecution. As a result, by 1928 both state and federal law embodied the principle that cooperatives could borrow from the corporation and still comply with the nation's policy on free, competitive markets.

This dissertation addresses important questions about the relationship of American farmers to the emerging industrial state. Growers changed the corporation's legal form to accord with the principles of cooperation. In the process, they challenged prevailing legal conceptions of the market and their role in it. Ultimately, they forced a reconsideration of the existing categories of public and private, competition and cooperation, association and corporation. As a result, their own conception of the applicability of corporation law to their marketing problems changed as they came to embrace the new incarnation of the cooperative gospel.

This study shows how the insights of business history can help to explain the legal transformation in cooperation. Agriculture's adaptation of the corporation to serve its marketing needs obviously borrowed the central legal innovation of industrial manufacturers. This borrowing was essential to the cooperative movement's conversion from a decentralized agrarian protest program to an economic institution with a defined role. In terms of economic theory, the cooperative corporation made efficiencies of scale possible in a mode of production that is inherently inefficient. This relationship becomes clearer when we apply the vocabulary of the trust movement to agriculture. In the cultivation and harvesting aspects of fruit-growing, only limited productive and allocative efficiencies were possible because so much of the requisite labor had to be done manually. The processing end of the business, in contrast, was more amenable to improvements in efficiency, economies of scale, mechanized mass production, and long production runs. Thus horticultural cooperatives vertically integrated two very different kinds of firms, one peripheral and one center. These cooperatives took on some of the most

salient characteristics of center firms, particularly a high degree of vertical and horizontal integration. This development confused contemporary legal and economic analysis of cooperation's new form; most observers continued to perceive cooperatives as cartels of independent entrepreneurs and missed the significance of the processing and marketing ends of the business. Thus Sun-Maid's achievement takes on greater importance. It demonstrated that integrated market control not only was possible in agriculture but indeed could be devastatingly effective in commodities endowed with natural monopolies. The raisin growers' conviction that monopoly and the cooperative ideal were thoroughly compatible became incorporated into American law.