The American Antitrust Institute

April 29, 2013

William J. Baer
Assistant Attorney General
U.S. Department of Justice Antitrust Division
950 Pennsylvania Avenue, NW
Washington, D.C. 20530

Edith Ramirez, Chairwoman
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

Via Electronic Delivery Re: Horizon Milling, LLC-ConAgra Joint Venture

Dear General Baer and Chairwoman Ramirez:

I. Introduction

The American Antitrust Institute (AAI) has been active in supporting a strong response to impediments to competition in all segments of the U.S. agricultural supply chain. This includes mergers, exclusionary conduct, and collusion that potentially harm competition and consumers in the upstream production, midstream processing and food manufacturing, and downstream retail grocery markets.[1] The summary of the joint U.S. Department of Justice (DOJ)/U.S. Department of Agriculture workshops held in 2010 reveals that concerns over market concentration, merger enforcement, and monopsony permeated the workshop discussions.[2] For reasons explained below, we urge the DOJ and the Federal Trade Commission (FTC) jointly to review the proposed Horizon Milling-ConAgra joint venture (JV).

The proposed transaction extends participation in the existing Cargill-CHS "Horizon Milling" JV to ConAgra in what will be called "Ardent Mills." The new deal comes on the heels of ConAgra's acquisition of private label rival Ralcorp only months ago. The proposed JV raises potentially significant competitive concerns in the midstream food processing and manufacturing segment of the wheat supply chain. These include enhancing the ability and/or incentive for the JV participants to exercise monopsony power, seller market power, and/or to engage in exclusionary conduct with respect to rivals upstream and downstream of the midstream segment.

[1] The AAI is an independent non-profit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. AAI is managed by its Board of Directors, which alone has approved this letter. For more information, see www.antitrustinstitute.org.

[2] U.S. Department of Justice, *Competition and Agriculture: Voices from the Workshops on Agriculture and Antitrust Enforcement in our 21st Century Economy and Thoughts on the Way Forward* (May 2012), at 4. Available http://www.justice.gov/atr/public/reports/283291.pdf.

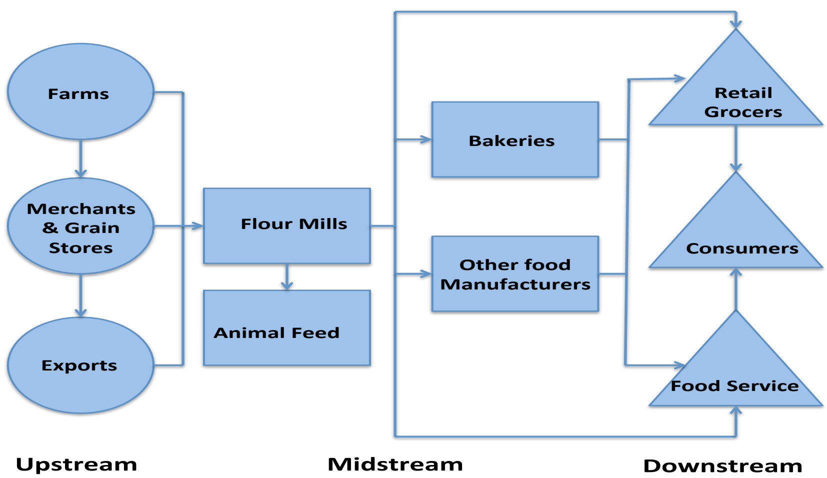
2919 ELLICOTT ST, NW • WASHINGTON, DC 20008
PHONE: 202-276-6002 • FAX: 202-966-8711 • bfoer@antitrustinstitute.org
www.antitrustinstitute.org

The DOJ Antitrust Division has typically evaluated competitive issues involving the upper to middle portions of the agricultural supply chain while the FTC has handled the downstream segments, including retail grocery mergers. The midstream markets potentially affected by the proposed transaction are critically interrelated with upstream wheat growers and downstream retail grocers. As a result, the AAI believes that a comprehensive approach to evaluating the potential competitive consequences of the proposed transaction is needed. We therefore encourage the DOJ and FTC to pool their expertise to jointly evaluate the proposed JV and to pursue additional information that will enable the agencies to fully analyze its likely competitive effects.

II. Background on the Horizon Milling-ConAgra Joint Venture

The Horizon Milling-ConAgra JV will involve three firms with a collective "wingspan" that covers, at a minimum, the depth and breadth of the midstream segment of the wheat supply chain. A simplified diagram of the supply chain is shown in Figure 1. For example, Cargill's major business units range from farmer services to agricultural grain trading, grain processing, financial and risk management, and food/beverage ingredients and products for the foodservice sector. CHS is engaged in grain marketing and transportation, commodity brokerage, grain milling, and the manufacture of food ingredients.[3]

Figure 1: The Wheat Supply Chain



ConAgra is one of the largest packaged food companies in the U.S. It has extensive flour milling operations that feed businesses located in the lower midstream portion of the supply chain. ConAgra has two major business divisions – commercial and consumer foods. The former involves manufacturing and selling specialty food products (e.g., potatoes, flours, and seasonings) to restaurants, foodservice operators, and other food manufacturers while the latter involves the supply of branded, private label, and customized food products.[4] ConAgra has almost 50 nationally known

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[3] *See* http://www.cargill.com/company/businesses/index.jsp and https://www.chsinc.com/portal/server.pt/community/1about_us/338. Both Cargill and CHS are also in the business of supplying animal (Cargill) and crop (CHS) nutrients and feeds – activities that extend to inputs in the upstream production segment.

[4] *See* http://www.conagrafoods.com/our-food/business-to-business/food-serviceand and http://www.conagrafoods.com/our-food/business-to-business/commercial-foods.

consumer brands covering a wide range of products and is the largest private label (i.e., store label) food producer – a rapidly growing segment of the industry.

The Horizon Milling-ConAgra JV is at an important nexus in the midstream segment of the wheat supply chain. The JV will operate 44 flour mills, three bakery mix facilities, and one specialty bakery in the U.S., Canada, and Puerto Rico. Total daily wheat and durum flour capacity for the combined company will be 576,100 cwt (hundredweight per day). ConAgra Foods and Cargill each will own a 44 percent stake in Ardent Mills, with CHS owning a 12 percent interest.[5] Cargill and CHS have been partners in Horizon Milling since the JV was formed in 2002, with Cargill taking the managing partner role. The JV agreement that formed Horizon Milling included 16 Cargill mills and five mills owned by CHS. At the time of the joint venture, the network of 21 mills had a capacity of 293,000 cwt. The proposed JV therefore almost doubles the size of the joint venture in terms of total milling capacity.[6]

Three firms account for more than 50 percent of total U.S. wheat flour and durum milling capacity – Horizon Milling (18 percent), Archer-Daniels-Midland (17 percent), and ConAgra (16 percent). The proposed transaction would concentrate control of 34 percent of total U.S. wheat flour and durum milling capacity in the hands of two entities. More than 50 percent of such capacity would be held by the two largest firms. For wheat flour only, the combined share of Horizon Milling and ConAgra would be about 36 percent and the two top firms would control about 56 percent of total U.S. capacity. The next largest firms in milling are Cereal Food Processors, Inc. (6 percent share), Bay State Milling Co. (5 percent share), and General Mills Inc. (5 percent share).[7]

Based on national market shares, overall U.S. market concentration in wheat flour and durum milling is just over 1,000 HHI. The JV would increase concentration by almost 600 HHI points, for a post-merger level of about 1,600 HHI. For wheat flour only, U.S. market concentration is about 1,200 HHI. The JV would increase concentration by about 650 HHI points, for a post-merger level of about 1,800 HHI. According to the 2010 DOJ/FTC HORIZONTAL MERGER GUIDELINES, the post merger market is considered "moderately concentrated (1,500 – 2,500 HHI).[8] Increases in concentration in such markets of "more than 100 points potentially raise significant competitive concerns and often warrant scrutiny."[9] The HHI increases induced by the proposed JV far exceed the thresholds in the DOJ/FTC GUIDELINES. However, geographic markets for milling are smaller and regional in scope and may have higher levels of market concentration, suggesting that the effects of eliminating a competitor are likely to be magnified.

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[5] Carey Gillam, "Flour power: ConAgra, Cargill, CHS to create mega-miller," newsandinsight.thomsonreuters.com, March 5, 2013, http://newsandinsight.thomsonreuters.com/Legal/News/2013/03_-_March/Flour_power_ConAgra,_Cargill,_CHS_to_create_mega-miller/ and "ConAgra Foods, Cargill and CHS announce agreement to form joint venture combining flour milling businesses into new company, Ardent Mills," cargill.com, March 15, 2013, http://www.cargill.com/news/releases/2013/NA3071787.jsp.

[6] "Cargill, CHS Finalize Horizon Milling Joint Venture," grainnet.com, January 14, 2002, http://www.grainnet.com/articles/cargill__chs_finalize_horizon_milling_joint_venture-13078.html.

[7] An additional 17 milling companies populate the U.S. market, with shares ranging from a low of about one-half percent to almost 3 percent.

[8] U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (August 2010), at 18. Available http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf.

[9] *Id.*

III. Competitive Effects of the Proposed Joint Venture – "Consolidated Integration" of the Midstream Segment of the Wheat Supply Chain

ConAgra's motivation for joining Cargill and CHS in the Horizon Milling JV is easy to grasp. As a ConAgra spokesman stated: "Ardent Mills will set the new industry standard by addressing…the need for more cost-effective supply."[10] Another spokesman added: "The future of flour milling is tied to serving the innovation and supply chain management challenges of food producers."[11] The drive for supply chain management in wheat is generated at the downstream level of the industry. For example, almost 20 percent of ConAgra's consolidated net sales in recent years were to Wal-Mart, which has a substantial presence in the retail grocery market.[12] Wal-Mart's share of the national retail grocery market has increased from virtually nothing in the 1980s to 28 to 32 percent today.[13] It is well known that Wal-Mart exerts significant monopsony power over some of its suppliers, forcing down their prices and squeezing margins. Indeed, industry sources note that ConAgra, whose products are considered second and third tier brands that do not enjoy the popularity of nationally recognized brands, is particularly susceptible to the dictates of Wal-Mart.[14]

Logical industry responses to the effects of monopsony power exerted on midstream wheat processors by retail grocers include bulking up at the milling level to exert countervailing seller market power. Another response is to link together the upper and lower portions of the midstream segment – namely wheat inputs and the manufacture of food ingredients and products. The JV will do just this. Perhaps the best way to view the proposed Horizon Milling-ConAgra JV, therefore, is as "consolidated integration." The JV significantly concentrates the markets for wheat and durum flour milling, potentially enhancing enhance both seller and buyer (monopsony) market power. The JV's enhanced control of milled flour, a critical input for food ingredients and products, can also change the parties' incentives vis-à-vis their conduct in adjacent markets such as food manufacturing.

Consolidation in milling could allow ConAgra to exert countervailing seller market power against mammoth downstream retail grocers. Such a strategy, however, does not come without a cost. One industry source notes of retail grocers such as Wal-Mart: "Keeping costs down is what keeps prices low for consumers. But the savings have to come from somewhere and the ripple effects can reach all the way back to the farm."[15] Another commenter noted: "The private labels are going to try and squeeze farmers because they need to come into a lower price and the branded people are going to

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[10] Cargill, *supra* note 5.

[11] *Id.*

[12] ConAgra Foods Form 10K (May 27, 2012), http://phx.corporate-ir.net/phoenix.zhtml?c=97518&p=irol-SECText&TEXT=aHR0cDovL2FwaS50ZW5rd2l6YXJkLmNvbS9maWxpbmcueG1sP2lwYWdlPTgzNzI4MjMmRFNFUT0wJlNFUT0wJlNRREVTQz1TRUNUSU9OX0VOVElSRSZzdWJzaWQ9NTc%3d.

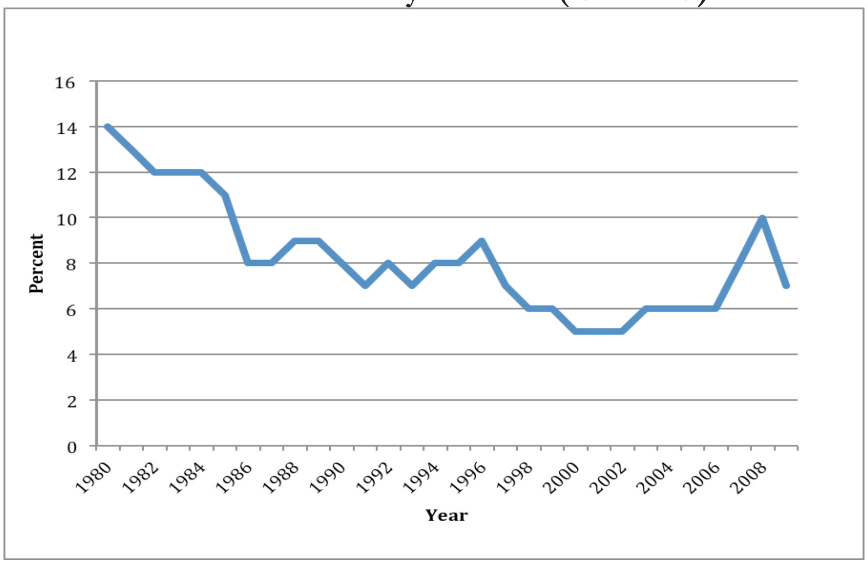
[13] Grant Gerlock, "What Does Walmart Have To Do With Conagra's Move Into Store Brand Food?" April 10, 2013, NET News/Harvest Public Media, http://netnebraska.org/article/news/what-does-walmart-have-do-conagras-move-store-brand-food.

[14] Martinne Geller and Jessica Wohl, "Analysis: Wal-Mart's price push tests manufacturers' prowess," March 6, 2012, http://www.reuters.com/article/2012/03/06/us-usa-consumer-walmart-idUSTRE8250GM20120306.

[15] Gerlock, *supra* note 13.

squeeze farmers because private labels are coming in at a lower price."[16] Squeezing farmers through the exercise of monopsony power at the midstream processing level will further impair the ability of wheat growers to obtain competitive prices for their products. Indeed, the farm value share of the retail dollar for cereals and bakery products declined precipitously over the last 30 years. As shown in Figure 2, shares decreased by 50 percent over this period – from 14 percent in 1980 to about 7 percent in 2009.[17]

Figure 2: Farm Value Shares for Cereals and Bakery Products (1980-2009)



The DOJ has emphasized that both the antitrust laws and the agency itself target monopsony harm.[18] The DOJ/FTC GUIDELINES explain that a merger can enhance buyer power and depress prices paid to growers for their product, resulting in a transfer of wealth from growers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.[19] The DOJ has raised monopsony concerns in a number of recent agricultural mergers, including: grain traders in U.S. v. Cargill, Inc. and Continental Grain Company, beef packers in U.S. and Plaintiff States v. JBS S.A. and National Beef Packing Company, Inc., and poultry processors in U.S. v. Georges Foods.[20]

In merger cases, relevant markets are defined around the alternatives available to sellers in response to a decrease in the price paid by a hypothetical monopsonist. In the Horizon Milling-ConAgra case,

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16 *Id.*

17 Data derived from "Price Spreads from Farm to Consumer," U.S. Department of Agriculture, Economic Research Service, http://www.ers.usda.gov/data-products/price-spreads-from-farm-to-consumer.aspx#.UW7wRuC7BZ9.

18 DOJ, *supra* note 2, at 18-19. Monopsony concerns include the reduction of buy-side competition, agreements among buyers that unreasonably restrain competition, and exclusionary conduct enabling the acquisition or maintenance of monopsony power.

19 DOJ/FTC, *supra* note 8, at 33.

20 In either blocking or extracting remedies in these transactions, the Antitrust Division variously cited high concentration in regional markets, reduced numbers of buyers for producers to choose from in selling their output, unilateral or coordinated effects, and anticompetitive reductions in prices paid to growers and intermediaries.

the “draw” area for flour mills, i.e., the grain elevators from which mills can purchase wheat to avoid a price increase, is limited by a number of factors, including transportation costs. While information and data limitations prevent the AAI from specifically defining regional milling markets, it appears based on publicly available information that the consolidation of Horizon Milling LLC and ConAgra could substantially lessen the choices available to grain elevators in a number of areas, including: California, Minnesota, Alabama-Tennessee-Georgia, and Virginia (northern)-Maryland-Pennsylvania-New York. The DOJ is in the best position to collect the information necessary to define relevant markets for purposes of evaluating the effect of the JV on enhancing buyer market power.

Coupled with increased market power in milling, the span of Cargill, CHS, and ConAgra operations highlights further potential competitive dangers of the proposed JV. Horizon Milling’s presence in the upper midstream segment and ConAgra’s role in the lower midstream segment provide a roadmap for framing up potential vertical concerns. Namely, the proposed transaction could enhance the ability and incentive of Horizon Milling-ConAgra to frustrate rivals’ access to critical food ingredients or inputs, or to deny rivals access to outlets for their products. To the extent that ConAgra does not source all of its manufacturing needs through the JV, it is also possible that ConAgra could serve as a conduit for the exchange of information on upstream milling rivals, which could facilitate coordination among the now more concentrated milling segment.

Given the potentially concentrated structure of wheat milling markets and growing concentration in food manufacturing, the AAI believes that the DOJ and the FTC should look carefully into potential adverse effects of the Horizon Milling-ConAgra JV. Such effects could be felt at any number of stages in the wheat supply chain and raise concerns about prices, quality, food safety, and the diversity of suppliers. We appreciate your attention to this matter. If the AAI can be of further assistance, please feel free to contact us.

Sincerely,

Diana L. Moss

Diana Moss
Vice-President
American Antitrust Institute

cc:
Julie Brill, Commissioner, Federal Trade Commission
Maureen K. Ohlhausen, Commissioner, Federal Trade Commission
Joshua D. Wright, Commissioner, Federal Trade Commission
Richard Feinstein, Director, Bureau of Competition, Federal Trade Commission