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ENSURING COMPETITIVE AND OPEN AGRICULTURAL MARKETS: ARE MEAT PACKERS ABUSING MARKET POWER?

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

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SIOUX FALLS, SOUTH DAKOTA

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FRIDAY, AUGUST 23, 2002

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Sioux Falls, SD.

The Committee met, pursuant to notice, at 1:30 P.m., at Sioux Falls Convention Center, 1211 North West Avenue, Sioux Falls, South Dakota, Hon. Richard J. Durbin, presiding.

Present: Senators Durbin, Dayton, and Johnson.

OPENING STATEMENT OF HON. RICHARD J. DURBIN, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DURBIN. Good afternoon. Welcome to the Senate Judiciary hearing on the effects of concentration in the meatpacking industry and packer ownership of livestock. I'm Senator Richard Durbin of Illinois, a member of the Senate Judiciary Committee. And I am happy to be with you today and to be joined by my colleagues in the United States Senate, Senator Tim Johnson from the State of South Dakota, of course well known I'm sure, and Senator Mark Dayton from the neighboring State of Minnesota.

Although they are not members of the Judiciary Committee, I have invited them to join me at the panel this afternoon to consider the testimony which we are about to receive. They are here because of their interest and leadership on this important issue.

Let me assure you that although I come to this meeting as a very strong Bears fan, that I do not come with a hatred of all Packers. In fact, in my own callow youth, growing up in East St. Louis, Illinois, I worked four summers at the Hunter Packing Company pork processing facility owned by John Morrell. And that's how I paid my way through college. So I know a little bit about that part of the industry. But I readily concede, as you can tell by the gray hair on my head, that it's been many years since I have been personally involved in this industry. And I've spent some time trying to catch up with the progress and changes that have taken place.

I also understand that what we are here today to discuss is an issue of great seriousness. It's an issue of economic concentration in the beef and pork industry. This is not a strange issue to federal government. At the turn of the last century, concern over our nation's largest meatpackers and their engaging in anti-competitive practices led President Theodore Roosevelt to enact the Sherman Antitrust Act, to sign that into law, along with the Clayton Act, and in part to the creation of the Federal Trade Commission. So this issue was well recognized over a hundred years ago.

In the 1920s, when it was found that the beef industry needed even more specific protection, Congress passed the Packer and Stockyards Act. At the same time, the U.S. Supreme Court recognized the meat industry's vital importance to our nation's overall economy and affirmed Congress's ability to regulate under the United States Constitution commerce clause.

More recently, due to concerns over the expansion of the nation's largest meatpackers, the Justice Department under the Clinton administration created a special council to assist in the oversight of merger and acquisition activities related to the industry.

Today we hope to examine whether ownership of livestock by the nation's larger meatpackers is harming the industry, its members, and consumers, and if so, what we can do about it.

Because of wide scale consolidation and vertical integration over the past 20 years, the major meatpackers are in a convenient and tempting position to exert their economic power in order to manipulate the prices paid to farmers. Recent data suggests that the major packers account for approximately 80 percent of all U.S. beef slaughtered today; whereas the same packers accounted for only 35 percent of U.S. beef slaughtered 20 years ago.

Consumers, as well as producers, have responsibility in preventing, if not stopping, this trend. Rarely a day goes by when we don't read about how market manipulation and unfair practices have damaged consumers and market participants in our overall economy in other corporations. Take the cases of Enron, WorldCom as examples. The negative impact that market manipulation can have is just as true for our livestock industry and meat markets as it is for energy and the stock market.

It's important to look how we can help the independent producer gain more access to the market. The bottom line is that our independent producers are being denied the value of their livestock because they don't have market access. We are a free market economy, but you cannot have a market where farmers are locked out of the marketplace and there is little competition and call it a free market. The purpose of this hearing is to ask some hard questions about those issues. At this point, let me turn to Senator Tim Johnson.

STATEMENT OF HON. TIM JOHNSON, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator JOHNSON. Senator Durbin, welcome to South Dakota. Thank you for chairing today's Judiciary Hearing on livestock market and antitrust problems as well as my bill to ban packer ownership of livestock. Senator Dayton, welcome, and thanks for your participation as well. And we welcome Congressman Thune as well who will testify shortly.

It's an honor to introduce two South Dakotans, Tom Connelley of Belle Fourche and Bob Mack of Watertown, who will testify later based on their experience as market participants. Mr. Connelley is a rancher and cattle feeder. During the 1970s, purchased cattle for meatpackers. His testimony will reveal the changes that have occurred to the market which make it difficult for independent producers to compete for a price. Tom's wife Dorothy is here as well.

Mr. Mack is a five-generation farmer, livestock producer and feeder. He has been active in supporting legislation to restore competition to the livestock market and make improvements to mandatory price reporting.

Thirteen other South Dakota agricultural groups have provided me with testimony in advance of this hearing, and I ask unanimous consent to add their testimony to the record.

Senator DURBIN. Without objection.

Senator JOHNSON. Today we are here to discuss livestock market problems and revenues. One solution, one part of the solution, is my legislation which forbids packer ownership of livestock. Three years ago I first introduced bipartisan packer ban legislation. Senator Grassley, my Republican colleague of Iowa, and I reintroduced this legislation in 2001. We were able to pass the packer ban provision during consideration of the Senate farm bill. Unfortunately it was killed by the House conferees while the farm bill was pending in conference committee earlier this year.

During debate of the farm bill, Senator Grassley and I were disappointed that packers challenged the truth by claiming our legislation would prohibit all forward contracting which gave lawmakers without the courage to support our amendment a convenient excuse to avoid taking a stand on the issue. Forward contracts have never been prohibited by this legislation, not three years ago, and not now. But the packers persisted in trying to dilute the Johnson amendment into a study of packer ownership.

Therefore, I worked with Chairman Harkin and Senator Grassley to offer language in February to clarify without question that forward contracts were permitted under our packer ban farm bill amendment. We developed additional language which clarified the intent of the word "control" in our amendment. The Grassley–Harkin–Johnson change made it clear that the word "control" did not apply to forward contracts, but rather to arrangements where the packer exercises control of livestock production, not the mere contractual right to receive future deliveries of livestock from a producer.

After we offered our clarifying language, on a vote of 53 to 46 our packer ban ownership—packer ownership ban remained in the Senate farm bill. Once in conference, Chairman Harkin and I developed a number of compromise alternatives to the packer ban for the House to consider. First, we discussed allowing packers up to four years to divest of their livestock rather than 18 months. The House rejected that offer.

Second, we discussed a creative approach to require packers to procure a certain percentage of their daily slaughter needs from the cash market. This was Chairman Harkin's idea at the time. This compromise offer was also rejected by the House.

Several months later some in Congress have now introduced bills requiring 25 percent of packers' daily purchases come from the cash market by 2008. I welcome the opportunity to discuss this issue again, but fear that if the House wouldn't accept a similar concept during the farm bill conference committee, there is no reason to believe that they would accept it now. Furthermore, a concern that the bills just now introduced on this topic were drafted in a rush and overlooked critical marketplace data.

According to USDA mandatory price reporting information just last week, packers purchased 40 percent of their slaughter needs from the cash market, and 60 percent were captive supply or packer owned cattle. So it strikes me as ironic that someone suggested making packers enter the spot market in just 25 percent of their slaughter needs. That may do significant harm to independent producers because it would allow packers to control up to 75 percent of the slaughter from captive supplies and captive ownership.

Finally, Senator Harkin and I even suggested grandfathering existing packer ownership levels and making our legislation prospective rather than retroactive. Like all the rest, this compromise was rejected by the House.

Today, 20 feedlots feed 50 percent of the cattle. And they are directly connected to the largest four beef processors who control 81 percent of the slaughter market. During this time, agribusiness profits have inflated. In fact, Cargill increased profits by 67 percent last year, Smithfield, the largest pork producer in the world, increased profits by 28 percent.

Let's put it in context with the economic state of the U.S. cattle and beef market. One, retail beef prices—retail beef prices are at all time highs, so retailers are making money. Two, demand for beef remains very strong. Consumers want to eat beef. Three, U.S. cattle herd size has fallen to its lowest level in 40 years. Supply and demand economics suggests that that ought to be good news for cattle prices. Four, however, live cattle prices are abnormally low with producers losing as much as 250 dollars a head when they sell cattle. If this trend continues, Mr. Chairman how many cow/calf ranchers and cattle feeders will remain in business as independent entrepreneurs?

I'm also discouraged by the common threads between corporate dishonesty on Wall Street and meatpacker influence over livestock markets. On Wall Street, earnings are a key indicator of success. Manipulative accounting strategies have been employed to cook the books, leaving shareholders and company employees feeling the economic pain.

In livestock markets, cash prices are key indicators of success. Yet, when packers manipulate the marketplace, producers lose out due to less competition and lower prices.

When investors lose confidence in Wall Street, it can result in panic selling of stocks. When producers lose confidence in livestock markets, they may engage in panic selling as well.

This issue goes to the heart of what agriculture will look like in the future. Will it be controlled by a handful of powerful firms where farmers and ranchers are low-wage employees bearing all the risk but none of the gains in the market, or will it be a future of independent family farmers and ranchers contributing to rural communities that are diverse and economically strong?

It's my hope, in addition to better enforcement of laws by USDA, the Department of Justice and Federal Trade Commission, Congress take the following steps:

First, enact my legislature forbidding packers from owning livestock prior to slaughter. This time the House must act on this bill rather than avoid the issue all together.

Second, enact legislation sponsored by Senators Harkin, Lugar and I, bipartisan legislation, which would permanently create a position within the Department of Justice to handle agriculture antitrust issues.

And finally, I especially urge the committee to ensure action on legislation. S20 sponsored by Senator Daschle and myself requires USDA to review proposed mergers, calls on the Attorney General to create a special council for agriculture, increases penalties for antitrust violations, and creates a farmer and rancher claims commission so fines levied for unfair practices would be redirected back to the producers.

Thank you, Mr., Chairman for conducting this hearing today.

Senator DURBIN. Thanks, Senator Johnson. Senator Dayton.

STATEMENT OF HON. MARK DAYTON, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator DAYTON. Thank you, Senator Durbin. Very pleased to be here. I'm a member of the Senate Agriculture Committee which I joined when I took office a year and a half ago because in Minnesota, as in South Dakota, as in Illinois, agriculture is so vital to our state's economy. And we share—and I know there are a number of Minnesotans who are part of this audience today, being just a stone's throw away from South Dakota—more with this state than just a common border. We share that recognition that agriculture is the life blood of our economy, that every business on main street Minnesota, as in South Dakota, depends on a healthy agricultural economy.

And all I can say, Mr. Chairman, is Senator Johnson is a hero to Minnesota producers and farmers, as he is in South Dakota, because of the amendments that he has put forward and because of the efforts he has made in the face—I think heroically in the face of the kind of assaults and misrepresentations and distortions which occurred by the—the very powerful financial interests that opposed his amendments to do what we have to do if we are going to survive in rural Minnesota and elsewhere in this country, and that is put the price and the profit back into agriculture in the marketplace.

I come from a business family. I was Commissioner of Economic Development for Minnesota back in the 1970s and 80s, and I traveled all over the state. And I learned my agricultural economics from farmers, producers in this region of Minnesota. And you can't make a price—if you can't get a profit in the marketplace with what you are producing, you can't survive. And that's what we have lost, whether it's the grain commodities or in livestock.

And across southwestern Minnesota from Luverne to Pipestone, Worthington, Fairmont, Jackson, Albert Lea, where there used to be meatpacking operations, small size, medium size, a few larger ones, now it's almost entirely gone, and it's been taken over by the large processors, and the producers themselves have—have nowhere to turn. They are stuck. They are basically indentured to these firms that say it's our contract or you're out, and literally out of business. And we have seen the results of more and more producers have been squeezed out of the business.

So, Senator Johnson, what you have done has been just to say not only heroic, but it's exactly what we must do in America to restore profitability in agriculture, to give people—restore competition, give people a chance to negotiate for prices, to keep farming in the hands of farmers and producers as independent economic entities, not as assembly men or women in a chain of corporate production and control and profiting from our nation's food supply.

Mr. Chairman, I would like to also just request unanimous consent to introduce the testimony of my senator colleague from Minnesota, Senator Paul Wellstone, who has also worked with Senator Johnson on these issue, strongly supportive. And, unfortunately, he had commitments in Minnesota which prevented him from being here today.

Senator DURBIN. It's without objection. It's my understanding Senator Harkin would like to have a statement entered in the record which will done without objection.

Also, for the record, the committee extended invitations to Smithfield, IBP, Tyson. However they declined the invitation to join us today. I will include the committee's letter to them as part of the record.

We will have three panels. The first panel will be Congressman Thune, who I welcome to the stand. The second panel will be Doug Ross, Special Counsel on Agriculture from the Department of Justice. The third panel will be Profession Peter Carstensen from the University of Wisconsin at Madison, as well as two cattle producers from the State of South Dakota, two independent pork producers from Iowa and Minnesota, and finally on that panel a representative of the American Meat Institute who will speak on behalf of the meat industry and their perspective.

Congressman Thune, thank you for joining us today. We welcome your testimony. Please proceed.

STATEMENT OF HON. JOHN R. THUNE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

Representative THUNE. Thank you, Mr. Chairman, and I want to welcome you and your committee to South Dakota. I appreciate the opportunity to testify today on the lack of competitive and open agricultural markets. As South Dakota's lone member of the House of Representatives, I want to welcome you. I know the farmers and ranchers of this state appreciate your willingness to come to South Dakota and hear from them.

We have a series of challenges facing South Dakota farmers and ranchers right now. Some are immediate, some are long-term. One of the more immediate ones is a drought which I look forward to working with my colleagues in the House, as well as with you in the Senate, to addressing when Congress returns in September. It's something that is creating enormous economic impact and hardship for people, particularly in western South Dakota, but all across our state. And so I hope that we are able to address that with legislation that will provide direct assistance to our farmers and ranchers.

A couple of other issues. I had the opportunity just recently to host a meeting in Rapid City on the issue of some of the environmental regulations. Prairie dogs have been proposed as a threatened species. That is something that has created also hardship for ranchers in the western part of our state. And in response to that, I have introduced some legislation that would reform the Endangered Species Act to require that sound science be used before that sort of thing can take place and, secondly, that landowners be given an opportunity to comment, that there will be local input before a decision like that is made.

I think that is critical as well in terms of putting in place a framework that will allow independent, small family farmers and ranchers to survive in an increasingly competitive environment. But here today, I want to tell you that, as I have listened to South Dakota producers, they tell me that they want closer scrutiny of large agribusiness mergers. And I understand why.

Farming, food processing and retailing industries are moving toward fewer and larger operations. Vertical integration, such as ownership or tight control of more than one phase of production and marketing by a single firm, is more common. Agribusinesses such as seed, chemical, transportation and biotechnology companies are also consolidating.

The agricultural marketplace has changed rapidly in recent years. As members of Congress, it's our job to protect those who provide food for our country and the world. As I travel South Dakota talking to producers, I hear the concerns about the choke-hold that big business has on family farmers. In conversations with lawmakers, I've proposed that Congress thoroughly examine existing antitrust statues, and consider how those statutes are being applied and whether agencies and courts are following the laws according to congressional intent.

There are laws on the books that prohibit monopolistic or anticompetitive practices. The very purpose of our anti-competitive statutes, namely the Sherman Act and Clayton Act, is to protect our supplies from anti-competitive practices that result from market dominance. Unfortunately, these laws are failing our family farmers and are not preventing such activities from occurring. Congress needs to do more to stop anti-competitive practices.

South Dakota farmers and ranchers have been a catalyst for legislative proposals to defend agricultural producers in this changing marketplace. I have worked with them to develop a four-point plan to foster more competition for South Dakota farmers and ranchers through country of origin labeling, banning packer ownership of livestock, modifying our antitrust laws, increasing spot market purchases.

As you know, the 2002 farm bill included country of origin meat labeling legislation. This is enormously important to independent small farmers and ranchers in South Dakota and something that throughout my tenure in Congress I have worked toward. And I am happy that the Congress this year adopted that as part of the farm bill. I think it's important that we get it implemented in the quickest and most efficient way possible because we want to make sure that our farmers and ranchers, who raise the highest quality products in the world, that is recognized with the "Made in the USA" label.

The second legislative solution to fostering competition for producers is banning packer ownership. I submitted for the record some testimony including tables. When you compare Tables 1 and 2 at the end of my testimony, you will see that the largest producers of pork in this country are also the largest packers. In my opinion, the independent farmers and ranchers should be the producers of pork, beef and lamb.

If we ban packer ownership of livestock, while continuing to allow forward contracting and other risk management tools, we empower our farmers and ranchers in the marketplace. This debate was ongoing through the course of the last several months. I introduced legislation with Congress Jim Nussle from Iowa that specifically exempted contracts from this ban, and in hopes that we would enable our farmers and ranchers to have as many competitive options available to them as possible.

The Agricultural Competition Enhancement Act is my third proposal, and the most relevant to your committee. And I appreciate very much, Mr. Chairman, the fact that you are here today. This has also been referred to your counterparts in the House Judiciary Committee.

The Agricultural Competition Enhancement Act, what I call the ACE Act, would prevent large agribusiness entities from merging with each other if it would reduce competition in the agricultural marketplace. Additionally, the ACE Act would require the Department of Agriculture, the department that knows agriculture, to review proposed mergers to determine the merger's effects on prices, and whether that merger would result in significantly increased market power.

The USDA would also be assigned the task of determining whether the merger would increase the potential for anti-competitive actions or predatory pricing. Producers would be allowed to comment on the merger, and USDA would incorporate those comments in a report detailing its findings. The Department of Justice, the agency ultimately responsible for enforcing the antitrust laws, would then consider the report in its review of the merger.

The legislation would also require the Department of Justice have an Office of Special Counsel for Agriculture which would be responsible for handling agriculture antitrust issues. Our farmers and ranchers need someone at the Department of Justice looking out for them.

When you look at Table in my testimony, you see the five top producers have almost 65 percent of the market share. This surely cannot be a competitive atmosphere for independent producers. It's clear we need to make changes to our antitrust laws to protect our farmers and ranchers and rural economies and preserve the rural way of life we all hold so dear.

I would add, at a fundamental level, all the things we are talking about doing are good, but I really believe that the antitrust laws, that we need to strengthen and come up with a new framework. It's, in my opinion, very antiquated and these laws that were drafted a hundred years ago don't apply to the modern marketplace.

Finally, right before the August recess, I introduced, along with Congressmen Lantham and Ganske of Iowa, a new and innovative approach to fostering competition for independent farmers and ranchers. This idea originated with South Dakota producers as well as with your colleague, Senator Grassley from Iowa.

The Livestock Packer and Producer Fairness Act would guarantee that independent producers have a share in the marketplace while assisting the Mandatory Reporting Price system. The proposal would require percent of a packer's daily kill come from the spot market. As a result, the market would have consistent, reliable information, improving the accuracy and transparency of daily prices. In addition, independent livestock producers would be guaranteed a competitive position due to the packers need to fill the daily percent spot market requirement.

The legislation is designed to complement banning packer ownership of livestock and price reporting. The intent of this proposal is to improve price transparency and hopefully the accuracy of the daily Mandatory Price Reporting data.

Together these four proposals provide a comprehensive approach to protecting agricultural competition for South Dakota farmers and ranchers. The purpose of our current antitrust laws is to guard competition for the benefit only of consumers. Our antitrust laws are not intended to keep our agricultural producers in the market. We need to take these steps to ensure a marketplace for our independent producers.

In closing, Mr. Chairman, I want to thank you again for bringing this hearing to South Dakota. My constituents and I share a concern for the future of the agricultural marketplace and our rural economy. I appreciate the opportunity to discuss my plan, some of the other issues that are out there, and fight an epidemic of growing concentration in agriculture.

[The prepared statement of Representative Thune appears as a submission for the record.]

Senator DURBIN. Thank you, Congressman. Your full statement will be made part of the record. I would like to ask you just a couple of questions, if I might.You have talked about several pieces of legislation which you have introduced with other colleagues and some Senate counterparts. Can you tell us the status of any of these bills? Have they been brought to hearing in committee or are they pending on the calendar on the floor? Do you anticipate a vote on, for instance, any of the bills relating to packer ownership in the House of Representatives this year?

Representative THUNE. My guess is that we are going to have hearings. The House Agriculture Committee has agreed. Iin fact, there is a survey that has been sent around to the leaders of producer organizations asking for recommendations on the whole issue of concentration. The House Agriculture Committee will take this issue up. That is something that came out of discussion in the farm bill here recently. So we will be addressing packer ownership, we will be addressing the spot market legislation, ACE legislation. I think I have testified once on this in the 106th Congress. There has not been a hearing in the 107th Congress.

But, frankly, again, I believe on a fundamental level that this is where we need to start in terms of improving the outlook for farmers and ranchers. Antitrust laws, in my opinion, are statutes that are a hundred years old, need to be updated and modernized, and I don't think are reflective of the current agricultural marketplace.

Senator DURBIN. If I could ask a follow-up question on that. Both Senator Johnson and I previously served in the House on the House Agricultural Committee, and so I am familiar a little bit with the dynamics of that committee.

I really find this unusual in two instances here. When Senator Johnson put the amendment on the farm bill for labeling for meat, that survived in the conference committee. We were happy it did. And then when he also added the amendment on packer ownership, which he had 53 votes, that went into this conference committee on the farm bill, and did not survive. And he talked about some of his efforts there to try to hang onto it and to work out a compromise.

What is the problem in the House of Representatives? Why are we running into such resistance to a measure that Senator Johnson passed with bipartisan support in the Senate? What is it about this packer ownership issue that makes it so difficult for congressmen from ag states to carry the day in the House on the farm bill?

Representative THUNE. Well, I think that, Mr. Chairman, having been experienced in the House and on the committee as well, it is a challenging job indeed to try and put together the votes not only in the House itself, but on the House Agriculture Committee as the members of the House Conference Committee and Senate Conference Committee meet. There was not support on either side of the political aisle among House members for a ban on packer ownership.

Senator DURBIN. Is that right? For instance, on your bill, do you have—you mentioned your own bill on packer ownership or any other bills on the subject. Do you have a strong bipartisan sponsorship in the House for the Johnson position or anything like it? Have you seen—seen that so far?

Representative THUNE. I drafted legislation along with Congress Jim Nussle from Iowa. We took the Johnson/Grassley language and ran it by a number of the producer organizations, individual farmers and ranchers, got their input as to how we might improve upon it. And one of the concerns that was raised is whether or not in fact the question of contracts was being adequately addressed in the Senate language. And so we drafted legislation that would address that, specifically exempting contracts. And then subsequent to that, brought it before a number of the members of the committee, the conference committee, as well as some of our other colleagues.

Senator DURBIN. Do you have a majority of the members of the Agriculture Committee supporting your bill or any bill on packer ownership?

Representative THUNE. There isn't at this point, I don't believe, a majority of members of the Agriculture Committee who have endorsed any specific position. I do, however, believe that as a result of the hearings that we intend to hold in front of the House Agriculture Committee coming up this fall, that we will settle on a course of action. And I think it's very encouraging to see that we are actually going to address this issue. This is the first time in my experience in the Congress, in my three terms, that we have had an opportunity to examine in comprehensive detail the issue of concentration in the agricultural marketplace.

I know there have been hearings prior to my arrival here on the House Agricultural Committee, I think during your days. And my understanding is at that time there was not a consensus as well on which direction to move. The Livestock Subcommittee I think held hearings back in the early 1990s on the subject.

But my hope is as we draw awareness to this issue, that we will be able to put together consensus in the House. And I view it as my responsibility, as well as others who represent states in this region who care about the subject, to continue to push the cause. And I believe that is what has led to the hearings that are going to be held this fall.

Senator DURBIN. Thank you. We will continue—the Senate will continue to pass the Johnson measure and others like it, and I hope we can persuade some of our colleagues in the House to join us in this effort.

Senator Johnson.

Senator JOHNSON. I welcome Congressman Thune here and appreciate his comments. They will be part of the committee record. And I have no questions at this point.

Senator DURBIN. Senator Dayton.

Senator DAYTON. No questions.

Senator DURBIN. Thank you for joining us.

Representative THUNE. Thank you, Mr. Chairman.

Senator DURBIN. Testifying at this point is Doug Ross who is the Special Counsel on Agriculture for the U.S. Department of Justice. Mr. Ross, thank you for joining us today. Your full statement will be made part of the record. If you would like to summarize it for us at this point, and then we will ask a few questions.

STATEMENT OF DOUGLAS ROSS, SPECIAL COUNSEL ON AGRICULTURE, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE, WASHINGTON, D.C.

Mr. ROSS. Good afternoon, Mr. Chairman and members of the committee. I appreciate the opportunity to discuss the role of antitrust enforcement in the agricultural marketplace, and in particular in the livestock slaughter marketplace.

Antitrust enforcement benefits consumers, producers and the economy by promoting better quality, increased innovation, lower prices and healthy business incentives. I would like to highlight a few points from my written statement. I understand it will be included in the record. Thank you, Mr. Chairman, for that.

We take very seriously the concern you and others have spoken of, and we have been active in recent years in this sector, bringing a number of enforcement actions. In addition, we have met with numerous producers in Washington and traveled to a number of places around the country as part of an ongoing outreach effort. We are very much aware of the trends toward increasing concentration in some agricultural markets, including the steer, heifer, lamb and hog slaughter markets. We are monitoring these markets carefully. High concentration in the market is not in and of itself a violation of the antitrust laws, but it increases the potential for antitrust scrutiny.

There are three basic antitrust violations. First, collusion or conspiracy to suppress competition; second, the use of predatory or exclusionary conduct to acquire or hold on to a monopoly; third, mergers that are likely to substantially lessen competition.

The first one, collusion, violates Section 1 of the Sherman Act. Separate firms agree to cheat the competitive market process by joining forces against their consumers or suppliers to manipulate prices and deny choices such as by fixing prices, allocating markets, and boycotting particular customers, suppliers or competitors.

Proving collusion requires evidence of an agreement among competitors. It is not enough to show merely that two meatpackers bid a similar price or that some packers go to some auction barns or feedlots and other packers go elsewhere.

In recent years, we have brought criminal prosecutions against Archer Daniels Midland and others for fixing the price of the feed additive lysine, against F. Hoffmann-La Roche and others for fixing the price of vitamins used as animal feed additives, and under Assistant Attorney General James' leadership, against Akzo Nobel and others for fixing the price of herbicide ingredients known as MCAA. Participaing firms have paid stiff fines, including the largest fines in antitrust history. Participating executives have been sentenced to serve time in prison as well as pay fines.

On a smaller scale, a few years ago we successfully prosecuted two cattle buyers in Nebraska for bid rigging after an investigation conducted with help from the USDA, which was investigating some of the same conduct under the Packers and Stockyards Act. This case differed from others that I have mentioned in that agricultural producers were victimized as sellers rather than as consumers. The structure of the agricultural marketplace presents more possibilities for this to occur, and we keep a lookout for it and will prosecute when the facts warrant.

The second type of antitrust violation, monopolization or attempt to monopolize in violation of Section of the Sherman Act, might involve, for example, a packer with a monopoly attempting to drive rival packers out of business by illegally interfering with their ability to engage in the business. I should emphasize, however, how rarely we see a true case of monopolization. First, the firm's market share has to be extremely high. Even the lower threshold for attempt to monopolize is upwards of 60 to 70 percent, combined with a dangerous probability of going much higher. That is a single firm's share, not the four-firm combined share often discussed in agriculture.

And merely having a monopoly is not an antitrust violation. There must also be illegal conduct to exclude competition, not just to disadvantage rivals. It is quite rare that we encounter monopolization, and I don't have any recent cases to cite you on agriculture. But if we ever did find it in agriculture, we would certainly take appropriate enforcement action as warranted by the facts.

The third type of antitrust violation, a merger in violation of Sectionof the Clayton Act, has a different kind of legal standard. We are focusing not on whether the merging parties have engaged in wrongful conduct, but whether the merger would change the market structure to such a degree that competition would likely be harmed. If so, we sue to stop the merger or we insist that it be modified to remove the cause for concern. We analyze mergers pursuant to the Horizontal Merger Guidelines developed jointly by the Department of Justice and Federal Trade Commission to determine whether the merger is likely to create or increase market power or to facilitate the exercise of market power in the market. Market power is the ability of sellers to profitably maintain prices above competitive levels or the ability of buyers to depress prices below competitive levels and thereby depress output.

After we determine the scope of affected markets, a complicated but necessary step explained more fully in my written statement, we then determine the various firms' market shares and predict how those markets would be affected. We look at the markets from both the buyer's and the seller's perspective.

There is no magic threshold of market concentration above which the merger violates Section 7, but concentration is our starting point because as a market becomes highly concentrated, not only are price fixing and other collusion easier to coordinate, there is also a dampening effect on competitive rivalry even in the absence of collusion.

In the recent past, the Antitrust Division has carefully reviewed a number of mergers in the agricultural sector, including mergers among meatpackers. In 1994, we stopped one meatpacker merger before it was even formally proposed. We heard that Cargill's Excel Division was looking into acquiring Beef America. Both packers were then in the top five. We opened an investigation, aggressively questioned Excel and others, and made clear our concern that it would harm competition. According to a Cargill executive, this convinced them to abandon the merger.

Other recent agricultural merger challenges include Monsanto/DeKalb, Cargill/Continental, Case/New Holland, Monsanto/Delta & Pine Land, and just last December, Suiza/Dean Foods.

In Cargill/Continental we required divestiture of grain and soybean facilities in several locations around the country to preserve competitive market outlets for farmers in a number of states, including South Dakota, Minnesota, and Illinois. In Suiza/Dean, we required modification of a supply contract to ensure that affected dairy processors would have the competitive option to obtain their milk from independent producers.

We have a long-standing cooperative relationship with USDA. USDA has shared its wealth of information about agricultural markets and has also provided insights and leads such as the lead resulting in the Nebraska cattle buyer prosecution I mentioned. This working relationship is reflected in an August 1999 memorandum of understanding, which was augmented last year when Assistant Attorney General James designated a special point of contact with the USDA for criminal matters.

Let me close with a few caveats about antitrust enforcement. The responsibility entrusted to us as enforcers of the antitrust laws is not to design the best possible market structure for the marketplace. The antitrust laws are based on the notion that competitive market forces should play the primary role in determining the structure and functioning of our economy. Our job is to stop specific kinds of private sector conduct from interfering with those market forces.

We are law enforcers, not regulators. We don't have the power to restructure any industry, any market, or any company, or to stop any practice except in a precise and focused fashion to prevent or remedy specific violations of the antitrust laws that we can prove in court. The Court ultimately determines whether there is a violation and whether the proposed remedy fits the violation.

While the antitrust laws play an important role in helping keeping markets competitive, they are not going to address all the complex issues affecting American agriculture in this time of change.

Mr. Chairman, we urge anyone who believes they have information that could be relevant to our enforcement activities to contact us. As a law enforcement agency, we treat conversations with us in confidence. And if the information leads us to conclude the antitrust laws have been violated, we will take appropriate enforcement action. We remain committed to protecting competition in this important sector.

Mr. Chairman, I would be happy to try to answer any questions.

[The prepared statement of Mr. Ross appears as a submission for the record.]

Senator DURBIN. Thanks, Mr. Ross. Thanks again for being here today. Let me ask you, how long have you been with the Department of Justice?

Mr. ROSS. Senator, I have been with the Antitrust Division in two phases—I was there from 1975 to 1982, and this time from January of 2000 to the present in the current position as Special Counsel.

Senator DURBIN. And could you give me an idea, in the—your particular responsibility, agriculture, the antitrust division, how many professional attorneys, investigators are involved in that work in the Department of Justice?

Mr. ROSS. In antitrust enforcement generally in the whole division—

Senator DURBIN. Agriculture.

Mr. ROSS.—or agriculture? Senator, that is a difficult question. It could be answered in the sense of taking a photograph at any particular instant that this many are working on agriculture, but it's important to understand that like with other sectors of the economy, the Antitrust Division will put the necessary resources behind agriculture-related investigations as they come up.

And, for example, the Cargill/Continental merger was pending at the same time as the Case/New Holland merger, so a section within the Antitrust Division, which has the name agriculture in it—Transportation, Energy and Agriculture—handled one matter and a different section altogether handled Case/New Holland. So it depends on the time.

Senator DURBIN. I understand that the question may not be as pointed as I wanted it to be, but what I'm trying to do is focus on and determine whether the Department of Justice has the resources in terms of appropriations and staffing to deal with an issue of this magnitude. We know the industry that we are overseeing is huge with great resources and great legal talent. The question I'm asking is on the side of the producers, livestock producers and consumers, how big is our team? Can we with deal with this challenge and the complexity of the economic issues that are involved?

Mr. ROSS. Senator, I welcome your question. I would not want the record to reflect when I get home to Washington that I rejected additional appropriations for the Antitrust Division.

Senator DURBIN. You would be the first.

Mr. ROSS. However, we are comfortable that the budget proposed by the administration is sufficient to address the problems in this area of the economy as well as other sectors.

Senator DURBIN. I'm going to ask a more specific question and give you an opportunity when you get back home to answer it with more detail. But in addition to resources, do you feel that you have the authority in the Department of Justice to go after what is clearly a very complicated situation in this whole livestock processing industry?

Mr. ROSS. Senator, we do. We think the antitrust laws, although enacted as early as 1890 and added to in 1914 with the Clayton Act, have accomplished the goals that they set out to in protecting a competitive marketplace. And the administration is not seeking any amendments at this time.

Senator DURBIN. Then let me take you to the next question, and this will not relate to your service in the Department of Justice, but just your observations that may be similar to my own.

In 30 or 40 years, we have seen a dramatic change when it comes to meat and livestock processing in America. I've seen it where I grew up in the midwest. I'm sure my colleagues have as well. But there are clearly now fewer companies that are involved in processing slaughter. We also know for a fact that there are fewer livestock producers. The numbers are coming down rather substantially; the numbers of larger producers growing.

In my own state, hog production is larger than beef and cattle. Twenty years ago we had 20,000 hog producers in Illinois; ten years ago, 6,000; today, 1800. And the size of these operations is just growing, what is left, expedientially. So we can see what is happening to the input side of this. We are losing more and more individual farmers and ranchers who were feeding the livestock processing industry.

And we have also seen the processing facilities decline dramatically. The numbers that used to be just around the St. Louis area were a dozen or more major ones. And now people travel great distances with their livestock in order to have them processed.

What I'm trying to get to is this. As we watch this trend, you said at one point it is not the Department of Justice's role to define the optimum, perfect economy and what it should look like, but to respond to changes as it goes along. What is it the Department of Justice is looking at now, if you believe that this trend is not good for us, that would stop it from progressing even further?

Mr. ROSS. Senator, as I said, the Division is hearing the same kind of concerns you hear from your constituents. In fact, I have met with a number of the people in the audience in Washington, and heard many of these concerns. We are keenly aware of how highly concentrated certain aspects of the agricultural marketplace are, and as a result, we will be watching extremely closely should there be any effort to change that.

Senator DURBIN. I guess specifically, will it take a merger? Is that when the Department of Justice will step in and say, now, that's where we play a role, as you mentioned here, with the Cargill/Excel/Beef America? Will it take that or are you reviewing the current situation and the current ownership to see if there are any antitrust violations?

Mr. ROSS. Well, Senator, as I note in my testimony, there are three kinds of antitrust violations. We could look at any one of those three. Mergers and acquisitions is certainly one of the most straightforward ways where we would certainly take a very close look were such a merger to be proposed. And as evidenced by the last horizontal merger among the top five, we acted very aggressively and stopped it in its tracks.

The other areas, monopolization, which is single firm conduct as well as high market share, and the third area would be the Section 1 of the Sherman Act or collusive behavior. We are constantly looking for violations of the antitrust laws. And we have an open door. I'm happy to share with anybody—I brought plenty of cards—my phone number. The door is open. One of the reasons I've been appointed and the functions I perform is to be a public face and be available for people who want to bring to our attention considerations that might lead to uncovering a violation of the antitrust laws. And we welcome that.

Senator DURBIN. Thank you. My time has expired. Senator JOHNSON.

Senator JOHNSON. Mr. Ross, welcome to South Dakota. Thank you for your participation in this hearing. Does Department of Justice policy agree that monopsony or buyer power is a legitimate antitrust concern? If it is, how has the DOJ addressed this issue specifically in the meatpacking industry?

Mr. ROSS. Senator, thank you for welcoming me to South Dakota. I'm pleased to be here, and I welcome your question.

As you know, monopsony is an important concern for the antitrust laws, and is specifically mentioned in our horizontal guidelines as being of equal weight and concern to us when we investigate the anti-competitive potential effects of a merger or acquisition. We also look at it in other contexts. I don't have a specific meatpacking matter on which I can make reference for you, but suffice it to say that Assistant Attorney General James is committed to the importance of applying monopsony concerns in his antitrust enforcement efforts. And we will continue to do so.

The Cargill/Continental matter is the latest example where we did actually apply that to protect the producers of grains from the anti-competitive impacts of the buyer power that would have been created through that merger if it had not been changed as we required.

Senator JOHNSON. Well, if there was one buyer in a region, and that region then suffered lower prices in relation to other regions, would you recommend action be brought? Is that cause enough for Department of Justice action if that were to occur?

Mr. ROSS. Senator, you can appreciate that I would not want to speculate on what set of facts might be sufficient to open an investigation or to proceed. However, what I would say is if any of your constituents have that kind of information available, they should bring it to our attention and we will pursue it and evaluate it in terms of what anti-competitive violations there may be behind it.

Senator JOHNSON. If a packer was a long-time buyer from a particular livestock producer, but the packer stopped buying at the feedlot because the producer chose to sell to another packer for a few weeks, does this amount to a boycott that would cause you to recommend any antitrust action?

Mr. ROSS. Again, Senator, that sounds like a hypothetical situation that we would be happy to hear from anyone who knew about it. But, again, a boycott in particular would probably require an agreement, more than one actor, to be involved. And so that's the kind of evidence, along with what I set forth in my written statement, that we would be looking for. But, again, I would welcome hearing from any producers who have information such as you suggest in your hypothetical.

Senator JOHNSON. We know that the farm-to-wholesale spreads in beef have increased by 50 percent in the last eight years in inflation adjusted terms. These data have screened out value added products, focusing on the same cuts. Have you performed any investigation as to whether any or all of this increase in spread is due to market power? And if not, why wouldn't DOJ be investigating that issue?

Mr. ROSS. Again, Senator, we would investigate in order to develop sufficient evidence to take to court to establish one of the three kinds of violations that I mentioned in my testimony. The kind of concern that you mentioned is, again, one that we have heard about frequently from individual producers, and it would be relevant in many of the kinds of investigations that we conduct. And we would take it into account as one of many factors that would be evaluated in terms of the ultimate question we have in antitrust enforcement, what is the anti-competitive effect of the behavior or the merger before us.

Senator JOHNSON. When you talk about mergers, not by themselves, being violative of anything unless it causes a harm to the competitive environment, are you talking about harm to the consumers or harm to the producers or both?

Mr. ROSS. Both, Senator, as the Cargill/Continental case most recently illustrates, where we were concerned specifically about the impact on producers. Ultimately, of course, the concern under the antitrust laws is for consumer welfare, but having effective antitrust enforcement means that both producers and consumers will benefit.

Senator JOHNSON. Just in my small amount of time remaining, let me ask one—one last question, Mr. Ross. There have been reports indicating how packers can manipulate prices with captive supplies, including packer-owned livestock. There is a private suit, Pickett versus IBP, that focuses on that issue. Have you performed any independent investigation as to the motive or opportunity for packers to manipulate prices with captive supply or have you performed any investigation as to whether captive supplies have actually resulted in depressed prices during specific time periods? I appreciate that this falls somewhat in the province of Packers and Stockyards, but it's my understanding that under Clayton and Sherman, the Department of Justice does have jurisdiction over—over these issues as well.

Mr. ROSS. Senator, you are correct. The case you refer to is brought under the Packers and Stockyards Act which is enforced in the first instance by the Department of Agriculture rather than the Department of Justice. And you are further correct that the kinds of concerns that you mention in your question are relevant to antitrust concerns. And we would certainly be interested in specific information that we could use as part of an investigation into the possibility that antitrust laws are being violated. But, again, we are talking about one of the three kinds of violations that I discuss in my written statement, and the evidence that we would need to take to court to prove that.

Senator JOHNSON. My time has expired, but thank you, Mr. ROSS.

Senator DURBIN. Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman. Thank you, Mr. Ross, for the chance to visit with you here today. I appreciate the instances you cited here, the intervention of your department and the effects you've had. In gauging the scope, it's a little hard, though, without knowing how much—what the total number of possible interventions were to gauge the extent of your activities. Sort of like baseball; if you say you got hits at bats, that is 500. 12 hits at 100 bats, that is not so good.

That is the part—I guess I would be interested to know how many of these cases did you decide not to get involved in, but particularly what, you know, the criteria are for one or the other. But I guess my question here, given the limits of time, is in terms of the industry, agricultural meatpacking process, agricultural commodities, processing like in the mergers, as you say, the Continentals, the Cargills, some very good companies in their own right, is that merger activity over the last ten years or so, in your experience, comparable to other sectors of our economy? Is it more active in that arena than elsewhere or less active?

Mr. ROSS. Senator, that is a good question, and I am not sure I have the facts to respond accurately to it. It's fair to say, I think, that we have gone through a very significant merger wave in the last few years, and agriculture has not been excepted from that.

Senator DAYTON. Maybe I will ask if you could go back and review your facts, your information, and give me a reply or give the committee a reply for the record, just in the future, just for the record—how it does measure with others, if you wouldn't mind.

Your testimony regarding the Cargill/Continental merger, I was interested in this section here where you said, it goes to this issue of monopsony, this relief is designed to ensure that—you required some divestitures of Cargill/ Continental. You said that relief you required was designed to ensure that farmers in the affected market would continue to have alternative buyers to whom to sell their grain and soybeans. In this case the focus of the competitive problem was the so-called monopsony concern, that is, that the merger would harm producers as sellers.

And Senator Johnson probed into this area, but it interests me as well what the criteria are to get to intervene for that reason. That if farmers in an affected market would not continue to have alternative buyers to whom to sell their grain, their soybeans, their livestock, does that constitute the basis then for antitrust action?

Mr. ROSS. Well, Senator, you are right to focus on that kind of analysis because that is exactly what we did in the Cargill/Continental matter and what we do in any other investigation. In that particular investigation, you may be interested, and others in the audience as well, because we went through what is called the Tunney Act proceeding, filing our proposed final judgment, and the public had an opportunity to comment. We were required to respond to those comments. There were a number of comments that asked us did you look at this, why didn't you look at that, and so forth.

And we laid out the scope of the investigation on what kinds of things we looked at, and specifics—we literally got maps out and drew circles around the grain elevators and the ports to figure out which farmers were going to be affected if this grain silo was no longer an option for other farmers. And so the concern was exactly who is going to be affected and in what markets, and that's—we determined that we needed relief in specific markets to protect farmers who would try to sell their grain, and they would have fewer options available. So that is the monopsony concern, and that's the kind of analysis we would do.

Senator DAYTON. If that has hypothetically occurred in some part of the country, such as South Dakota, such as Minnesota, if farmers in that area only have one source of—which they can sell their grain or their livestock, is that after the fact the basis to come in and look at that situation from the monopsony concern and take action accordingly?

Mr. ROSS. Well, again, Senator, we are not a regulator, so we can't just say, well, looks to us like South Dakota doesn't have enough opportunities for producers to sell right now, so let's do something about that. It would come instead in the context most likely of a particular merger or acquisition. And our ability to act in that context would be limited only to the impact on the markets of that particular merger or acquisition.

Senator DAYTON. So you can only do this at the time of a proposed merger, and in advance of the effect it's going to have, then evaluating what that effect would be. And if you think that it's going to be—have too much of an effect and this is a monopsony, you are going to stop it, you might intervene, but once it has—the merger has occurred if that same result occurs in terms of monopsony, it's too late. There is no recourse.

Mr. ROSS. Not necessarily, Senator. It would depend again on the facts. Technically speaking, as you are going to hear from another witness, there is no statute of limitations under the Clayton Act, so it's technically possible for us to reopen a matter that has been investigated before. However, I would point out that there are a number of practical considerations that would have to be taken into account before that kind of step could be taken.

Senator DAYTON. What was the trigger on the Cargill/ Continental situation there where you say the relief was designed to ensure that farmers in affected markets would continue to have alternative buyers to whom to sell their grain and soybeans? Where—where in—I'm not a lawyer, so forgive me. Where in, you know, law or regulations, whatever, is there the basis for going in and saying, you know, we are mandated to ensure that farmers in affected markets would continue to have alternative buyers, and if they do, we are going to allow this to go through, and if they don't, we are not. Where does that authority come from or that discrimination occur?

Mr. ROSS. If I understand your question correctly, Senator it's in the first instance, the hook, if you will, the catalyst that would get us involved in the first place, and in that instance it was the proposed merger between the two companies. We have under the statute the requirement to assess whether the effect of the merger would be to substantially lessen competition in any market or to tend to create a monopoly. As I mention in my written statement, the Justice Department and FTC have merger guidelines under which we analyze when we think that standard is satisfied to the Court's requirement.

Senator DAYTON. I'm sorry—we are running out of time. I'm sorry to interrupt. I will rephrase my question. I didn't phrase my question very well. If farmers only have one buyer of their products, is that a—I mean is that a monopsony such that you would act to prevent that?

Mr. ROSS. Well, Senator, that's the kind of concern that we are looking at when we do the kind of evaluation under the merger guidelines and elsewhere for the monopsony issue.

Senator DAYTON. If mergers have occurred in the past and the result has been after the merger is concluded at some point in time that that monopsony condition has occurred, your farmers and producers only have one buyer which to sell their product, then they should report that to you and you would look into that situation?

Mr. ROSS. Well, as I said, Senator, we would certainly want to hear from producers who have concerns that they think might establish a violation of the antitrust laws. And certainly, as you have correctly understood our testimony, monopsony is a concern that we—

Senator DAYTON. So only having one buyer—only having one available buyer is a violation of the antitrust laws?

Mr. ROSS. No, I wouldn't quite go that far, Senator. Again, antitrust enforcement is very fact-specific, and so it depends on the facts and on the particular circumstances that we have before us.

Senator DAYTON. It's a potential violation?

Mr. ROSS. It has the potential for raising concerns that we would certainly want to look at. Again, in terms of reopening a matter where several years later there is some concern about anti-competitive effects from that merger, I would just say that there are a number of practical concerns that would make it more challenging to prove to a court that the merger should be reopened and a change should occur. The passage of time makes it very difficult to draw cause and effect relationships. The Congress enacted the Hart- Scott–Rodino Act in order to avoid just this kind of problem. The difficulty of unscrambling the eggs is substantial, so for those reasons, I just suggest it's practically challenging.

Senator DAYTON. Thank you, Mr. Ross. My time has expired. That you, Mr. Chairman. I would add, Mr. Chairman, I think this is very fertile ground for some further inquiry and legislation because if the intent of antitrust is to prevent what is occurring here, which is the farmers are reduced down to one or barely two buyers to whom to sell, and we can't—there is no recourse, then it just means that the laws are no longer sufficient to have the effect that they were originally intended to have. (Applause.)

Senator DURBIN. Thank you, Senator Dayton.

Mr. Ross, I guess my frustration here is as follows: What I hear you saying is that if someone suggested a merger, change in the players on the bench, so that there are fewer, the Department of Justice is going to take a hard look at this because it can clearly have antitrust implications. But we know from the facts that over the lastyears, a lot of the changes have taken place.

Apparently this doesn't fall on your doorstep because you haven't been at the Department of Justice for that entire a period of time. I'm not pointing to you specifically, but just to the government in general. We have acquiesced in the creation of, Senator Dayton's description, monopsony or monopoly situations in this country to the detriment of many people who are gathered in this room. We now have fewer processors, we now have fewer bids being offered for the livestock. And from where these men and women are sitting, it appears that the government, which was supposed to be protecting them from this sort of monopoly situation creating, didn't do its job. Somewhere along the job we didn't step up. (Applause.)

And I suppose what it comes down to is this. When we are proactively looking at the situation today and the bottom line, if we have seen a situation—and I think that that is correct, that the major meatpackers account for 80 percent of the beef slaughter, and years ago it was 35 percent, on its face there is a concentration of ownership here, and a negative impact on livestock producers who are trying to find markets and who are being closed out. They are given a price, take it or leave it. And that means no competition from their side, no free market from their side.

So my question to you goes back to an earlier one. What are we doing proactively to look at the current market and saying—don't give me an idea of a new merger, but take a look at what it is today and saying is this fair, should the government be stepping in to the current situation, changing the current ownership situation so that we can provide more competition and more opportunity for these livestock producers? Do you feel we have an obligation to do that, and if we do, are we doing it?

Mr. ROSS. Senator, let me start again by reiterating what I said in my testimony which is that concentration in and of itself, a high concentration level, is not a violation of the antitrust laws. There are three kinds of antitrust violations, and certainly concentration is an important factor that we look at. But, again, as law enforcers rather than regulators, we are not free to just decide we don't like the way a particular market looks, and therefore let's go change it. We have to operate within the confines of the antitrust laws. So there either has to be collusive behavior under Section 1 of the Sherman Act, single firm monopolization or attempt to monopolize, or a merger or acquisition.

Senator DURBIN. That doesn't give much comfort to the people who are gathered here today that what is currently existing, the status quo, has evolved into a position where it can't be challenged by our government if that is what you are saying.

Mr. ROSS. No, I'm not saying it can't be challenged. And I would encourage, again, anyone who is here who has an understanding of what the elements are the courts have required that we prove to make out a violation of the antitrust laws, who has information that might help us get to that point, to bring it on. We want to have it. We want to hear it. We want to look at it. But without evidence, we can't go to court and say there is a violation of antitrust laws here, we think the remedy is we have to divest the plant or break up this particular situation. We have to prove a violation of the law, and the remedy that the court structures has to fit that violation.

Senator DURBIN. I bet Senator Johnson can find quite a few ranchers and livestock producers in this state who can tell you about what has happened to their lives over the last years, if that is the evidence you are looking for, if that's the encouragement you need. Senator Johnson.

Senator JOHNSON. Well, the Chairman is correct. I've listened to too many stories from people telling me how there was a time when there were multiple buyers at repeated times during the course of a week in which to negotiate a price for the sale of their livestock. That it increasingly has become fewer and fewer, now sometimes only one, and then only for a very select, small period of time, and there is no negotiation opportunity. It's simply take it or leave it. There is no negotiation, there is no leverage. And that is what has transpired over a relatively, in the larger scheme of things, short period of time.

And it is distressing, I think to me and to a lot of people in my state, when we say the concentration is not in itself a antitrust violation, so there is really not very much we can do except wait for specific instances of tough-to-prove collusion or very rare instances where a single party has a complete monopolization. It doesn't take a rocket scientist to figure out if you havebuyers out there, that the seller has opportunities then to negotiate a better price, and pick and choose.

And what we are talking about is trying to reinvigorate free enterprise in rural America. I think most South Dakotans would agree free enterprise is the best economic system in the world, bar none. The whole world wants more of it. But it only works if there is competition. So while there are those in Washington that say, well, if you act proactively that is interference in the market, the fact is, as we discovered with our—with Enron and with others in—WorldCom and so on, unless there is a cop on the beat for—to impose fair rules, the free enterprise system isn't going to work at all.

And so if we find ourselves down to one buyer, take it or leave it kind of attitude, and then are told that that is not an antitrust violation, it seems to me that that is a real indictment of Congress and the administration both for not getting its act together and strengthening these laws because the status quo is wildly unacceptable. I believe in terms of—(applause).

So your testimony today I think is helpful. Unfortunately it's helpful in pointing out the inadequacy of current law and the necessity of Congress not simply saying we need to be more aggressive with enforcing existing laws, we need to do that, but frankly the law has got to be strengthened. The laws that were effective for Teddy Roosevelt no longer are getting the job done. And Congress is going to have to strengthen the law (applause) to give you the tools and the regulators the tools to proactively get involved in this.

Otherwise it is not just a matter of the decline of farmers and ranchers; it is the decline of our free enterprise economy. The genius that has made America the wealthiest nation in the world is going to lose if we continue to have this concentration in sector after sector of the economy. And I think the agricultural sector is the canary that ought to be a warning to the rest of the world what is going to happen to them if we don't change our ways and significantly strengthen these antitrust laws.

Thank you, Mr. Ross, for your testimony. (Applause.)

Senator DURBIN. Senator Dayton.

Senator DAYTON. Just one last observation, Mr. Chairman. We talk about the market concentration and the percentage of the market that one—or a handful of packers, processors, whatever, a sector they have, but that really overlooks the other side of this issue which I was really struck by today, the monopsony. I mean if we have a utility, electric utility, they don't have to be a monopoly in the larger scheme of the national utility market to have a monopoly by virtue of the fact that there is no where else that people can buy their electricity from except from that entity. We treat that as a regulated monopoly.

In this case, you can have a meatpacker of any size—and what share of the national rural market it has when it sells, is one thing—but if it's the only one in that area, that region, that anyone can sell to, then it is a monopoly. It doesn't matter what its percent is. It has a monopoly. And given the costs of transportation and the time of delivery in many of these areas in Minnesota, and I assume South Dakota, there is only one place you can go, and you don't have a practical option to go anywhere else. And that is de facto a monopoly.

And we need—as Senator Johnson said, as you pointed out to Mr. Durbin, we need to have some regulations with some teeth. Not just once in a lifetime when two entities merge, but every month, every year, ongoing to make sure that this does not occur, and break it up when it does.

Senator DURBIN. Thank you very much, Senator. Mr. Ross, thank you for joining us.

The next panel is a large one, but we want to bring them all up at one time so we can ask questions and keep this moving.

Professor Peter Carstensen is a law professor at the University of Wisconsin at Madison. Professor Carstensen was formerly an attorney at the Department of Justice Antitrust Division.

Also on the panel we have two cattle producers, Tom Connelley and Bob Mack, both from Senator Johnson's home state of South Dakota. In addition we have two independent pork producers, Tim Bierman from Iowa and Jim Van Der Pol from Minnesota.

Finally on the panel is Sara Lilygren. Did I pronounce that correct, Sara? Thank you. Sara Lilygren, vice-president of the American Meat Institute.

We will start the panel with Professor Carstensen. If you would be kind enough—I've read your statement. It's good, and it's going to be included in the record in its entirety. And if you would be kind enough to summarize—for my benefit, if you would kind of react to what we just heard, I think you might be a good person to reflect on what Mr. Ross has said about the current state of antitrust laws.

STATEMENT OF PETER CARSTENSEN, GEORGE H. YOUNG-BASCOM PROFESSOR OF LAW, WISCONSIN LAW SCHOOL, MADISON, WISCONSIN

Mr. CARSTENSEN. Thank you very much, Senator. And I appreciate the opportunitY to be here. For a guy that is used to 55 minute lectures, this is going to be a challenge because they whispered in my ear we are down to 45 minutes for the whole panel.

So markets are important. We all agree about that. We have got problems of market manipulation. I think it's very important to look at the Enron experience, the WorldCom experience, where we had regulators on the beat. They missed there because the regulations weren't well thought out in energy, they were not properly implemented in securities markets. In both cases we now have to go to the next level of doing important changes in the law and ratcheting up the level of enforcement.

In livestock markets, we start with the serious problem of concentration that everybody has referred to. Concentration is much worse. Those 80 percent and 65 percent figures are on the selling side into the retail market. As you have all pointed out, on the buying side we have got monopsony or another word I love, oligopsony, a handful of buyers. And buyer power is a serious problem. It leads to many of the issues that we have in livestock markets today.

My cousins who farm in eastern Iowa, when I used to go back there to visit, family picnics, would be talking about having four or five, six buyers coming out to their farms to look at their hogs or their cattle. We don't have that anymore. We don't have the benefits of—of competition.

I'm not going to go through the various particular kinds of problems that exist—I've laid them out in my written presentation—other than to point out one very major problem as we move towards a world in which we are going to be using contracts more and more for the sale of livestock, and that is discriminatory access to contractual opportunities. If we are going to use contracts, then all feedlot operators, all feeders of hogs, need to have access to those contracts. That's a (applause)—that's a market organization requirement to make these markets achieve the benefits of the market economy.

Since my—my good friend and sparring partner, Doug Ross, has talked to you a little bit about antitrust, and referenced the fact that, yes, indeed as I point out in my paper, mergers law has no statute of limitation, those mergers back in the 1980s could be reopened. The IBP/Tyson merger could also be looked at. Again, there is no legal limit. Even I, moderate bomb thrower that I am, have many reservations about reopening closed matters. It's not something you do lightly.

The interesting point here is that the administration at the Federal Trade Commission, Tim Muris, has at least suggested that he wants to revisit a bunch of hospital mergers which seem to have greatly inflated health care costs. If we are going to do it in hospitals, let's do it in meatpacking as well.

Other good news, you have been concerned about whether oligopsony and monopsony are recognized as antitrust problems. In addition to Assistant Attorney General James' commitment, we have had three recent opinions from courts of appeal around the country, all recognizing this problem and highlighting—something that I disagree with Mr. Ross about—highlighting that market share analysis when you are looking at buyer power is different. The kind of leverage you get even with fairly modest market shares can be sigificant. In one case—Toys R Us, it only had a percent market share, but they were directly able to influence their suppliers' willingness to sell toys to Toys R Us competitors in the marketplace.

So one of the problems that we have right now is to get the antitrust enforcers to rethink the measure of buyer power as they look at and analyze various kinds of situations.

Another piece of pretty good news, I think, the Microsoft opinion in the D.C. Circuit is a pretty good antitrust decision forcing us to think about how to approach abuse of market power. There are some other decisions that reinforce that, and would make it easier if the antitrust division wants to be vigorous, as you have all been suggesting. There are more ways of looking at what is going on, many of these kinds of problems that we have can be addressed.

That said, again, as Doug Ross pointed out, antitrust is very case specific. It's very much focused on particular offenses. For the problems that face agriculture today, we need market constituting, market facilitating, regulation. That is law that helps the market work better, more efficiently. Fairness, access, equity, transparency. Those are the kinds of goals. And so there is, I think, a real need today for more legislation and its effective enforcement in addition to keeping Doug Ross and company under the gun to enforce the antitrust laws.

[The prepared statement of Mr. Carstensen appears as a submission for the record.]

Senator DURBIN. Thank you very much, Professor.

Tom Connelley is an independent order buyer, rancher, cattle feeder, and has a statement which will be made part of the record in its entirety. And if you would be kind enough to summarize a few thoughts for us, we would appreciate it.

STATEMENT OF TOM CONNELLEY, INDEPENDENT CATTLE PRODUCER, DEALER, AND FEEDER, BELLE FOURCHE, SOUTH DAKOTA

Mr. CONNELLEY. Thank you, sir. I appreciate this opportunity.

In the 1970s, I was a cattle buyer for American Beef Packers. At that point in time, they were a packer that would probably kill from seven to nine thousand head a week, and we were one of the larger packers at that time. Later on I went to work for Flavorland, a smaller plant in Denver, Colorado. We didn't kill but about seven, eight hundred head a day in that plant. But at the time that I was buying cattle for these packers, I was actively competing against other companies in my weekly rounds at feed yards. We bought cattle every day, we had a beef order every day, we had a hot beef—what we call a hot beef order.

Any of the phrases, if you don't understand, please ask me later because I will explain it to you. I want you to know exactly what I'm talking about.

Anyway, as I was traveling around in the feed yards or farmers' places, my job was to evaluate these live cattle, estimate the weight, estimate the grade of select, choice, estimate the percentage of yield, and deliver them to that packing house at a hot weight hanging in the cooler. For instance, if I had a hot beef order of a dollar. and the cattle would yield 63 percent, I had to deliver them to the packing house for 63 dollars cwt. That was the equivalent, into the cooler, of a dollar.

Okay. This has all changed. I wish it was still that way. But since then, the market for slaughter cattle has totally changed. Monday and Tuesday by noon the grid and the formula cattle are committed to the packers. And from—from Tuesday noon the packer, having these grid and formula cattle committed, he knows exactly how many cattle he has got for the week's kill. There is no question about it. He also knows how many cattle he has available in his own feed yards that he is feeding.

There is one question left. How many cattle will he have to buy Thursday or Friday to finish his kill. If he hasn't got enough cattle coming in, he is going to have to buy a few. But for some reason, he will wait until Thursday afternoon at the earliest, after the futures closes, in order to procure the cattle for the rest of that week. And if he doesn't need them by Thursday, he will probably wait until Friday.

And if you'll look at the longer statement that I gave you, you will see where I've showed you a typical week in the futures market of the way the thing acts, and as the week goes on, how the packer uses the market to depress the feed yard optimism to buy cattle cheaper. And when you read what I said there, you will find that if they don't buy them on Thursday, the market will be down on Friday, the futures market.

Well, about a half hour before the close today, it was down a dollar. So we will get some cattle traded this afternoon, and we will probably get them traded at no better than steady money. And today they were buying cattle at a dollar two in Nebraska, where the cut out value for a 50 percent choice steer as of last night was a dollar nine. We are buying—they are buying cattle at a dollar two today, and the cut out value is a dollar nine. That's on a steer that is 50 percent choice.

Okay. Today there is a lot of cattle priced on the basis contract, and there has been for the last, I don't know, seven, eight years. Basis contract has been pretty popular. Those are contracts basis the board that a producer can sign up his cattle to a packer four, five, six month ahead of time, and they agree on a basis to board contract which means whatever the futures board is trading at, they can sell them at. Maybe he will give two dollars over the board at sometimes, maybe he is offering two dollars under the board.

The producer has the opportunity to price his cattle at any time prior to that delivery month. So while the futures trade is operating, the board is open. If I was a cattle feeder and I had a contract like that, I could call up this packer and say, okay, price my cattle today, I will sell them at whatever the board price is. That is how a basis the board contract works.

But too many times, especially into a downtrending market—and if you'll look at the addition that I have put on there of the charts, it showed that well. In a downtrending market, many times the futures is driven down right into that contract pricing period to a low. And as soon as we get those cattle all priced, you will normally see in the first two weeks of this delivery month, you will see a three or four dollar rally up.

Now, that looks pretty much like there is some huge control being exercised over our market through whoever is trading those futures, and I suppose packers got a lot to do with it. But they are driving that thing right down into where producers have got to price those cattle, and then we see the rally.

A little example that I've given is if—if for some reason a packer or three or four packers can hold that price down by just three dollars a hundred going into this pricing period, if they have got 50,000 cattle committed to them—and these are I think very low numbers, I think the numbers are much greater than this—but a three dollar per hundred weight depression in prices is 36 dollars a head. 50,000 cattle amounts to 1.8 million in gross proceeds that they could obtain by just controlling this market a little bit. So, gentlemen, I think you can see how a little bit of leverage can make a lot of money for a few big corporate entities.

Today, if I have got cattle on the show list in a commercial feed yard, that show list would be put out on Monday morning, there may be three, maybe four packers come pick it up if I am in an area where the big three are and maybe one little one. By late Thursday or Friday, maybe I'll get a bid on those cattle, and maybe I won't. And if I do get a bid, it could be a take it or leave it. You are telling me now, you sell them. If you don't, we will pass and go to next week. Or I may have an hour to make up my mind. But what good is an hour to make up my mind when there is only two or three big packers that is going to bid me anyway because they are all going to bid the same money.

And if—when you watch your market reports, you will find if 62 dollars is buying the cattle in Kansas and Texas today, that is the price. I don't care how good they are or how—if they are extremely inferior, they will bring less, but the average cattle is going to bring 62 dollars. You are not going to pry 62 and a half out of them as I did back in the days we had competition. But the average price is where they will sell.

I have had to resort to selling most of my cattle on the grid, and I do that because I feel I get a little better than the average Kansas, Texas, Nebraska price if I do that because my cattle are mostly all northern cattle. The genetics are good. I keep them hormone and implant free. And those cattle out-grade the implanted cattle by approximately 30 percent.

When I say the grid market, they are price—a base price that is set on the average prices for the week. If the Kansas high is 64 dollars, that's the base. I get a premium for prime and a premium for choice. If you have grades one and two, if they are three, it's the base price. But I get premiums and/or deductions from that grid price. And if there is anything you don't understand about a grid price, please ask me.

[The prepared statement of Mr. Connelley appears as a submission for the record.]

Senator DURBIN. Mr. Connelley, I will ask you if you'd please wrap up at this point. We want to make sure everybody gets a chance here.

Mr. CONNELLEY. It won't be but a second. What I want—what I want to stress to you is this. Through all these ways that I've told you about, the packers learn to reduce competition. He gets commitments early in the week to keep a large inventory of packer-owned cattle, and he forward contracts basis to the board. Depressed futures forces feeders to sell lower, which probably happened today. Line up grid cattle early in the week, set the base price late in the week. When I sell my cattle on the grid, I don't know what they are going to bring until that basis price is set late in the week. That is not the way to sell cattle, but I have no better alternative.

Senator DURBIN. Thank you very much.

Mr. CONNELLEY. I appreciate it.

Senator DURBIN. Mr. Mack, Bob Mack from Watertown, South Dakota.

STATEMENT OF BOB MACK, INDEPENDENT CATTLE PRODUCER AND FEEDER, WATERTOWN, SOUTH DAKOTA

Mr. MACK. Thank you, Senator Durbin, and also thanks to Senators Johnson and Dayton for this opportunity to address competition in the livestock industry and how it affects myself and my friends and neighbors.

I operate my family's farms and have spent most of my life raising crops and livestock. Our farrow to finish hog operation, cow herd and feedlot allows us to add value to our pasture, grain and hay, and to more fully utilize our equipment and labor.

When faced with the loss of the largest hog packing plant in the State of South Dakota, Smithfield was convinced to purchase the plant after the State of South Dakota contributed millions of dollars in incentives. Not long after this purchase, Smithfield bought the only other pork processing plant in the state and shut them down. This eliminated the only competition we had locally, and took at least five dollars off the value of every hog we sold. The rapid consolidation and subsequent collapse of the hog market nationwide forced nine out of ten hog producers in my area out of business and led us to focus more on our cow herd and feedlot operation.

At one time by working with several other feedlots we could receive bids on a regular basis from three or four packers, and could usually get—or occasionally get bids from a couple of other packers, depending on the type of cattle we had for sale and if they were in the market. Today we can usually get regular bids from a couple of packers with occasional bids from a couple of more. It also means shipping cattle as far as 700 miles to get them slaughtered.

Many farmer feeders are lucky if they have one packer they can get a bid from. One bid from a packer—from one packer isn't competition.

Part of the problem, in addition to having less buyers available, the rules keep changing. The buyers used to buy hanging, now want us to sell on a grid. One packer that we sold cattle to on a negotiated grid for years now refuses to buy cattle on that same grid unless we contract the cattle to them months in advance. When you figure out what the rules are, they change them. Most cows that are standing out there with the bulls right now will not—their offspring will not go and get to market for two or three years. We are always aiming at a moving target, a long ways out.

What can be done to ensure competitive and open markets in the livestock industry? Forbid large packers from owning and feeding their own livestock. The livestock they feed are used to leverage influence over feedlots and to leverage control over cattle they don't even own. I would like to commend Senators Johnson and Grassley for taking the lead in addressing this issue in the Senate.

Restrict capital supplies by requiring forward contract, formula and marketing agreement cattle to have a base price established at the time they are committed to the packer. In addition, require that forward contracts are offered in an open public manner to any producers that choose to take advantage of them. I believe Senator Enzi addresses this with his recently introduced Senate Bill 2021.

Revise the confidentiality provisions of mandatory price reporting to provide additional information and investigate the information that has already been collected by the program, but never made public, for competition and antitrust violations.

Tougher restrictions on future agribusiness mergers. The packing industry is one of the most concentrated industries in the country. Because they purchase a perishable commodity (fed livestock), they are able to exert a higher degree of influence than concentrated industries dealing in non-perishable commodities. Give equal weight to the effect mergers will have on suppliers to the industry instead of just the effect on the consumers of the industry.

When Packers and Stockyards violations occur, involve the injured party in any negotiations or plea bargains and require that injured parties are compensated for the damages caused by the violation.

Require that investigations of the industry are done by economists and investigators who do not have a history of working for the same companies they are supposed to be investigating.

Review what effect the rapid consolidation of the food retailing sector is having on prices paid to producers and charged to consumers. Are slotting fees and other methods being used to prevent smaller packers and producer-owned alliances from getting access to consumers? Why aren't retail prices reflecting the prices being paid to producers? Producers have always relied on lower retail prices to help clear out surplus production. This no know longer seems to be happening.

We talk about packer profits. I would just like to quickly put this into a little perspective. And it's using figures quoted by Wayne Purcell in an article he wrote for the American Meat Institute. An industry analyst went and figured that the average cattle packer's profit during the 1990s wasdollars and 38 cents a head profit which seems to be a fairly modest profit. But now I want to put this in perspective. At that rate, they have got that animal for five days, and the meat is gone. Well, I sell fat cattle. I'm happy if I see a check within a week, so I guess I go and finance the raw material.

Let's look at a cow/calf guy that goes and runs his calf seven months. Just the time he has that calf on the ground, at a dollar seven cents per head per day, he should be averaging a profit of 225 dollars a head. A background or a stocker running them five months should be realizing a profit, an average profit, of 160 dollars a head. A cattle feeder feeding for 180 days should be realizing a profit of 190 some dollars a day. The cow/calf producer who feeds his cattle all the way out, retains ownership for 428 days, should be realizing an average 450 dollar profit to be receiving the same modest profit that the packer industry says they are earning.

Let's put this in a little more perspective though. Producers out here control, maintain, finance and pay the taxes on 85 percent of the assets needed to get that steak from the pasture to the plate. So at that rate—and the packers and the retailers, they support 50 percent of the assets. You know, maybe we need to go and adjust those numbers a little further.

Cattlemen have an innate ability to look at an animal that appears healthy to a layman and know that animal is off feed, sick or has some other problem. The ability is part intuition, part experience. It's something they feel in their gut. They know if they don't correct the problem, the animal will probably die.

They have this same feeling in their gut when looking at what is happening in the packing industry. Without strong enforcement of the laws already on the books and steps to assure that the livestock industry maintains open, competitive markets, they know the livestock industry for independent producers will die. Thank you, Senators.

Senator DURBIN. Thank you, Mr. Mack. (Applause.)

[The prepared statement of Mr. Mack appears as a submission for the record.]

Senator DURBIN. Jim Van Der Pol from Minnesota.

STATEMENT OF JAMES VAN DER POL, INDEPENDENT HOG PRODUCER, KERKHOVEN, MINNESOTA

Mr. VAN DER POL. That is going to be a hard statement to follow. I am going to tell you, though, a little bit about my farm today. I made the majority of my livelihood since I begin farming in 1977 with hog production. For the first years, I never lost money on hogs, though sometimes it was close. But things changed. In the mid 1990s, Dakota Pork of Huron, South Dakota, which was buying most of my production, was bought by Smithfield Foods which immediately closed it when there was talk of state ownership and keeping the processor open for small farmers.

My son and daughter-in-law joined us on the farm in 1997. Consequently, we built two hoop houses for hog finishing and tripled the hog production from 60 litters per year to 180. Most production was done in pastures seasonally, while the hoops enabled us to produce a certain number of hogs year round. Our first full year of production was 1998.

In the fall of 1998, when most of our first year of expanded production was ready, hog prices dropped to eight cents a pound. Now, it takescents worth of feed, even at corn prices we have now, to produce a pound of pork. Every pound those pigs put on was costing us seven cents out-of-pocket just on feed. We were hemorrhaging money.

We started calling everyone we knew or ever heard of that bought pigs to try to get rid of them. We finally found a Hmong butcher in South St. Paul interested in light weight hogs who bought most of what we had left, market price, eight cents.

And what did the industry have to say? It's not us, they said. We are innocent, they said. It's the shortage of shackle space, they said. That's what drives the price down. As long as I live, I will remember that series of excuses out of the industry in 1998 in the light of what they had done to my hog buyer a few years earlier. We should have seen the handwriting on the wall when Dakota Pork closed.

We now operate under the assumption that the commodity market is the enemy. We do whatever we can to minimize that commodity market's access to our farm's production. In 1999, we started direct marketing our hogs, purchasing a trailer and freezers with which to run a monthly delivery route into the Twin Cities, 130 miles distance. In 2000 we started moving into a few small grocery stores with our own pork label. We have built this meat business to the point where it uses about 40 percent of the hogs, of the farm's hog production. The remaining 60 percent is sold to a specialty company which pays a premium for our husbandry methods and the meat quality of our animals. Only the cull sows are exposed to the commodity market now, and we are working to fix that.

We didn't stop there. We are converting the farm from row crops—the farm, by the way, is 300 acres. We are converting the farm from row crops to grass for our replacement heifer grazing business, replacement dairy heifer business. We are not interested in selling commodity corn anymore than commodity pork.

1998 was a very expensive lesson for us. At age 50, my wife and I lost at least ten years of worth of equity and work in several weeks' time. Any hope of a conventional retirement is gone for us at this point. My son and daughter-in-law had a very rocky start to their farming careers and are angry and suspicious of everything and everyone connected with farming. We are all exhausted, having worked seven day weeks for four years now to try to build our meat company's sales in a very adverse environment.

Even though our dependence upon commodity production is not what it was, we know very well that if the meat industry is not brought under some kind of control, they will do to our meat licensing and our meat business just what they are doing to commodity producers. We are pleased with our two senators, Mr. Dayton and Mr. Wellstone, as well as very pleased with our senator from South Dakota, Mr. Johnson, for their moving against packer ownership of livestock. This bill needs to pass.

I appear before you today a very angry man. I am angry because my government fails in what should be a central task for a democratic government in a market economy. It has failed and it is failing to restrain the power so that others might survive. It is this failure that is decimating rural America. We should not have to think in rural America of our own government as an enemy. You folks have the power to do something about that. Please use it. Thank you for your time. (Applause.)

[The prepared statement of Mr. Van Der Pol appears as a submission for the record.]

Senator DURBIN. Tim Bierman from Iowa.

STATEMENT OF TIMOTHY BIERMAN, INDEPENDENT PORK PRODUCER, LARRABEE, IOWA

Mr. BIERMAN. Good afternoon. I am a pork producer from Larabee, Iowa. I am the president of the Iowa Pork Producers Association. I am an owner/operator of a hog farm that markets over 10,000 hogs a year. I also farm nearly 500 acres of corn and soybeans. I appreciate this opportunity to present our views on competitive and open markets.

The Iowa Pork Producers Association is the oldest and the largest state pork producer group in the country. IPPA represents over 6500 pork producer-leaders proactively on issues ranging from international trade missions, pseudorabies eradication, ag policy and environmental regulation. In Iowa, the pork industry accounts for over 86,000 jobs, contributing nearly three billion dollars in payroll to our state's residents. If you look at the total economic impact to the State of Iowa, our pork production affectsbillion dollars in the state.

Our organization has previously testified on the issue from a different perspective, specifically on the proposed ban on packer ownership. While we strongly support this concept, today I would rather focus on a new proposal to require a percentage of the livestock to be purchased on the spot or cash market.

This new concept was apparently discussed during the conference deliberations of the farm bill which was sidelined until further review. This approach appears to be—appears to have bipartisan support, including South Dakota Senator Johnson and Representative Thune. The proposal has been introduced by Senator Grassley in the Senate and in the House by a number of co-sponsors.

Just this week our board of directors voted to endorse the legislation and to devote resources toward its passage. Our board took this action because farm—livestock farmers are concerned about the availability of competitive livestock markets. This approach would guarantee that independent pork producers have a share in the marketplace while assisting the mandatory price reporting system. Requiring negotiated sales ensures that processors will provide for public shackle space for all hog farmers.

Available shackle space has become critical for independent farmers because promises of new slaughtering plants will not benefit farmers if the slaughter is only for packer-owned hogs and the new plant results in the closing of another plant. The legislation would improve the accuracy and the transparency of all livestock markets. As our national organization correctly stated in a 1999 press release, more negotiated sales would help ensure prices reported for the spot market reflect the current value of hogs.

Furthermore, we think that this approach makes sense for a number of specific reasons, including both packers and producers need accurate market information from negotiated livestock sales. While the information will be used to determine daily cash purchases, this approach will also impact animals purchased on the contract and formula basis because most of the marketing contracts are tied directly to the cash market.

The legislation phases in the required spot purchases and is not fully implemented for six years. This will allow farmers and packers time to fully implement and adjust to the legislation.

Smaller packers and single plant entities are exempt from the law.

Most, if not all, packers are currently in compliance with the five percent purchase requirement.

Farmers who form and operate cooperative packers would also be required to purchase spot and cash markets—market animals, but at half the percentage compared to the traditional packer.

These are a few reasons to support legislation, and I'm sure there are many more. Pork producers throughout the country need more competitive markets. We urge Congress to give the producers an opportunity for success by enacting this legislation.

And another market issue facing farmers is the full implementation of the federal Mandatory Price Reporting law. USDA started in the right direction, but continued market oversight is now crucial.

In closing, IPPA is committed to a fair, transparent and a noncompetitive marketplace. Our producer members constantly remind us of our duty. Mr. Chairman, thank you for holding this important hearing, and giving me the opportunity to address the committee.

Senator DURBIN. Thank you.

Mr. BIERMAN. The Iowa Pork Producers Association stands ready to assist you in the work you are facing.

[The prepared statement of Mr. Bierman appears as a submission for the record.]

Senator DURBIN. Thank you very much, Mr. Bierman.

Our last witness on this panel is Miss Sara Lilygren with the American Meat Institute. Miss Lilygren.

STATEMENT OF SARA J. LILYGREN, VICE PRESIDENT FOR LEGISLATIVE AND PUBLIC AFFAIRS, AMERICAN MEAT INSTITUTE, ARLINGTON, VIRGINIA

Ms. LILYGREN. Thank you, Senator Durbin. AMI is the nation's oldest and largest organization representing meatpackers and processors whose business practices, as we 80 have noted today, are governed not only by the Sherman Act, the Clayton Act, the Robinson–Patman Act and the Uniform Commercial Code, but also by the Packers and Stockyards Act, a statute that is unique to our industry alone and clearly prohibits meatpackers from engaging in unfair or deceptive business practices. To my knowledge, there is no other sector of the U.S. economy in which the federal government plays such a watch dog role with respect to raw material suppliers.

And yet, ironically, we are here today to discuss whether meatpackers should receive yet additional scrutiny, enforcement or business restrictions in order to protect or benefit livestock producers.

While some suggest our laws and the enforcement of them are inadequate, I would suggest another theory, which is perhaps we have not done a good job of pinpointing the real problems and coming up with effective and constructive solutions.

You know, it's interesting we have spent about 95 percent of our time today talking about the supply side of the chain with very little mention of what is equally, if not more, important which is the demand side of the chain. Someone asked earlier who is going to control agriculture in the future. And I would say that the consumer, who hasn't gotten a lot of attention here today, plays a very large role in that.

AMI's members have one common objective; to make things consumers will buy. We know that U.S. consumers have diverse tastes, and 95 percent of them eat meat and poultry regularly, so there is ample room in the marketplace for many different kinds of products with different attributes. And we also know there is a robust global appetite for our meat and poultry products. We now export about percent of our beef, about percent of our pork products, principally to Japan, Mexico and Canada.

In fact, livestock producers, many of you in this room, have raised and spent hundreds of millions of dollars in the past decade to build consumer demand through check off programs, both domestic and international consumer demand. All of these efforts have had many benefits, including improved communications throughout the meat chain, among retailers, packers and producers. This has led to increased vertical integration.

AMI's own members have increased their coordination with both livestock producers and retailers to try to produce the products consumers want to buy. In fact, sometimes AMI's members have changed their management or operations in order to meet their customers' needs.

Now, this vertical cooperation has some positive benefits you are all familiar with. One I would cite is the reduction in fat content in the average serving of beef and pork. That was clearly the result of working together with the retail, packer and producer elements of the chain.

Another is improved risk management options for producers. And I would just cite contracting, as others on the panel have cited, as one of the risk management tools that helped some hog producers when the bottom fell out of the hog market in 1998. Those hog farmers who had contracts are doing a lot better than those who did not. At the same time, packers were obviously—who had the contracts were obviously paying far over the market value for hogs, but both parties ultimately benefit from the certainty provided by a steady, consistently priced, contracted supply of hogs.

Before I leave the topic of benefits of coordination and integration, I just want to mention that this is a trend throughout the manufacturing and service economy, and it's driven largely by consumers who are demanding consistent product quality at the lowest possible price. This demand for low prices has led to fewer and larger retail chains in every arena. The consolidation at the retail level has driven consolidations at the manufacturer level, not just for agricultural products, but for tools, appliances, and other consumer goods. The demand for consistent product quality has led many firms to exert greater control over their supply chain.

Just ask anyone who supplies products to Wal–Mart or McDonald's what that means. It means you must meet their standards or you can't sell to them. It often means you must subject your products and your plants to periodic customer audits. That's the way business is done today, and the meat industry should be no exception.

Against this backdrop, I hope you can understand why AMI strongly opposes efforts that would make it illegal for meat manufacturers to do what the rest of the global business community is doing, which is to form relationships with suppliers of raw materials in order to produce consistent quality, lowest priced products that consumers will buy. In our view, the proposed ban on packer ownership, control or feeding of livestock would do just that. Further, we will oppose any effort to restrict meatpackers who comply with existing antitrust and fair business practice laws from sourcing their raw materials in anyway.

If there is a consensus that the livestock market is not working properly, then we would advocate a thoughtful, reasoned, fact-based approach that will help all businesses—farms, ranches, processors and retailers—pinpoint problems, and develop targeted and effective solutions.

Thank you.

[The prepared statement of Ms. Lilygren appears as a submission for the record.]

Senator DURBIN. Thank you for your testimony. Let me ask the first question of you then. What is the American Meat Institute's position in terms of the traditional source of meat, the independent owner, operator and producer, do you feel that that is just a thing of the past like the shops on the downtown square that went away when Wal–Mart showed up on the outskirts of town? Is that a vanishing phenomenon?

Ms. LILYGREN. It appears to be a shrinking part of the market. Are you asking me if it's a dying source that is going to become extinct, I don't think we can predict that. We don't have a point of view advocating for that or not.

Senator DURBIN. Would you not say that the policies of your members are moving that extinction along faster by your own ownership of production and by the lack of competition available for prices for these producers?

Ms. LILYGREN. What I would say is that the policies of the federal government have made it more and more difficult for the independent meatpacker to stay in business. Many of the packers that have sold to larger packers in recent years, who may or may not have chosen to continue those plants' operations, have done so because they cannot tolerate the risk associated with meeting federal food safety and other requirements on a day in, day out basis, particularly single plant operations.I21Senator DURBIN. So you are saying that we have got to make a choice here, whether we want to have safe food—

Ms. LILYGREN. No.

Senator DURBIN.—or we want to have these ranchers and livestock producers?

Ms. LILYGREN. No. I'm saying that one of the motivating factors for much of the consolidation in the packing sector that has occurred over the last ten years, one of the strongest motivations for that, has been tougher federal regulations that make it difficult for the small independent packer to comply.

Senator DURBIN. Let me go to particular points you raise here. You were arguing that in order to get quality control you have to control much more than you did in the past, and perhaps the conclusion is you have to own a lot more than you did in the past. So you are suggesting that if you went to a pork producer or beef or cattle producer and said to them this is what we are looking for in terms of leanness and fat content, that they would ignore you?

Ms. LILYGREN. No.

Senator DURBIN. Well, then, why do you need to own so much more on the front end of the process to get the quality that you are looking for? If you establish a standard, don't you believe that men and women in South Dakota and Minnesota will be producing cattle and hogs to meet that standard?

Ms. LILYGREN. And that's why—I'm sorry, I may have misunderstood your original question, Senator. The need for the food manufacturer to have some degree of control, or let's call them product specifications for their raw materials, drives them to enter into some sort of arrangement, whether it's contracts, forward contracting, a marketing agreement, or outright ownership of the supply. That is quite—that is quite a spectrum of different arrangements whereby the manufacturer and the raw material are in some way connected.

So, now, your question is do I think an independent producer can't for some reason meet the requirements of a packer who wants to control certain attributes. The answer is no.

Senator DURBIN. I don't believe it either. In fact, I think history says otherwise. I think that these gentlemen here with us today can tell you what has happened in pork and beef production over the years in terms of standards that they are meeting and that the industry is demanding, and they are doing it. And they don't have to be paid employees of any major packing company in order to produce the hogs and cattle that are going to meet those standards.

I also think that the fact that you are eliminating risk, as you say it here, you can eliminate risk by giving them a price that they are going to go out of business on. That is quite an elimination of risk. It's also an elimination of their livelihood.

Senator Johnson.

Senator JOHNSON. I want to thank this panel. In the limited time we have here, I want to say, Professor Carstensen, I want to thank you for your—a lot you did in your testimony here, in your statement. I can't agree with you more that—when you note that restoring greater balance in the market, the government taking an aggressive role to make that happen, is not some sort of radical interference with the market. In fact, it is consistent with what we do in many areas, including the regulation of credit, insurance, product safety, job safety, franchising energy and securities markets. So that we have numerous examples of where we have in fact stepped in to our free market economy to ensure that it in fact remains a free market and free enterprise type of economy. And I think it's a very important observation that you have made.

Let me ask Tom Connelley, again, just observe—what you are telling us that the packers schedule blocks of captive supply livestock for slaughter over a period of time, then they pull out of the market during that time, and watch the open cash price for livestock fall, then they can take advantage of that—of that fall. Is that—is that the process that you were driving at?

Mr. CONNELLEY. Yes, sir. When they have a large captive supply, whether it be through contracts or through their own feedlot-owned cattle, maybe through one of the big feeders that is packer-oriented or packer-tied, where they go in there and have access to those cattle at any point in time, and they can stay out of the cash market until the individual independent cattle feeder or the independent feed yard, until he finally comes down to their price. That price is sometimes determined by the way that the commodity futures board acts. A big sell off on the board, you will definitely buy cattle cheaper. In an uptrending market, they will be trying to buy them at steady prices or less, depending on how many of their own cattle they have got to kill.

Does that answer your question?

Senator JOHNSON. I think that does, Tom. I think that is a valuable contribution here.

Let me ask Mr. Mack, it seems to me that market power is often mistaken for efficiency in livestock markets. In your opinion, if a meatpacking firm generates more profit, is it because that packer is efficient or is it because the packer has exercised market power to increase its profit margins, doing that by driving commodity prices below what would otherwise be competitive levels?

Mr. MACK. I would say in many cases it is a matter of market power. I think that many of our smaller packers were not driven out of business due to lack of efficiency. It was just that they did not have equal market power to their competitors. It's much the same thing in livestock production.

A farmer feeds, whether you are a hog producer or you're a cattle producer—and I'll just try to put some round numbers on it—but it would cost that producer cents a bushel to haul the corn to market. If he was going to buy it out again to use it as a feeder, it would cost another cents a bushel mark-up for handling. You got cents a bushel to haul it back to the farm. You add that up, that's 32 cents a bushel. Well, much of the time in the last few years, we have had corn at a dollar and a half or less. That farmer feeder already increased his efficiency on the price he got on the grain by percent just by utilizing it on the farm. At the same time they utilize equipment and labor that they utilize in other production practices, those costs spread out greater.

There is significant research out there showing that once you would get over about a 150 farrow to finish unit, and even on cattle feedlots and things like this, that you can be as efficient as the largest lots in the country. No one can get beat on efficiency.

The thing is, I'll go up against any feedlot or any other production, I don't care what size they are, on efficiency. But I have got to go and have access to the same comparable market for the same quality of livestock that they have got. And if I'm squeezed out just because I only market one or two pot loads of cattle at a time instead of, you know, having control over an entire lot, then I'm in trouble.

Too much of the packer ownership in livestock, when it comes to cattle feedlots and things, is going in and putting—agreeing to put a few head of livestock into a lot, and then using those few head to leverage control over cattle that they may not even own. Maybe some rancher, they were his cattle. But that feedlot operator, the only way he goes and makes money is to keep his. And if you don't think a packer in there with ten percent of the cattle in there, and at the same time one providing you a market, doesn't have a lot of influence over his choices and his recommendations to his customer, you have got another thing coming.

Senator JOHNSON. Thank you. My time has expired. The CHAIRMAN.

Senator DURBIN. Senator Dayton, I know you have to catch a plane.

Senator DAYTON. One last stop. I appreciate that. Miss Lilygren, you mentioned, if I heard you right, the consumer is going to control the food markets of this country when your industry and others in the food industry have done everything possible, it seems to me, to prevent that from happening. Irradiation of meat is not something consumers have control over that has been pressed, to ferment opposition to the country of origin labeling, opposition to content labeling, you know, pushing for higher retail prices that are unrelated to lower prices for producers.

I see just the opposite. I see consumers being kept away from having the kind of control that they ought to have, the kind of choices, the kind of information to make those choices and decisions. And I think that is the whole reason we are talking here, is because the economic power is being concentrated in the hands of those who are in between the producers, the farmers, the growers, and the consumers. And that's—not to put people out of business, but just to restore a balance so that people are getting better quality, they are getting—know what they are getting and they have choices, and they are reasonably priced and farmers and producers get paid enough to survive. And that means, you know, that people—everyone else takes something less in order for that to be possible. I just don't see that that is the way it's unfolded in this country or is even headed in that direction.

I would like to go to your testimony here where you talk about that American Meat Institute strongly opposes efforts that would make it illegal for meat manufacturers to do what the rest of the global business community is doing which is to form relationships with suppliers of raw materials in order to produce consistent quality, lowest priced products that consumers will buy. What are you talking about here?

Ms. LILYGREN. Senator Dayton, our view is that a ban, in other words, making it illegal for a meatpacker to own or have substantial managerial supervisory or operational control over or to feed his or her livestock supply, would be tantamount to making it illegal for that manufacturer to have supply chain management which is a term people use in manufacturing, and you see it in the retail sector. I mentioned McDonald's and Wal–Mart as just two blatant examples of others further down the chain that want to have some control over their supply.

Senator DAYTON. Illegal for manufacturers to form relationships with suppliers of raw materials. That presumes that the suppliers are entities which produce that product and supply that product. I mean that's—and you are saying that is going to be made illegal?

Ms. LILYGREN. It would be illegal.

Senator DAYTON. To do what?

Ms. LILYGREN. For a manufacturer to have substantial managerial, supervisory or operational control. Now, there is some debate about what exactly that ends up meaning. Our interpretation and our attorney's interpretation of that is that it would make contracting which you stipulate—

Senator DAYTON. You must pay your attorney a lot of money to misunderstand the legislation. We went through in Washington—really. No, I mean the kind of obfuscation that your institute put forward and, you know, just fundamentally misrepresenting what the language stated. And then we even went back and restated it again, Grassley and Johnson went back, restated. You don't want to understand what it really is because you don't want what it does.

Ms. LILYGREN. With all due respect—

Senator DAYTON. I'm not done yet. (Applause.)

Ms. LILYGREN. With all due respect, Senator Dayton, neither you or I are attorneys, so we can blame the attorneys maybe for the obfuscation.

Senator DAYTON. I'm not blaming the attorneys. I am blaming the institute. I think you are the ones whose obfuscating because you wanted to try to muddy the waters. And you were actually fairly effective for a while doing so. Now you are trying the same thing here; to say it would be illegal for you to do what the rest of the global business community is doing which is to form relationships with suppliers.

The legislation is intended to preserve suppliers so there will be suppliers. It's saying you can't become the suppliers, you can't take over the suppliers, you can't run the whole show, become the whole show. It's exactly the opposite of what you are saying.

Ms. LILYGREN. Let me ask you a question. Under this law if you were the—if you were the livestock producer and I'm the packer, and I want to buy your cattle, but I want—I only sell to the consumer hormone-free cattle raised having listened to Beethoven their entire lives and fed on clover flowers, and I put that into my specifications, our attorneys have said—my purchase specifications—let's say I have a contract with you, I need to market that, I have Sara's Special Beef. My attorneys say that under the packer ownership ban, the latest version of it, that it would illegal, that that would constitute substantial operational, managerial or supervisory control because I'm telling you what I need you to do to the animals before I buy them.

Senator DAYTON. I have to disagree with your attorneys.

Ms. LILYGREN. You disagree.

Senator DAYTON. I don't know. I honest—I honestly don't know.

Senator JOHNSON. Will the gentleman yield?

Senator DAYTON. I'm not going to yield so much as I'm going to leave the room.

Senator JOHNSON. I would observe for the gentleman from Minnesota that your position and my position relative to this legislation not forbidding contracting was agreed to by three of the leading economists, analysts in America, including Mr. Neil Harl of Iowa State University. So it isn't just a matter of you and I arguing about what this language means. It seems that we have had some of the best agriculture and legal minds in the world examining this and agreeing that the meat institute is wrong, we are right; the legislation does not prohibit—forbid contracting. (Applause.)

Senator DAYTON. One last question. Mr. Van Der Pol, when you talk about the 130 miles to market, what is the cost factor of that? Was this round trip? What does that add to your costs of production?

Mr. VAN DER POL. It's a little difficult to say since it's not our entire production. I will say that our transportation costs are by far the largest cost involved in our meat marketing. And on the order of, in terms of gross meat sales, to percent.

Senator DAYTON.15 to 18 percent. So we are talking about monopsony being a monopoly in a region where you only have one buyer to sell to. I mean the transportation costs really are limited in terms of where else you can transport a product, especially an animal, to be—to have another place to sell it.

Mr. VAN DER POL. Oh, absolutely. We—on the other side of my testimony, which is the specialty market, I would like to point out to the committee that I spent the first years of my hog production delivering my hogs miles to one packer or buyer, or miles to another buyer, or miles to a third buyer. And then there was another one at 20, which I never used. I am now transporting that specialty production 170 miles into Iowa, and it's up to me to arrange the trucking. And I think—any farmer in the audience, and we have got a few by the sounds of it, knows what that means, especially at my level of production.

Senator DAYTON. I have got to go catch a plane.

Senator DURBIN. Thank you. I would like to ask a couple more questions. I thank Senator Dayton for joining us.

Miss Lilygren, one of the points you made at the outset of your testimony is you have to listen to your customer, the American Meat Institute has to listen to the customers. I would like to make a proposal to you. I would like to ask your customers—and let's agree on the pollster who is going to ask this question so we both understand that it's someone reputable—whether or not they agree or disagree with Senator Johnson's proposal for labeling country of origin of meat. And if it comes back that your customers agree with Senator Johnson for labeling the country of origin so that people know when they are buying American beef or American pork as opposed to other countries, will the American Meat Institute then support Senator Johnson's amendment?

Ms. LILYGREN. Are you going to ask retail and our food service customers—

Senator DURBIN. No, the people, the consumers.

Ms. LILYGREN. The consumers, oh. That—we use the term "customer" to mean our accounts. Yeah, we should talk about that. I thought—let me just—I'm not dismissing it. I'm saying we should talk about that.

But let me ask you another question. Could we agree that in future discussions about the marketplace and the prices that producers and packers receive for the sale of meat products, that we include the retail and food service customers in the discussion because they are an important piece of the economic chain here.

Senator DURBIN. I'm sure there is no objection to that. We tried to invite a number of your members and they decided they didn't want to come and testify.

Ms. LILYGREN. But no one from the retail or food service sector, which is an important piece of this, has been involved in these discussions, and I think it would add information that would be useful to all.

Senator DURBIN. We are going to send a little letter along to the American Meat Institute and ask them—in fact, I think we can probably find some people to ask this question about country of origin, which I believe the American Meat Institute has been opposed to.

Ms. LILYGREN. Yeah.

Senator DURBIN. I think that the consumers across America, I think your consumers that drive your decisions, want you to change your policy, so let's find out. (Applause.)

Ms. LILYGREN. I think our customers in the middle would disagree.

Senator JOHNSON. Let me just close this session here. It's an honor for me to have an opportunity to serve with Senator Durbin on the Judiciary Committee. The Senate Judiciary Committee is not normally a committee on which I serve. And I am very appreciative of Senator Durbin coming to South Dakota, appreciative of Senator Dayton for his participation as well, and appreciative of all the panel members, of the diverse points of view. I think this has been a very positive interchange that we have had here today for the Judicial Committee, also for me, and it's something that we are going to take back to Washington with us.

Clearly we are dealing with an issue that is of absolute fundamental importance to the South Dakota economy, but I think to the economy of the nation as well, to the interests of consumers all across this country. It seems to me that—that from what I can hear now, and what I have been listening to has confirmed what I have always felt, and that is the consumers ultimately are best served by a broad network of independent livestock producers, that the free enterprise system requires competition, and that we have fallen down on the job in Washington in terms of assuring the fact that a high level of competition exists.

And what has happened is that the benefits of free enterprise have in too many instances been lost, and independent producers find themselves with fewer and fewer options, find themselves in a take it or leave it circumstance. And as has been the case in other countries, whether it's the former Soviet Union or otherwise, where they have chased independent private agricultural producers off the land and replaced them with corporate employees, collectivized employees and then found out they couldn't feed their people and they want to come back and restore private agriculture and family farmers, and found that once they have been pulled up by the roots, they can't be brought back.

Well, that is what this county is going to learn if we continue to stay on the current track, chasing independent family producers off the land. We are going to wind up ultimately damaging not only them and the economies of these rural areas, but the consumers themself. So it's in the interest I think of all of us that we continue to create a situation where decent competition exists, where a fair price for the product exists, rather than having this race to the bottom to see which country in the planet—on this planet can impoverish its farmers and ranchers the fastest. That is what we are doing right now. That has got to change.

Thank you, Senator Durbin. (Applause.)

Senator DURBIN. As is our custom on the Judiciary Committee, we will keep the record open for one week for senators to submit questions and statements to the witnesses.

I want to thank all the witnesses for participating today. I especially want to thank Ms, Lilygren for coming under adverse circumstances. Your employer owes you a steak dinner. Let's hope it's from an independent producer. (Applause.) I also want to thank Senator Dayton, and a special thanks to Senator Johnson who has really been the leader in the Senate on this issue.

Assuming there is no further business before the committee, the Judiciary Committee stands adjourned. (End of proceedings at 3:50 p.m.)

[Submissions for the record follow.]

[Additional material is being retained in the Committee files.]

SUBMISSIONS FOR THE RECORD

The Senate Judiciary Committee

"Ensuring Competitive and Open Markets in Agriculture"

Sioux Falls, SD

August 23, 2002

Testimony of the American Cowman's Association

By

Jim Strain, Executive Secretary

Our small association is made up of the first subset of beef cattle production, the cow/calf producer. Men and women who are the stewards of one of this great country's most beautiful natural treasures, it's vast and productive, self-renewing grasslands. Our cattle graze land that nature seeded to grass, not land cleared of rain forests to make room for cattle herds. We harmonize with nature and try not to alter it.

Rarely does the cow/calf producer in the U.S. sell his/her production to a meat packer, but commonly sells to one of the other downstream subsets of production. However, sales made to a beef packer eventually affect the cow/calf producer more than any other link in the production chain. All others subsets are pass-through owners, but the cow/calf producer has no one to pass price problems back to. Therefore, this level of production has more to lose because of non-competitiveness in the beef delivery system than any other production-participant.

It is this associations position that the agency of government (GIPSA), charged with maintaining competition in the meat business has failed to discharge its responsibility which is succinctly delineated in the following, which is from a 1985 USDA Publication entitled: **The Packers & Stockyards Act, Economic Law and Order in the Marketplace. The act was designed to " assure economic law and order in the marketing of livestock, meat and poultry, and to assure effective competition and integrity in the marketplace."**

A shared monopoly (oligopoly, as it is described by economists) has been allowed to evolve. **GIPSA has granted, by its inaction, a great economic privilege to the few beef packers and one must keep this in mind when considering our recommendations.** Just as an English monarch granted, to one of his favored subjects, the exclusive right to manufacture playing cards in the kingdom in times long past. It was this act, history tells us, that gave the English language the dubious distinction of the creation of the word, monopoly.

The level of concentration in itself is a problem, but we believe that it is just one of two problems. The second problem is, in our opinion, just as much a problem and liability to both producers and consumers as the oligopoly. The second problem, and one which could be very easily remedied, is buying practices that compromise the very **"competition and integrity in the marketplace"** that GIPSA was established to protect. We speak of what has commonly come to be know as "captive supplies", which consist of three practices: delivering finished cattle on a formula basis (no price negotiated prior to delivery, but pricing after slaughter on some arrangement, generally tied to negotiated purchases), forward contracting to a packer for future delivery and packer feeding for his own account.

All of these practices compromise and undermine competition and should be stopped by GIPSA, immediately. **It matters not if sellers of finished cattle want these practices continued. If it can be shown that, as we contend, that competition is compromised the issue is closed.**

We believe that certain practices must end now and certain others should be put in place. Our contention is that Section 202 of the Packer and Stockyard Act is broad in scope and gives GIPSA strong authority to demand the changes we suggest which are as follows:

1. Stop the packer from feeding cattle (if you pack cattle you, or a subsidiary of your parent company, cannot feed cattle), no forward contracting of finished cattle to a packer and end formula buying by a packer.
2. Price reporting of live finished cattle sales should be mandatory. It should be to an agency of the Federal government. Sales should be reported by both parties to the transaction within 10 minutes of the time of the transaction and should be made public by the receiving agency immediately (easily and inexpensively accomplished with today's technology). Failure to report and fictitious reporting should be punishable by stiff fines (Market transparency is critical to any market, stocks, commodities, financials, etc., the livestock market is no different).

   We have no problem with in-the-meat sales, off a grid, or any other system, but the price must be negotiated at the time of the transaction and the price reported, along with all discounts and premiums.
3. A three-day pickup of purchased cattle should also be mandatory and day of delivery reported to the same agency.
4. The packer should be barred from the short side of the cattle futures market.

The only leverage the cattle feeder has ever had in selling his production to the packer is the threat of interrupted supply flow. Remove, or weaken that risk, and the balance of trading power shifts dramatically. Captive supply has totally disarmed the seller and the cattleman's shrinking share of the consumers beef expenditure is ample proof of our contention.

Arguments will be made that other manufactures are permitted to forward contract their raw material needs, but one must remember that finished cattle are a perishable commodity, not storable and, therefore, a reliable daily market should exist and has existed in the past. **The cattle futures market gives the beef packer the opportunity to cover his future needs and the same is true for the retailer.**

We would like to include the following from The Congressional Record, obtained from the Library of Congress. It is a portion of the debate that preceded passage of the Packer & Stockyards Administration Act. The speaker, Senator John B. Kendrick, himself a stockman from the state of Wyoming: ***"I want a commission that is eternally and continuously on the watch, and not one which will merely give its attention to the meat-packing and live-stock problems as incidental business, not one which from the press of other duties will be compelled merely to review the findings of other and perhaps less able men. The magnitude of the packing industry is so great and it is so tremendously important to the country that it cannot be treated as incidental business.***

I wish to say that nothing under the sun would do more to conduce, to increase production in this country, and ultimately to cheaper food products for the people of the Nation, than a dependable market. One wherein the producer would understand, beyond the shadow of doubt that he would not merely get what is called a fair market, but would get the market for his products, based on the law of supply and demand.

The average producer in this country is a pretty good sport; he is not afraid to take his chances; but he wants to know that he meets the other man on the dead level and does not have to go against stacked cards."

We believe that, because of inaction by GIPSA, the practices we object to, which should have been "nipped in the bud", have been allowed to move the selling process off "dead level" and the seller is now up against "stacked cards". We want to un-stack the cards and move the contest back to level, we will take our chances on that basis. We are good sports and anxious to feed the American people their meat of first-choice as we, and our predecessors, have done so reasonably for several generations.

Our recommendations are simple and straightforward and would not necessitate any dramatic changes. The only dislocation that we see would be the divesture of either the feeding or packing business of some of the present participants. Hardly like the divestiture of a certain percentage of a company's packing capability, that some feel needs to happen. Those who hold that opinion may be proven correct, but we suggest that our less drastic approach be tried before a more severe remedy, to an obvious problem, is considered.

Respectfully submitted

Jim Strain, ACA Executive Secretary

FOR RELEASE ONLY BY THE SENATE COMMITTEE ON THE JUDICIARY

Statement of

Timothy Bierman
President
Iowa Pork Producers Association

before the

Senate Judiciary Committee

Hearing on Competitive and Open Agricultural Markets

August 23, 2002

Good Morning, Mr. Chairman. My name is Tim Bierman, and I am a pork producer from Larabee, Iowa. I am the President of the Iowa Pork Producers Association, and I am the owner/operator of a hog farm that markets over 10,000 head a year. I also farm nearly 500 acres of corn and soybeans. I appreciate this opportunity to present our views on competitive and open livestock markets.

The Iowa Pork Producers Association is the oldest and largest state pork producer group in the country. IPPA represents well over 6,500 producer leaders proactively on issues ranging from international trade missions, pseudorabies eradication, ag policy and environmental regulation. In Iowa, the pork industry accounts for over 86,000 jobs, contributing nearly $3 billion in payroll to our state's residents. If you look at the total economic impact to the state of Iowa, our pork production affects nearly $12 billion in the state.

Our organization has previously testified on this issue from a different perspective, specifically the proposed ban on packer ownership. While we strongly support this concept, today I would rather focus on the new proposal to require a percentage of livestock to be purchased on the spot or cash market.

This new concept was apparently discussed during conference deliberations of the farm bill but was sidelined until further review. This approach appears to have bi-partisan support including South Dakota Senator Johnson and Representative Thune. The Livestock Packer and Producer Act of 2002 (S. 2867) has now been introduced by Senator Grassley in the Senate and in the House (HR 5247) by a number of co-sponsors.

Just this week our Board of Directors voted to endorse the legislation and to devote resources towards its' passage. Our board took this action because livestock farmers are concerned about the availability of competitive livestock markets. This approach would guarantee that independent producers have a share in the marketplace while assisting the mandatory price reporting system. Requiring negotiated sales ensures that processors will provide for public shackle space for all hog farmers.

Available shackle space has become critical for independent farmers, because promises of new slaughtering plants will not benefit farmers if the slaughter is only for packer owned hogs and the new plant results in closing another plant. The legislation would improve the accuracy and transparency of all livestock markets. As our national organization correctly stated in a 1999 press release, "More negotiated sales would help ensure prices reported for the spot market reflect the current value of hogs".

Furthermore, we think this approach makes sense for a number of specific reasons, including:

*Both packers and producers need accurate market information from negotiated livestock sales. While the information will be useful to determine daily cash purchases, this approach will also impact animals purchased on a contract or formula basis, because most marketing contracts a tied directly to the daily cash market.

*The legislation phases in the required spot purchases and is not fully implemented for 6 years. This will allow farmers and packers time to fully implement and adjust to the legislation.

*Smaller packers and single plant entities are exempt from the law.

*Most if not all packers are currently in compliance with the first 5% purchase requirement.

*Farmers who form and operate cooperative packers would also be required to purchase spot or cash market animals, but at ½ the percentage compared to a traditional packer.

These are just a few reasons to support this legislation and I'm sure there are many more. Independent pork producers throughout the country need more competitive markets. We urge congress to give producers the opportunity for success by enacting this legislation.

Another market issue facing farmers is full implementation of the federal Mandatory Price Reporting law. USDA has started in the right direction, but continued market oversight is now crucial.

In closing, IPPA is committed to a fair, transparent and competitive marketplace. Our producer members constantly remind us of our duty. Mr. Chairman, thank you for holding this important hearing and for giving me the opportunity to address the committee. The Iowa Pork Producers Association stands ready to assist you in your work on these critical issues facing livestock producers. Thank you.

Controlling Misuse of Packer Market Power– A Step toward Greater Fairness, Efficiency and Equity in the Marketplace

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Statement for Senate Judiciary Committee hearing:
Ensuring Competitive and Open Agricultural Markets:
Are Meat Packers Abusing Market Power
Sioux Falls, South Dakota
August 23, 2002

I am honored to have been asked to offer my views on the need for restoring fair and open competition in the livestock markets. In the last four years, I have been particularly interested in issues involving competition in agriculture. I have been an invited witness at Congressional hearings including an appearances before the Senate Agriculture Committee, the Senate Judiciary's Subcommittee on Antitrust, Business Rights and Competition, and the Subcommittee on Agricultural Appropriations to discuss competition issues in agricultural markets. I have also been an invited participant in several events sponsored by the U. S. Department of Agriculture including the Public Forum on Captive Supplies, held in Denver, Colorado on September 21, 2000.

In 2000, I published an article in the Wisconsin Law Review: *Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy*, 2000 **Wis L. Rev.** 531. The central thesis of that article was that there are serious problems of market failure in agriculture directly related to the high and increasing levels of concentration in the industries buying from and supplying farmers and ranchers. I urged increased antitrust enforcement and also suggested legislative action in addition to antitrust enforcement was essential to restoring competition in agricultural markets. The goal of legislation should be to facilitate the operation of a dynamic market process that is efficient, transparent, open and fair.

Farmers are poorly served by existing market structures and practices both as producers and as buyers. The range of competitive market problems confronting farmers and ranchers today extend from the unnecessarily restrictive contracts for the purchase of genetically modified seed and the limited competition in many equipment markets to the excessive concentration in most of the industries buying and processing agricultural products including those in meat, grain and dairy. The existence of concentrated markets creates the incentive and the capacity for such firms to engage in conduct aimed at exploiting those participants with limited options and to entrench existing market power against the threat of deconcentrating and effective competition.

Free and open markets are generally the best institutional structure for achieving all the important goals of economic policy: efficiency, dynamic growth, equitable allocation of resource, opportunity for all participants. Economists and policy makers have also long recognized that markets are not inherently fair, efficient or open. Where markets are unconcentrated, there are many buyers and sellers, and there is a strong tendency for efficient, workable and fair methods to develop as the inevitable outcome of the interaction of many participants all seeking a neutral and open market place.

But no such inherent tendency exists in markets where a substantial difference in size between buyers and sellers exists and the market is also highly concentrated, i.e., there are few firms altogether on one side. Also, if one side has significant and persistent advantages in information or some other important element related to the transactions between buyer and seller, then too such a market is unlikely to experience much pressure for desirable conditions. There is a grave danger that such markets will be shaped by strategic conduct that frustrates the goals of an efficient, open, fair and accessible marketplace. This in turn imposes immediate burdens on the disfavored class of participants and ultimately on consumers and the economy as a whole as less efficient production and market transactions take place. When markets lack such inherent tendencies to desirable conditions, the law can play a vital role in defining rules for the participants that reduce their capacity to engage in strategic conduct and restore greater balance between the parties. The statute books contain many such laws including ones regulating credit, automobile dealerships), energy markets and, of course, securities markets.

It is true that in the last two examples we have seen massive regulatory failure. Enron and others were able to game the regulatory system in both gas and electricity, and Enron, Worldcom, and others lied about their income and profits in direct violation of existing law regulating publicly traded companies. For different reasons, both energy and public capital markets are very vulnerable to strategic conduct. Over the last 30 years, this country has gone through both a process of moving away from strict utility regulation in order to get the benefits of the market for consumers and a parallel effort to rewrite the regulation of capital markets to ease the burdens on those enterprises that participate in these markets. Unfortunately, in both cases, the process was flawed. Profit seeking energy firms and their managers have exploited the flaws in the new market regulations for their own gain to the great detriment of users of energy including farmers and ranchers. Managers and some of their close friends as a result of the false accounting have also profited greatly from the inflated value of the stock and stock options they held.

We are witnessing today a renewed awareness that such markets require well crafted and effectively enforced rules to ensure that the market process works in the best interest of the general public, producers, investors, and consumers. Such regulation does not replace the market. It seeks to facilitate its operation by ensuring that all participants have reasonable information, equitable treatment, and access.

It has been, I think, the genus of our economic system that we have over time preferred, whenever its is feasible, market facilitating regulation to governmental command and control of economic activity. Professor John McMillan of the Stanford University Business School has just published a very interesting book on the market process, **Reinventing the Bazaar: A History of Markets** (Norton, 2002). This book aimed at the general reader explains in convincing detail why markets are so effective and important. The author also emphasizes that for markets to fulfill their social function they must be competitive and equitable. Participants must have good information and access. Further, he emphasizes, as I have, the importance of government regulation in ensuring that markets remain open, balanced and fair when they are otherwise vulnerable to strategic conduct and self-seeking manipulation. Where one side or the other has special advantages, there will be an entirely understandable tendency to exploit that advantage. The role of law is to restore balance and facilitate the ongoing effectiveness of the market.

The focus of this hearing is on the questions of whether packers are abusing their market power and, if so, what can and should be done about it to restore open and competitive markets. My brief answers are that there is strong evidence of abuse: discrimination among producers, conduct strategically aimed at exploiting and entrenching market power. The harder problem is how to restore a fair, open, equitable and accessible market. Antitrust law can and should make an important contribution especially when other agencies of government having more relevant powers lack the political will and institutional capacity to act. Indeed, antitrust law provides tools that can deal with some, but not all, of the problems that exist in facilitating a fair, open and accessible market in livestock. But in the contemporary enforcement world and given the inherent limits to antitrust law and its enforcement, market specific laws that limit or eliminate opportunities for specific kinds of strategic behavior are essential to achieving improved market behavior in a timely and effective way. Such rules can constrain strategic and opportunistic behavior by packers and facilitate a more open, accessible and efficient market for livestock.

I want to discuss with you, first, the kinds of problems that exist in the contemporary market for livestock. Second, I will discuss the potential for antitrust law to deal with those problems.

Are Livestock Markets the Target of Strategic Conduct Having Adverse Effect on Farmers and Consumer?

The initial point that needs re-emphasis is that the markets for livestock, especially for the purchase of livestock, are highly concentrated. The four dominant firms in beef handle about 80% of all the steer and heifer slaughter. The level of concentration in pork is lower, but growing. More importantly, for any farmer there are very few choices–rarely more than two and often only one–for potential buyers. Thus, buying side concentration is substantially greater than selling side concentration which is the conventional measure.

High buying side concentration invites the kind of market price manipulation that we have recently seen in energy markets in California. Participants, especially those operating at more than one level (e.g., selling natural gas and electricity produced by the use of gas), had the opportunity and incentive to drive up prices enormously. The regulatory system seeking a competitive and open market was not able to identify and regulate the strategic conduct that was occurring. Only now are both state and federal regulators figuring out how the dominant firms exploited the market. The same opportunities exist in meat packing. Large firms buying livestock in largely non-competitive environments have the opportunity to manipulate prices to exploit farmers and ranchers. Eventually, this will drive many producers from the market. At that time, the packers will seek foreign imports and increase prices further.

The large packers led by Tyson are also entering into various kinds of special relationships with the increasingly concentrated grocery industry. Among the kinds of relationships being created are ones involving "slotting" fees in which the food processor pays for special access to the retail chain. This forecloses smaller firms from access and thus makes competition and deconcentration of these industries more difficult. Another growing and worrisome trend is the designation by a retailer of a leading firm in a class of grocery as a category captain. The captain then controls the selling of the particular category of food for the entire chain–setting prices, designating the brands to be offered, regulating access to specials or other competitive initiatives. This method of doing business is coming into meat as branding becomes more important in this area. There is a symbiotic relationship between the increasingly concentrated buying power of the retail chains and the buying power of the packers. In combination they will have a mutual interest in suppressing new competition at both levels. Resolving these competitive concerns would take us beyond the scope of this hearing, but it is suggestive of the range of competitive problems that exist.

The other recent lesson from the business world is that some large firms tend to have a culture of lawlessness. Enron not only manipulated the market for energy, it also engaged in significant deception of its shareholders and creditors by making false financial statements. Worldcom, Global Crossings, and Quest, each a major firm in its field, also engaged in comparable lawless behavior. In the meat packing business, we have recently had violations of food safety, employment and accounting requirements. Moreover, there is a long history of market exploitation by these firms and their predecessors. The beef trust was one of the inspirations for the Sherman Act. Early antitrust litigation featured a number of successful challenges to the anticompetitive conduct of the industry. After World War I, the industry was the target of a major FTC study that documented its lawless behavior; the Department of Justice brought an antitrust suit that resulted in a major consent decree that restructured the industry and forbad the surviving firms from engaging in certain businesses in an effort to restore competition;

and, of course, Congress adopted the Packers and Stockyards Act (PSA), one of the most sweeping authorizations to regulate a market to promote and protect fair and open competition on the books. The subsequent legal history shows a massive resistance to the decree by the packers and their continued efforts to avoid both its commands and those of the PSA. This historical record and contemporary behavior in other areas is highly suggestive that the culture of this industry is lawless. The central implication is that meat packers are likely to engage in abusive conduct if they can.

When I was reviewing materials about the operation of the beef slaughter markets in connection with the Public Forum on Captive Supplies (Denver, September 21, 2000), I was immediately struck by the inequitable treatment of feedlot operators. If the operator had an arrangement with a meat packer (captive supply agreement), then the operator got significantly more favorable terms than the operator down the road with the same quality of beef who was not so favored. Some economists argued that the evidence supported the claim that the manipulation of captive supplies only slightly effected day to day cash market prices. To me that was the tip of the tail of this dog. The real problem was and is that only favored producers have the opportunity to get the higher prices. This undermines two important goals of a workable market: access and equitable treatment. Surprisingly, economists other than Professor Taylor of Auburn have paid little attention to the implications of this record of discrimination.

There is also good reason to be concerned that the "higher" prices received by the favored feedlots are only relatively higher when compared to the concurrent cash price. Thus, the deeper danger is that the total mix of prices is manipulated downward by the trade off between captive and cash purchases. This strategy is feasible only in concentrated markets where competition from new entrants or marginal firms will not disrupt the scheme.

In addition, some packers were setting the prices for their captive supply price based on the cash price being paid at their own facilities at the time the captive supply was delivered. The packers have the capacity to schedule the delivery of the captive supply and so can match scheduled delivery with the prices they simultaneously pay in the cash market. The incentive to manipulate prices is obvious, and there is no legitimate business justification for the practice. Two years ago, there was a consensus among those of us participating in the Denver Forum that this practice should be banned under the PSA. Regrettably, the Department of Agriculture has yet to adopt such a regulation. This is one of the most conspicuous examples of the failure of the regulatory authorities to facilitate open and fair competition.

Assuming, as many predict, that longer term contracts with various quality specifications are going to replace most or all of the cash market, it should be obvious that there are complex issues to be resolved on how such transactions would work. In particular, how will prices be set once the cash market is largely or entirely gone? When and how will a seller be able to substitute comparable livestock from another source to fulfill a contract? How can access for all qualified producers be maintained when most or all purchases are made via a contract system? It would seem to me to be foolish indeed to allow the packers unilaterally to establish the terms and conditions for this emerging contractual system. The packers necessarily will consider primarily their own economic self interest and potential for strategic gain. The farm community groups and the legislators from farming areas should be at the forefront of insisting on the development of an appropriate, fair set of rules within which these new marketing relationships can develop.

Packer ownership of livestock is a particularly hot topic currently. It is an extreme form of captive supply and the element most fully manipulable. Moreover, such ownership contributes little or nothing to the more efficient operation of the packers. Any legitimate needs can satisfied through other types of contractual relationships. It is, as we all know, only part of the totality of captive supply. Because the exact numbers of both packer owned livestock and those under contract are not available nor do the packers disclose information about the timing for delivery of these cattle, there is substantial capacity to manipulate both short term and long term market prices for both cattle and hogs under contract and those sold in the cash market.

In addition, both types of captive supply allow the packers more readily to engage in other practices that avoid competition among themselves, to the extent that they still compete at all. For example, there are recurring reports that the packers establish informal arrangements not to compete with each other in bidding for livestock, in particular cattle, from any particular feeder. The result is that producers basically wind up with a single buyer for all practical purposes even if there are several buyers that could compete to buy from that producer.

Even when buyers compete, they often insist on a right of first refusal (if they will match a higher bid, they get the pen). This discourages price competition among bidders because the favored bidder can always win by merely matching a competing bid. The obvious reason for this practice is to stifle the incentive to compete for any particular purchase. It makes economic sense only if the potential competitors have an underlying understanding to allocate producers and want to avoid competing on price with each other. There is once again no legitimate business justification for this practice.

Another anticompetitive practice that has emerged from the highly concentrated buying markets is a collective refusal to compete on price. I am informed that in making cash market purchases where there is bidding, the packers will only bid up at a minimum rate of a \$1 per hundred weight. This means that the bid must go up roughly \$8 to \$12 a head which in turn means that the bid has to go up several hundred dollars for a pen of cattle. Obviously, imposing that kind of restraint on bidding reduces the incentive to compete because the buyer can not use a smaller price increase. This practice requires the concurrence of all potential bidders and lacks any legitimate business justification. It works once again to discourage bidding once a packer has made an offer. This allocates livestock without giving the seller the benefit of a competitive market.

Both of these patterns of conduct require some understanding among the buyers, and both have the effect of stifling competition. This is in the overall interest of all buyers only if they operate in a small enough circle of roughly comparable bidders that all can get what they want without paying top dollar for it.

The result is a dysfunctional market. Contracts govern many sales. The favored feedlots and farmers are under an unspoken economic pressure to work with the packer and not express concerns. If there are problems, then the packer can simply refuse to buy. In a market with very few buyers, such a refusal can often result in economic death.

The packers can control their costs by these strategies and can ensure that they will have a docile group of suppliers. It is in the interest of the dominant packers to enhance and maintain this system because they all gain regardless of the level of competition in the downstream markets for meat. Professor Taylor in his recent testimony (July 16) before that Senate Committee on Agriculture, Nutrition and Forestry Committee has provided an extensive economic analysis showing how the margins of the meat packers have increased as result of their exploitation of their buyer power. This directly harms producers and in the long run imposes inefficiency and higher costs on consumers.

In sum, the current market situation for beef and hogs is now very poor. The sellers have limited information, do not have access to all buyers, and can be subject to an arbitrary refusal to deal if the operator displeases the buyer or his supervisor. The implications of this kind of market situation are that producers with options are likely to take some other option even if that is a less efficient use of their skills and resources. Ultimately, the meat production process in this country will be less efficient and the slaughter houses will announce that they need to look overseas for supplies. These will be less efficient suppliers, but they will emerge as major sources of livestock because of the strategic conduct of the packers.

To bring the market for hogs and cattle back to a reasonably workable state of competition requires that there be a conscious effort to seek market governance rules (laws) that achieve the essential conditions of an effective market: good information, equitable treatment of participants, and access for all willing to participate in the market. Indeed, these have been the basic goals of American agricultural law over the years. Unfortunately, but not surprisingly, the dynamics of innovation and the evolution of markets have a strong tendency of make the law on the books less than fully relevant to the realities of the market place.

Can Antitrust Law as Currently Understood and Enforced Remedy These Problems?

Antitrust law has been a basic tool for dealing with anticompetitive conduct and market structures for over a century. But its use is limited to its concern for the overall competitiveness of markets, and it is applied in a case specific way so that it can not provide the basis for directly establishing generally applicable rules for the market. It has little capacity to address the problems of comparative equity that arise from economic discrimination when the discrimination has only an indirect effect on the overall state of the market, especially when the conduct at issue is either authorized by or left unregulated by laws and regulations more directly relevant to the specific market. For antitrust law to apply there should be an actual or potential effect on competition arising from the conduct. A major criticism of the Department of Agriculture studies of livestock markets is that they were not framed with that issue in mind nor was the data examined in ways that provide analysis directly responsive to those concerns.

The state of antitrust law with respect to the concerns of farmers as sellers of products into concentrated buying markets offers some good news but on balance does not provide a comprehensive system for facilitating a workably competitive market. I will briefly describe the present state of law as it relates to these concerns, emphasizing the cases that provide the best support for a pro-active program that can address some of the concerns that have motivated the packer ban.

The most important item of good news is that the courts have clearly recognized that buyer power is as much a source of antitrust concern as is seller power. Buyer power is called "monopsony" when a single firm has power; this is the buying side form of monopoly. When several firms have collective power, it is technically called "oligopsony." Within the last three years, three federal circuit courts of appeal, the Second, Seventh and Ninth, have all upheld challenges to buyer power and emphasized that the abuse of such power is of equal concern to antitrust along with the more traditional seller power problems. *Toys R Us v. FTC,* 221 F3d 928 (7th Cir. 2000); *Knevelbaard Dairies v. Kraft*, 232 F3d 979 (9th Cir. 2000); *Todd v. Exxon*, 275 F3d 191 (2nd Cir. 2001).

These decisions recognize that firms can have buyer power with a substantially lower market share than is usual in seller power cases (e.g., *Toys R Us*). The courts have also recognized that it may be rational for more firms to collude together to suppress their competition in buying than conventional theory holds are likely to be able to conspire successfully on the seller side (e.g., *Todd v. Exxon*). Thus recent case law finds that abuse of buyer power, both collectively and unilaterally, can be a violation of antitrust law, and recognizes that buyer power needs to be examined on its own terms and that the traditional seller power analysis may not be apposite.

In addition, in my view, the decision of the DC Circuit in the *Microsoft* case served as a strong reminder that a firm with substantial market power can not abuse that position to eliminate potential competition or exploit other market participants in unjustified ways. *Microsoft v. U.S.*, 253 F3d 34 (D.C. Cir., per cur. 2001). The opinion established a workable standard for judging the merits of conduct that has anticompetitive effect by looking critically at the non-monopolistic justification to determine its validity in fact and then asking whether alternative methods of doing business would have achieved the same legitimate goals without causing so much economic harm. Another recent trial court decision involving practices of monopoly airlines to exploit their power over fliers seeking to go to or from a hub city has also stressed the legal rule that, if a business has a monopoly position in some market, this does not give it a license to exploit that position to the detriment of its customers (or by implication suppliers) by imposing avoidable burdens or costs. *In re Northwest Airlines*, 208 FRD 174 (E.D. Mich. 2002).

Finally, when Cargill acquired Continental Grain, the Justice Department's Antitrust Division threatened to challenge the merger unless Cargill agreed to divest some assets. The basis for the challenge was only the potential adverse effect of that merger on grain producers. Thus, the issue was whether the merger would create unjustified and unnecessary buyer power. The fact that the Cargill choose to settle the case with a considerable divestiture suggests that it was convinced that the government had a good chance of prevailing if the case went to trial. See, *US v. Cargill*, 2000-2 Trade Cases para. 72,966 (D.D.C. 2000)(affirming consent decree). Although this particular merger case arose under the previous administration, Charles James, the current Assistant Attorney General for Antitrust, has committed that the Division will continue to focus on buyer power problems both in mergers and in other areas.

Thus, the state of the law and the stated commitment of the law enforcers are favorable to a more proactive enfrocdement policy toward the concentrated livestock buying markets.. Unfortunately, when we look at what has in fact been done and what can be done, the record to date is not nearly as hopeful.

First, in the 1980s, the government allowed several major mergers in the meat packing industry that contributed substantially to its present highly concentrated structure. It did so because at the time there was a belief, contrary to economic theory and business experience, that if the downstream markets were competitive, then buyer power would not be able to distort upstream supply market prices. It is now evident that these decisions were wrong. The real economics and efficiencies of slaughter come at the plant level, and not from coordination of many plants. Buyer side concentration has proven harmful to producers regardless of the level of competition on the downstream selling side.

There is, moreover, no statute of limitations on anticompetitive mergers. Therefore, as a matter of law, these mergers could be reconsidered today because the record of anticompetitive effects arising from them is clear. I would have said, however, that no federal antitrust agency is going to revisit its past decisions. In fact, there are powerful reasons supporting such a policy such that even I would be loath to re-open closed matters merely because the analysis of competitive effects proved to be wrong. But, to my surprise, Tim Muris, the Chair of the FTC, has recently announced that he is going to have his staff revisit a number of hospital mergers to see whether they had adverse effects on the price of health care. His statement implied that the FTC might then re-open some of the closed cases. If that happens in health care, then it should also happen in the case of packer mergers.

Second, and even more troublesome, there was the much more recent failure of the Antitrust Division to challenge the acquisition of IBP by Tyson. IBP is the largest beef packer in the country with about 1/3 of the steer and heifer slaughter market. It is also one of the top two firms in the pork industry, and it is a buyer of hogs from the other top pork producer, Smithfield. Meanwhile, Smithfield has itself entered the beef business with two acquisitions of smaller packers. Today, Smithfield and Tyson are both customer/supplier in pork and ostensible competitors in both pork and beef! This in itself would seem to raise serious competitive concerns as well as concern under the PSA.

Tyson, the nation's leading poultry producer, had long had a declared goal of entering the business of producing both beef and pork. If it had made that entry with either new plants or with the acquisition of smaller firms, as Smithfield has in fact done to enter beef, then competition in beef packing would have been increased and farmers would have had more competitive markets in which to sell their livestock. Even the threat of such entry by Tyson, given its position in related markets and its close links to major grocer retailers, would have deterred existing the packers from exploiting too excessively their market power because of the risk it would induce Tyson to enter sooner or on a larger scale. Despite the obvious competitive problems created by this merger the Antitrust Division cleared it without objection. Six months ago, Doug Ross of the Division in response to my public criticism at a farm meeting claimed that the Division had carefully examined the competitive issues in the Tyson-IBP case. Because such review is secret and the results are not revealed to the public, we have, of course, no way of knowing what the analysis in fact was or what facts the Division relied upon to determine that there was no likely adverse effect on competition. Yet this merger consolidated leading processors of beef, pork and poultry into a single firm which also had various exclusive and category captain deals with major grocer chains.

I would here note in the European Union the competition law enforcers are required to state publicly their analysis of each and every merger they review whether they allow it or deny it. The result is that the standards and their application are much more transparent in Europe. Today, the Department of Justice must provide a written evaluation of every bank merger and bank holding company acquisition in the country. This has provided greater clarity in that area and again has not deterred merger and acquisition. It is high time that the Antitrust Division and the FTC were required to report their analysis of all major mergers whether they challenge them or not. This would make the process more transparent. It would protect the enforcers from false acquisitions of laxness and would allow much more informed critiques of policy. But I digress.

While the Tyson-IBP merger is the most conspicuous example of what appears to be weak merger enforcement, I am aware of other mergers likely to have substantial anticompetitive effect in poultry, grain and livestock have not been challenged. This suggests that the present commitment to enforcement is not likely to reduce the level of concentration or significantly change industry structure.

For the same reasons, I am skeptical that the present antitrust authorities will undertake on their own a sustained investigation, let alone challenge some of the other industry practices that unjustifiably entrench and exploit the packers buyer power. Specifically, the practices of semi-exclusive dealing with producers, and the related practice of informal patterns of first refusal rights can be challenged as violations of Section 1 of the Sherman Act. They are in my view unreasonable vertical and horizontal restraints on competition. As such, they are illegal under the rule of reason as well as the per se rule that condemns naked restraints on competition.

Even more obviously, the understanding that bidding for cattle will be take place only on the basis of increments of $1 a hundred weight is an unlawful restraint under the antitrust laws. In this instance, there is a very parallel case involving the securities markets where the brokers agreed to set a fixed margin between ask and bid prices rather than allow the market to determine this spread. Those brokers wound up subject to antitrust damage liability of over $1 billion and an injunction barring such conduct in the future. See, e.g., *In re NASDAQ Market Makers Antitrust Litigation*, 176 FRD 99 (SDNY 1997). Despite this precedent, I have yet to learn of any effort by the Antitrust Division to investigate any of these practices of the meat packing industry or mount a challenge to them.

Even if some of these practices were not the result of an understanding among packers, they could still be challenged as either unlawful vertical agreements, in some situations, and as unlawful monopolistic conduct under Section 2 of the Sherman Act. The recent *Micorsoft* and *Northwest Airlines* decisions provide strong support for such challenges. In addition, a growing body of economic scholarship demonstrates that vertical restraints and unilateral conduct by dominant firms can unnecessarily and unjustifiably interfere with efficient competition.

It is even possible to challenge packer ownership of livestock prior to slaughter under Section 2. This conduct serves no legitimate business interest of the major packers that could not be addressed at lower cost and risk through other less intrusive contractual methods. The only benefit they get from this particular strategy is greater leverage as buyers and contractors for livestock. As a result this practice serves only to increase their capacity to exploit whatever inherent buying power they already possess. In addition, it assists their longer run strategy of increasing and entrenching their buyer power. In consequence, it seems to me, that such vertical integration constitutes unlawful monopolization.

I should also emphasize to you that the state of antitrust law is such that bringing cases on the theories I have just suggested, while valid in my view, would be risky. In the last several decades, the courts have not shown themselves to be overly fond of antitrust law in general and seem all too willing to accept the excuses or justifications tendered by businesses. How much this might change in light of the recent revelation that many businesses have engaged in a variety of unlawful practices is hard to estimate. Even if there is some change, the litigation risks of bringing cases along the lines I have suggested would be substantial. In addition, to mount such cases would take a large amount of staff time and other resources–both of which are limited.

Nonetheless, it seems to me that continued congressional interest focused on livestock markets may well induce the Antitrust Division to focus more attention and commitment in this area. Certainly it appears that there is a correlation between the number of matters being investigated or litigated and the increased number of hearings at which antitrust law enforcers were asked to explain their action or inaction with respect to agricultural markets. Thus, while current enforcement is much less than is necessary, strong pressure from congress can, I believe, cause a significant further increase in those efforts.

There are inherent limits to reliance on antitrust law as a central tool to create and enforce basic rules for market conduct. Antitrust law is enforced only through a case by case, litigation mode. Thus, it is very difficult to go from a specific case to a rule of general application in the market. Antitrust law can implement some very basic rules, but as soon as there is need for any nuance or complexity to the market facilitation regulation, then antitrust is a blunt and imprecise tool. It is especially badly adapted to developing new market facilitating regulation that requires changes in significant aspects of market conduct. Indeed, antitrust law often accepts as basic background the legal and institutional context within which enterprises operate. Antitrust seeks to ensure that, to the extent feasible, competition is maintained within that framework. But antitrust law is not a good means to revise fundamentally the rules governing a complex market.

The bottom line is that, despite the importance of antitrust and its undoubted role in policing the livestock slaughter markets, it can not be the only instrument for attempting to establish or change the rules governing the market place. Fundamental change is properly the role of the legislature and the administrative agencies, like FERC, the SEC or the CFTC, that are established to carry out legislative commands. When the relevant agency lacks the authority or the will to engage in market facilitating regulation as seems to be the case with the Department of Agriculture, it is the obligation of congress to respond with appropriate legislation and motivation.

Conclusion: Enhanced Antitrust Enforcement With Respect to the Structure and Conduct of the Meat Packers Is a Step Toward Better Market Regulation But It Is Not the Entire Answer

In my view there is a very strong case for increased antitrust enforcement in the livestock markets. The first best option would be to change the structure of the meat packing industry to create a more competitive one. I would here note that the efficient scale of packing plants is very dramatically less than the present market shares of the dominant firms. Thus, it would be possible to restructure the industry into a workably competitive set of firms. However, such a massive undertaking is extremely unlikely. What can and should happen, is that the Antitrust Division should take a more active stance in examining the conduct of the dominant firms in the industry. I have listed several areas where antitrust could be effective within the context of current law. In addition, if the administration is prepared to reopen merger approvals granted by prior administrations, then it can and should revisit the demonstrably bad decisions made on packer mergers both in the recent and more distant past.

Ultimately, however, without a massive change in the structure of the industry, antitrust has only a limited capacity to provide a comprehensive reformation of the market process for livestock that various legislative proposals have suggested. Such proposals also recognize that the Department of Agriculture under both the past and present administrations lacks the political will and institutional competency to engage in the rule making necessary to facilitate an efficient and fair market in livestock. The farm bill originally proposed in the Senate had a chapter that made a real attempt to develop a new and comprehensive set of regulations to facilitate fair and open competition. Regrettably that chapter was removed from the bill even before it came to the floor. Only a proposed ban on packer ownership of livestock made it that far and even that was eliminated by the conference version of the bill.

It seems to me that legislation is going to be required to mandate the regulations that are necessary if the fairness, openness, and accessibility of livestock markets are to be restored. Indeed, even if the Department of Agriculture were to come alive and commence work on market facilitating regulations, the present statutory structure has a number of anomalies that make effective enforcement difficult and frustrate the development of a comprehensive set of regulations that would govern all agricultural markets.

I welcome the interest of the Judiciary Committee in the problem of restoring and maintaining competitive markets in livestock. Achieving that goal is going to require diligent efforts on your part both to encourage enforcement of current law and the creation of a workable set of regulations to facilitate fair, open and accessible conditions in the new marketing contexts that farmers and ranchers will face.

**TESTIMONY OF
THE CENTER FOR RURAL AFFAIRS**

**TO THE UNITED STATE SENATE JUDICIARY COMMITTEE
FIELD HEARING**

**ENSURING COMPETITIVE AND OPEN MARKETS IN AGRICULTURE:
ARE MEATPACKERS ABUSING MARKET POWER?**

**SIOUX FALLS, SOUTH DAKOTA
AUGUST 23, 2002**

Members of the United States Senate Judiciary Committee, we appreciate the opportunity to submit this written testimony on issues of great importance to the family farmers and ranchers of South Dakota and the remainder of the nation. We thank you for convening this hearing and listening to and accepting the valuable testimony from organizations like ours and producers from across the region. We also thank Senator Johnson for inviting us to submit this testimony.

Established in 1973, the Center for Rural Affairs is a private, non-profit organization working to strengthen small businesses, family farms and ranches, and rural communities through action oriented programs addressing social, economic, and environmental issues. We have had a long history of research into the issues concerning competition in livestock markets, and we have long advocated for reforms that will ensure a more competitive marketplace for family farmers and ranchers and independent producers. During the Farm Bill we were one of many organizations that supported the ban on packer ownership that was included in the Senate bill. We continue to support the packer ban along with S. 2867 recently introduced by Senators Grassley and Feingold on spot market purchases of livestock.

While we support these efforts and believe they are necessary, we will focus our comments today on one specific aspect of the competitive market issue – price discrimination.

<u>The Packers and Stockyards Act and How it Should be Amended</u>

We will make the case for clear and decisive action by the Secretary to define the "undue price discrimination" prohibited by the 1921 Packers and Stockyards Act. We have drafted and offered language for a simple, but necessary, change to the Packers and Stockyards Act. This language would do something that has never been done in the over 80 years that the Packers and Stockyards Act has existed – define the term "unreasonable preference or advantage" that is listed as an unlawful practice under Section 192(b) of the Packers and Stockyards Act (7 U.S.C. § 192(b)).

Our proposed language is as follows:

The term "unreasonable preference or advantage" shall include, but not be limited to, any practice or device by a packer or a packer's agent or representative, including a single transaction, to directly or indirectly procure livestock from a producer on terms withheld from smaller volume producers unless such livestock is purchased within two weeks of slaughter in a public market through a competitive bidding process in lots that do not exceed one percent of the average daily slaughter of that species during the prior year. Price differences that reflect lower costs of acquiring livestock from larger volume producers, excluding cost savings from operating plants at or near full capacity, shall not be considered an unreasonable preference. Price premiums based on established and recognized standards for product quality, time of delivery and production methods that enhance product value and can be reasonably applied on a wide range of farm sizes shall not be considered an unreasonable preference or advantage provided that those premiums are offered in a manner that does not discriminate against smaller volume producers.

This definition would allow packers to pay premiums for quality. It would allow packers to pay premiums for volume that reflect real reductions in acquisition and transaction costs.

But most importantly our proposal would stop the current practice whereby mega-producers are allowed to use their economic power to negotiate price premiums price that far exceed any real cost savings.

This amendment is necessary because the courts will give USDA very narrow latitude in enforcing the undue price discrimination clause of the Packers and Stockyards Act as long as USDA refuses to clarify how it is interpreted. In *IBP, Inc. v. Glickman*, 187 F. 3rd 974 (8th Circuit, 1999), an USDA Administrative Law Judge and Judicial Officer found – and were affirmed by the 8th Circuit Court of Appeals – that price discrimination was not undue as long as the packer had a legitimate business reason for discriminating. That approach protects packers from poor business judgment but does nothing to ensure fair competition and a level playing field to family-scale and independent producers.

As long as the Packers and Stockyards Act does not define "undue preference or advantage," courts will abide by that very narrow interpretation to the detriment of livestock producers.

<u>Documentation of the Problem</u>

It is difficult for me to provide evidence of price discrimination by meat packers. The Center for Rural Affairs can collect anecdotes from producers and lenders in which they share what they were told by buyers with major packers.

However, we cannot provide systemic analysis of price discrimination because we do not have access to meat packers' records. Nor do mega-producers routinely share business information with us.

Of course, USDA does have access to this information. The Secretary has long enjoyed broad authority under the Packers and Stockyards Act to issue "special orders" requiring that packers file regular reports regarding all livestock transactions. Special orders may mandate that these reports include all important information regarding: 1) method of procurement; 2) terms of payment 3) captive supplies 4) practices for offering forward contracts and marketing agreements; and 5) any additional information the Secretary deems necessary to carry out the provisions of the Packers and Stockyards Act.

If the Secretary is committed to ensuring competition and if the Secretary believes that she needs more information to act, then the Secretary should use her authority to collect that information and resolve the issue. Instead, USDA makes excuses for inaction and concludes that the market is as competitive as it can be under the current circumstances. To many independent producers, current circumstances are the road off the farm or ranch and to bankruptcy.

The one effort USDA has made in this regard – the *Western Cornbelt Study* – is inadequate and out of date. The data were collected nearly seven years ago. Since then, the livestock industry and the practices of packers have changed dramatically.

Further, its usefulness was limited by its design. It lumped all producers selling more than 1,000 head of hogs during January, 1996 into a single category. Thus mega-producers with the capacity to exercise real market power were lumped with independent farmers selling 12,000 or fewer hogs annually and sale barns selling large mixed lots. That diluted the premiums received by mega-producers.

Nonetheless, the study found that large producers were more likely to sell on contract and as a result did receive more for their hogs. But it did not examine why larger producers were far more likely to have contracts that paid more than the spot market. It did not analyze whether contracts that provided higher prices than the spot market were offered exclusively or primarily to those with large numbers of hogs.

Congress should direct USDA, through the Agriculture Appropriations bill or some other legislative vehicle, to use its existing authority mandating The Grain Inspection Packers and Stockyards Administration to collect information by special order on livestock procurement contracts offered currently and over the last year by the nation's ten largest packers of pork and beef in a manner that demonstrates the differences in base price (controlling for yield and quality adjustments) and other terms offered to producers of varying sizes, the size categories that determine the terms offered, and the number of producers of varying sizes to which the various contracts and terms are offered. Further, Congress should order GIPSA to report its findings to the public in manner that clearly describes the size categories (in annual marketings) at which price premiums change and the size categories (in annual marketings) at which more favorable contracts become available. No reporting category should include more than 25 percent of the national slaughter.

We would urge Congress to immediately adopt this language and order USDA, through GIPSA, to conduct this study.

Social Costs and Benefits

When Chuck Hassebrook, the Center's Executive Director, served on Secretary Glickman's National Small Farms Commission he asked why the Packers and Stockyard's Administration had not acted on the Commission's request that it draft proposed legislation to clarify its legal authority to stop undue price discrimination. He was told that the recommendation would not be implemented because the view within Packers and Stockyards was that "volume premiums are the American way."

We believe that is wrong. I believe that a level playing field is the American way. But clearly, USDA's inaction in addressing price discrimination reflects the view within the agency that not only volume premiums, but the continued concentration of agriculture into fewer hands, are socially desirable. The loss of family farms and ranches and the death of rural communities is seen as part of the inevitable march progress that, though perhaps lamentable, enhances efficiency.

That is wrong. This is not about efficiency. We do not objective to volume premiums that reflect real costs savings and real efficiency associated with the lower cost of acquiring livestock from one mega-producer rather than many smaller farmers. So limited, volume premiums can enhance efficiency and benefit consumers.

There are also efficiency gains associated with operated packing plants at full capacity. But, those gains are the same whether the livestock filling the plant comes from small or large operations. In fact, efficiency is enhanced when packers are required to compete to fill their plants, rather than resorting to sweetheart deals with mega-producers and price discrimination against the family farms and ranches that have long been the backbone of rural America.

We do object to volume premiums based on market power. Mega-producers have market power. They are big enough that their decisions about who they sell livestock to can make or break packing plants. Packers that win long-term contracts that commit livestock of the giants producers to them are protected from the risk of having to compete in markets for their survival on a continuous basis.

But society does not benefit from that. Society gains no greater efficiency. There is no social interest in protecting firms from the rigors of continuous and vigorous competition.

There is a social interest in maintaining a large number of independent, owner-operated family farms and ranches. The decision on whether to address price discrimination will be critical in determining whether family-scale livestock production survives. We have lost over half of the nation's hog producers in the last seven years. The rest will quickly follow in the absence of decisive action to provide a level playing field.

It is not efficiency gains that are driving concentration in livestock production today. Research by Dr. Mike Duffy at Iowa State University, for example, found that hog farms in the Iowa Farm Record Systems gained no additional efficiency as they grew beyond 2,000 head. Efficient or not, modest-size family farms and ranches will not survive if they face discrimination in the market.

Their elimination is clearly contrary to the public interest. The social benefits of the family farm and ranch system are many.

1. Societies in which income, wealth and power are more equitably distributed are generally healthier than those in which they are highly concentrated.

A system of economically viable mid-size owner operated family farms and ranches contributes more to communities than systems characterized by inequality and large numbers of farm laborers with below average incomes and little ownership or control of productive assets. Replacing mid-size operations with mega-farms reduces middle class entrepreneurial opportunities in farm communities, at best replacing them with wage labor.

In his review of research on the relationship between the structure of agriculture and life in the farm community, University of California anthropologist Dean MacCannell concluded:

> Everyone who has done careful research on farm size, residency of agricultural land owners and social conditions in the rural community finds the same relationship: As farm size and absentee ownership increase, social conditions in the local community deteriorate. We have found depressed median family incomes, high levels of poverty, low education levels, social and economic inequality between ethnic groups, etc. associated with land and capital concentration in agriculture. . . .
>
> Communities that are surrounded by farms that are larger than can be operated by a family unit have a bi-modal income distribution, with a few wealthy elites, a majority of poor laborers, and virtually no middle class.

2. Society functions better when people have a stake in it.

Inequality has an impact on social behavior. People who have a stake in society and their community are the source of more social and community-minded behavior than those who have little stake. Enabling the people who produce the nation's food to own the operation and the fruits of their labor and gain control over their work and lives gives them a stake. That is good for everyone.

3. Community Matters.

The bonds and mutual obligations people form with others over time are a form of social capital. Without community, people are more likely to act according to their selfish-interest and less likely to act in pursuit of the common good.

There are a couple of reasons for that. Only within community is there a reasonable expectation that unselfish behavior will be reciprocated. In addition, the constraints on negative behavior and the social pressure for positive behavior are much greater within community.

Of course, community exists beyond agricultural communities. In general, however, those who move from agricultural communities to larger population centers and suburbia move to areas with weaker community and reciprocal ties.

The strength of those ties in family farm and ranch communities perhaps explains why they defy the relationship normally found between economic stress and social breakdown. The agriculturally-based communities of the Great Plains and Midwest have low income and high poverty levels, yet rank high on social capital. Their schools work and they have low rates of crime, unemployment and family break down. However, continued family farm and ranch decline, growing poverty and widening inequality will undoubtedly, over time, weaken that social capital.

4. The opportunity to exercise creativity and control over one's own destiny lends meaning to life and work.

The opportunity to be self-employed and assume ownership, control and responsibility over our own work generally provides a stronger basis for fulfillment than wage labor.

Most of us seek more than income out of our work. We also seek a sense of accomplishment and fulfillment. The opportunity for those who have labored on the nation's farm, ranches and rural businesses to enjoy the benefits of ownership and shoulder the responsibilities of ownership has brought meaning to life and work for generations of rural people.

5. Maintaining a diversity of farm sizes by preventing total domination by large operations enhances the resilience of American agriculture to resource shocks and other unforeseen problems.

The potential social harm caused by disruptions in production is greater in agriculture than in most other sectors of the economy. We can get along without many things. We need food, so we need a resilient food system. In the wake of recent events, maintaining a diversity of farms and ranches is a national security issue.

Diversity enhances resilience. If one approach is rendered ineffective due to unanticipated events, society needs optional systems to fill the void.

Industrial agriculture is all about uniformity. In fact, we are often told that the reason agriculture must industrialize is to provide greater uniformity. The classic example is integrated hog and poultry production, where genetically uniform animals, are fed uniform feed in uniform buildings following uniform management practices, enforced by company field-men. This is a highly vulnerable system that places our food supply in jeopardy. If we have learned anything from recent events, we must learn that vulnerable systems – agricultural or otherwise – need the push of public policy to make them less vulnerable. Rather than pouring billions of dollars in public funds into protecting a vulnerable system, a fraction of the cost could be diverted to methods and policies to protect diversity while enhancing the multiple social, economic and environmental benefits such diversity brings to society.

Conclusion

There is a profound social interest in retaining owner-operated, family-scale livestock production. Its survival is in doubt in large measure due to price discrimination and Congress' and USDA's failure to define "undue price discrimination" under the terms of the 1921 Packers and Stockyards Act. We urge Congress to take clear and decisive action to adopt the proposed amendment and issue a special order that quickly collects data from packers on price discrimination.

Ensuring Competitive and Open Markets in Agriculture: Are Meatpackers Abusing Market Power?

Testimony of

Tom Connelley

Rancher, Independent Order Buyer, and Cattle Feeder

705 Zenith
Belle Fourche, South Dakota 57717
605-892-0053

Before the

United States Senate Judiciary Committee Field Hearing

Sioux Falls, South Dakota

August 23, 2002

Mr. Chairman and Members of the Committee:

My name is Tom Connelley. I am a rancher, independent order buyer, and cattle feeder from Belle Fourche, South Dakota. I grew up in Colorado on our family cow ranch. At an early age, I learned to care for and raise cattle. After high school, I completed a course offered by the National Institute of Meat Packing. In 1973 I began buying slaughter-ready cattle for the American Beef Packers. In 1980 I became an independent order buyer operating on my own. I now own mother cows and I usually retain ownership of my calves until they are ready for slaughter. In 1970 I also began studying the futures market, and believe me, I paid my tuition to the school of hard knocks.

In recent years I have managed to earn a profit as a speculator in the futures market. As a speculator, my success or failure depends on my knowledge of the forces affecting the live cattle market. I can trade whether the market is weak or strong. It is unfortunate but true that while I have extensive knowledge regarding the functioning of the futures market, and can be successful as a speculator, I cannot apply that knowledge to profitably conduct my cattle operation. The live cash price paid by packers is very unpredictable, and I cannot depend on a price close to the futures price. The live cattle market is simply too weak to recover production costs, let alone a profit.

I wish to thank you today for holding this field hearing. Our United States cattle industry is at a crossroads and the future of our industry will be decided by either the action or inaction of Congress. Those of us involved in the production end of the United States beef industry, which is the live cattle industry, lack the economic and political power to change our present course leading toward a non-competitive marketplace. We, therefore, rely on you to help us shape a workable marketing framework that will restore an open and competitive market structure for our industry.

I am here today to tell you firsthand what is happening in the U.S. beef industry. In the 70s I was a salaried buyer and I purchased slaughter ready cattle for the American Beef Packers (one of the larger packers at that time), and later Flavorland Industries, which was a smaller packer. Every week I competed against buyers from 23 other packing companies in order to fill my packers' orders. I had a new order each day and I purchased cattle every day. My packers would give me a "hot price," which is the price they are willing to pay for a carcass ready to go into the cooler. It was my job to evaluate each pen of cattle, either in a commercial feedlot, the cattle owner's own feedlot, or, less frequently, in a stockyard. In my evaluation, I would estimate the cattle's grade and yield percentage. I would then estimate the live cattle price I could pay that would equate to my packers' "hot price." If the owner of the cattle didn't think my bid was high enough, he would turn it down and for sure, within a few hours, another buyer from a different plant would be there to estimate the cattle's value and would offer the owner a new bid. If my packer let me know the plant would pay a higher "hot price" than originally established in order to fill the plant's capacity for that week, I would call the cattle owner and offer him a correspondingly higher price, provided he didn't already sell to one of my competitors.

Over the past 8-10 years, the marketplace has changed radically. Today, when I am ready to sell my cattle ready for slaughter, the commercial feedlot feeding my cattle will put my cattle on what is called a "show list." The show list contains all the cattle the feedlot has that are ready for slaughter. If I am lucky, I may have three or four packer-buyers pick up the feedlot's show list. I do not receive any bids on my cattle at the beginning of the week because the packers are either killing their own cattle or the cattle they control through contracts. If one or more packers need to buy cattle later in the week, usually on a Thursday or Friday, I may get a single bid from one of the packers. Oftentimes, the buyer will give me a take-it or leave-it offer for my cattle during the time we are talking on the phone. Other times I may be given an hour to make up my mind. However, I am not usually able to get a second bid from another buyer during the hour I am considering the first offer and even if I do, the bid will be exactly the same. It is usually the case that if I don't take the bid during the first week, I must wait until the following week for another bid. And, the following week's bid is typically lower than the initial bid (the packer knows my cattle will depreciate in value if I don't sell them when they have reached their optimum weight). Although I can't remember the last time I actually received three bids in one week, in the weeks in which I did received more than one bid, both bids were for the same price.

In the late 80s and early 90s, packers increased the number of cattle they owned and fed themselves. They also began introducing new tools that allowed them to control even more cattle. These new tools included formula pricing, Basis the Board Forward Contracts, and marketing agreements. Forward contracts became popular because the lack of competition for live cattle ready for slaughter caused cash prices to be depressed and producers were looking for a means of beating the depressed cash market. With a Basis the Board Forward Contract, producers could forward contract on a live-price basis using the Chicago Mercantile Exchange (CME) futures market. The producer could price his cattle (Basis the Board) at any time prior to the delivery month stipulated in the contract. The price the producer selects is not a price based on competitive bidding for his cattle. Instead, the producer selects a price from the futures market for the month in which he must deliver his cattle to the packer. In an uptrending market, the producer would price his cattle when he thought the market was at its peak, but oftentimes the producer would price to early, fearful that the market might weaken. In a downtrending market, however, producers would wait to price their cattle at the latest possible date, at the end of the month, in hopes the market would strengthen. The packers know this is the usual behavior of the contracted producers and they are able to use this knowledge to drive down prices. (Attachments 1-6 are charts showing the effects of packer efforts to drive down the cattle futures market.)

In the past two years, I have sold most of my cattle on a grid basis. This is either based on the average Nebraska beef price for the week, or the average live price in Kansas for the week. Then, depending on the yield, grade, and cutability, I receive premiums or discounts from the average price. I have been receiving more than the weekly Kansas high because my cattle grade well above the plant average. I do not advocate this way of selling but it's the only way I have to get some form of premium for higher grading cattle. I have to commit my cattle to the plant for next week before I know what the basis price is for this week. When I commit my cattle as required on Monday or by Tuesday, the packers will then establish the base price for the week late Thursday or Friday using the cattle they are purchasing from the cash market. This type of arrangement encourages packers to use their influence to keep the cash market low. No, I don't like to commit my cattle before I have a base price, but I have no alternative given today's market structure. If I didn't like the price they established after I committed my cattle and refused to deliver, I guarantee they would not let me commit cattle ever again.

As reported by the Data Transmission Network (DTN), Cattle Fax, and other reporting entities, packers sometimes own or control 40 to 50 percent of the cattle they kill during various weeks of the year. Last week, for example, the DTN reported that formula cattle in the Kansas, Nebraska, and Texas markets totaled 181,601 head. The live cattle purchased in these markets during the same period was reported at 169,865 head. Thus, 52 percent of the cattle slaughtered last week in these three markets were captive-held inventories, and 48 percent were cattle purchased in the cash market. Because they control such a large portion of the cattle they need, they don't need to be as aggressive in their efforts to obtain the remaining 50 to 60 percent of the cattle they need. In fact, packers have learned to use their own inventories of cattle to not only lessen their aggressiveness, but also to lower the prices of the remaining cattle they need.

As mentioned above, one cattle procurement method used by the packers is called Basis the Board Forward Contracts.Under Basis the Board Forward Contractsa producer must commit to deliver his cattle to a specific packer for a price that (a) is not negotiated, and (b) depends on the reported futures price on the Chicago Mercantile Exchange for the particular month stipulated in the contract. This means a producer is at the whim of the CME Board for a price determination, and the producer is completely excluded from any negotiation or input into price. All cattle committed under Basis the Board Forward Contracts are inherently taken off the cash market and become a part of the packer's captive supplies.

Packers have large numbers of cattle contracted on the futures market in Basis the Board Forward Contracts. This means cattle are committed to them before their price is determined or known. Packers know that producers who own these contracts must price their cattle before the last futures trading day of the previous month. For example, on a June Basis the Board Forward Contract, cattle must be priced by the last trading day in May. It is to the packers' advantage to keep the futures price low until the producers have priced their cattle. Only after producers price their cattle will the market begin to rally, as it should have before the packers applied their economic muscle to the marketplace. It is the combination of the packers' control of a large portion of their needed inventories, the packers' dominant position in the futures market, and an established deadline that gives the packers the tools they need to gain a tremendous economic advantage over producers in the marketplace. This control equates to millions, if not billions of ill-gained profits. For example, if a packer has 50,000 cattle on Basis the Board Forward Contracts, and the packer can hold down the price by just \$3.00 per cwt, producers would lose \$36.00 per head on their cattle, but the packer would realize a savings of \$1.8 million on the 50,000 head of contracted cattle. (See Accompanying Charts 1-6.)

Today, packers use their captive supplies to strategically time their entrance to and exit from the competitive market, to the disadvantage of the producer. Because they require contract and grid cattle to be committed on Monday, or at least by Tuesday noon of each week, they know exactly how much inventory they have for each week and how much inventory is needed. This control allows the packer to stay out of the market until the end of the week, usually until Thursday afternoon or Friday afternoon, after the futures market closes. By waiting until after the futures market closes, even if the packer pays a higher price on Thursday afternoon, it is not disclosed until the USDA market reporters quote prices paid for Thursday's cattle on Friday morning. If packers wait to purchase cattle on Friday after the futures market closes, it is not disclosed until the following Monday morning, and the packer can continue to purchase cattle after close without producers knowing that higher prices may have been offered.

I would like to describe for you a typical week in the futures market. While there is minimal, if any, cash trade at the beginning of the week, Monday and Tuesday will normally find the futures market trading higher, with expectations for a higher cash market. Wednesday futures will probably be lower (the optimism is fading). If by Thursday we have not traded any cattle yet, the CME Board will have a big sell-off. If feedyards fold and sell lower, the futures will be higher on Friday. If feedyards don't sell, futures will be lower on Friday. When Feedyards don't sell any cattle for the week, or have light sales, futures traders assume we are backing cattle up and will sell the market off. Then we have to sell lower. This is how packer-owned cattle, contract, and formula cattle are used by packers to influence the cattle market for their benefit.

Most Grids and Formulas are based on the weekly average dressed cost or the weekly average live price. The packer then determines the plant average grade and yield, and calculates premiums or discounts based on these averages. For example: If the plant average yield for the week is 63 percent and my cattle yield 62.5 percent, I will be discounted for the one-half percent difference below the average. If the plant average grade for the week is 52 percent and my cattle grade 80 percent, I will receive premiums on the 28 percentage points above the average. There are also premiums and/or discounts on Yield Grade 1-5. While these premiums and discounts appear to offer rewards or penalties to the cattle producer based on quality characteristics, the fact is that by keeping the base or average price low, the cattle producer still loses between \$2 to \$3 per cwt even after receiving premiums for his higher quality cattle.

With the amount of cattle sold on this basis, it is to the packer's advantage to keep the weekly average live price low. This is why, when I try to sell cattle live, I will only get one bid. If I turn it down, they will most likely bid me lower the next week. Not every pen of cattle has the same value. Depending on the grade, yield, cutability, and bone-out percentage, each animal will have a different value. Why should all cattle sell for the same price? Packers want to keep the average price low. This provides them the ability to pay less for a higher quality animal than they would if the animal were sold in a competitive market. Using the example of a packer-established \$110.00 hot beef price on choice grade and a \$100.00 hot beef price on select grade, A pen of steers that will yield 63 percent carcass weight and grade 85 percent choice is worth \$68.55 live weight. A pen of steers that will yield 63 percent carcass weight and grade 50 percent choice is worth \$66.15 live weight.

In the foregoing example, when the packers establish the cash price they are willing to pay, both pens of cattle will sell for the same cash price and may well be in the same feedlot side-by-side. Thus, if cattle are selling for $66.15 in the cash market, the pen with the 85 percent choice cattle will not be rewarded for their higher grade. On the other hand, if the cash market is trading higher, the lower quality cattle will benefit from the higher average. This reveals why fewer quality cattle are being traded in the cash market, despite the fact that the premiums paid under the grid system are also inherently unfair when the same cash market also determines the base price of the grid system.

The following example will help explain how the packers are benefiting from the pricing structures they have designed:

Week of 8/08/02 from Hales Cattle Letter

1200# steer	1200# steer
x62.00 cwt Texas Avg.	x .63 % hot yield
$744.00 to Cattle Feeder	756# carcass weight
	x105.41 Beef cutout value 50% choice
	$796.90
	-744.00 Original Cost
1200# steer	52.90
x7.55 drop credit	+90.60 offal value
90.60 offal value	$143.50
	-40.00 kill costs
	$103.50 Per Head Packer Profit

As revealed by this example, the packer earns an additional $52.90 from the higher quality animal purchased from the producer in the cash market, but not reflected in the producer's cash market price.

Working in combination with the packers pricing schemes is the retailer who also enjoys the benefits of a less than competitive market for live cattle. The relationship between retail beef prices and live cattle prices has been lost and, consequently, retailers are maximizing their profits by keeping retail prices at the level the market will bear but purchasing their inputs at prices determined not by a competitive market, but rather, by the after-effects of the packer's use of buying power. This is why consumers have been paying at or near record prices for beef in recently while independent producers are receiving well below their cost of production. Below is an example of the share received by the retailer:

Week of 8/08/02 from Hales Cattle Letter

1200# steer
x .38% yield
456# Boneless Beef
x2.76 weekly Avg. retail beef price
$1258.56
-887.50 cost leaving packinghouse in carcass

$ 371.06 retailer profit less transportation expense and labor
103.50 packer profit
$474.56 **Difference between live steer value and what the consumer pays for beef.**

Thus, the giant food stores like Kroeger, Albertsons, Safeway, Walmart, and others are contributing to the shrinking share received by producers. Both packers and retailers are maintaining large profits on beef, at the expense of both producer and consumer. This monopoly-like control is choking our live cattle industry.

On May 21, 2002, I faxed the letter reprinted below to Mr. Michael Caughlin of the Packers & Stockyards Administration:

Beef Cutout Close	*Choice*	*750-900#*	*$119.61*
	Select	*750-900#*	*109.28*
			$228.89

$228.89 divided by 2 = $114.45 X .63% hot yield = $72.10 Live equivalent for 50% choice fat steer.

Packers today were buying cattle in Kansas and Texas for $64.00 cwt. live basis and $103-$104 hot beef price in Nebraska. This is how captive supply allows them to control the market. Today June live cattle futures closed at $59.40. Packers have large numbers of cattle contracted Basis The Board. Producers with these contracts have to price their cattle before June 1. It is to the packer's advantage to keep the futures price low till producers have to price cattle. After these cattle are priced, we should anticipate a good rally in June futures. When packers own or control 40 - 50% of their kill, they don't have to be aggressive in their procurement.

From: Tom Connelley
605-892-0053

The Packers and Stockyards Administration never responded to this letter. However, my prediction turned out to be entirely accurate. As the attached June chart shows, on May 31, 2002, the market closed at $60.47/cwt and by June 17, 2002 it rallied to $64.17/cwt.

Ladies and Gentlemen, I have shown you how the Big 3 controls the price of fat cattle through packer feeding, forward contracts, formulas, and futures pricing. Now, let me draw you a picture of the cattle industry 10 years from now, if we now do nothing to change their present practices.

As we now have 3 big packers controlling about 80% of the red meat slaughter, we will then have 5 or 6 large feeding companies finishing all of the cattle. Cactus Feeders, Con-Agra, Caprock Industries, Sparks & Co., and Continental Grain all have packer ties and formula deals. When the small feeder (family farm), the commercial feedyard (depending on investors to place cattle), and all small independent feeders are forced out of business, then these feeding giants will buy feeder cattle directly from the cow/calf producers in the same way packers are now buying from independent feedlots.

All independent order buyers like me will be gone unless they go to work for the giants on salary. Ranchers will be at poverty level on their own land. But large packer-owned feeding and processing businesses will be profitable. As you can see, we have now reduced market competition clear down to the producer level.

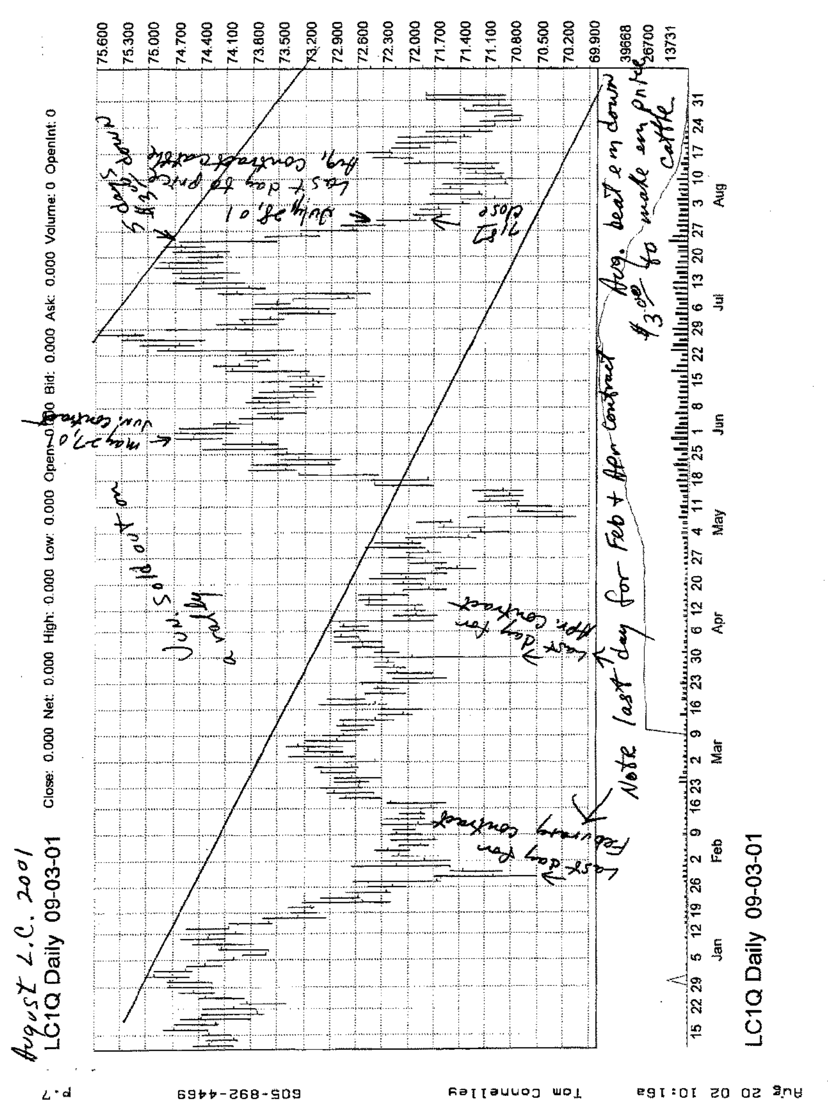
Ladies and Gentlemen, the hour is late and time is of the essence. We must act NOW to enforce the laws already on the books. The Packers and Stockyards Act and the Sherman Anti-trust act were written to prevent the monopolistic practices we now see in the packing industry. I urge Congress to immediately pass the ban on packer ownership of livestock, to prohibit all contracts that do not contain a firm base price at the time the contract is entered into, to investigate the packers futures trading activities for the 15 days prior to each contract delivery month, and to take any additional steps necessary to prevent the packers from interfering with the competitiveness of our live cattle markets.

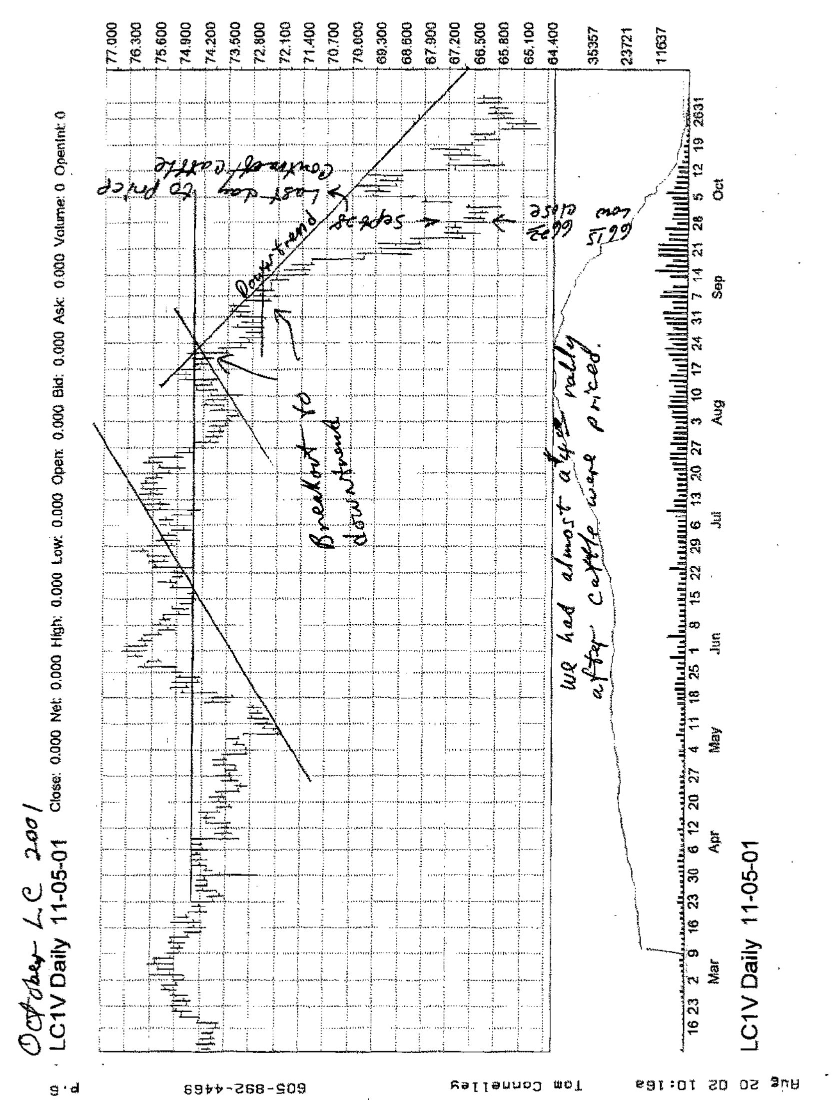
Oh, just in case you believe this will be consumer friendly and hold prices down for meat consumers, think again. When we have so few in control of meat products, they will write their own ticket. To keep agriculture a free enterprise and to keep independent producers in business, you must act NOW.

Thank you.

Tom Connelley

Attachments: Charts 1-6


August L.C. 2001
LC1Q Daily 09-03-01
Close: 0.000 Net: 0.000 High: 0.000 Low: 0.000 Open: 0.000 Bid: 0.000 Ask: 0.000 Volume: 0 OpenInt: 0
75.600
75.300
75.000
74.700
74.400
74.100
73.800
73.500
73.200
72.900
72.600
72.300
72.000
71.700
71.400
71.100
70.800
70.500
70.200
69.900
39668
26700
13731
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Jun. sold out on a rally
May 27, 01
July 28, 01
Close
last day for February contract
last day for Apr. contract
Note last day for Feb + Apr contract
LC1Q Daily 09-03-01


October LC 2001
LC1V Daily 11-05-01
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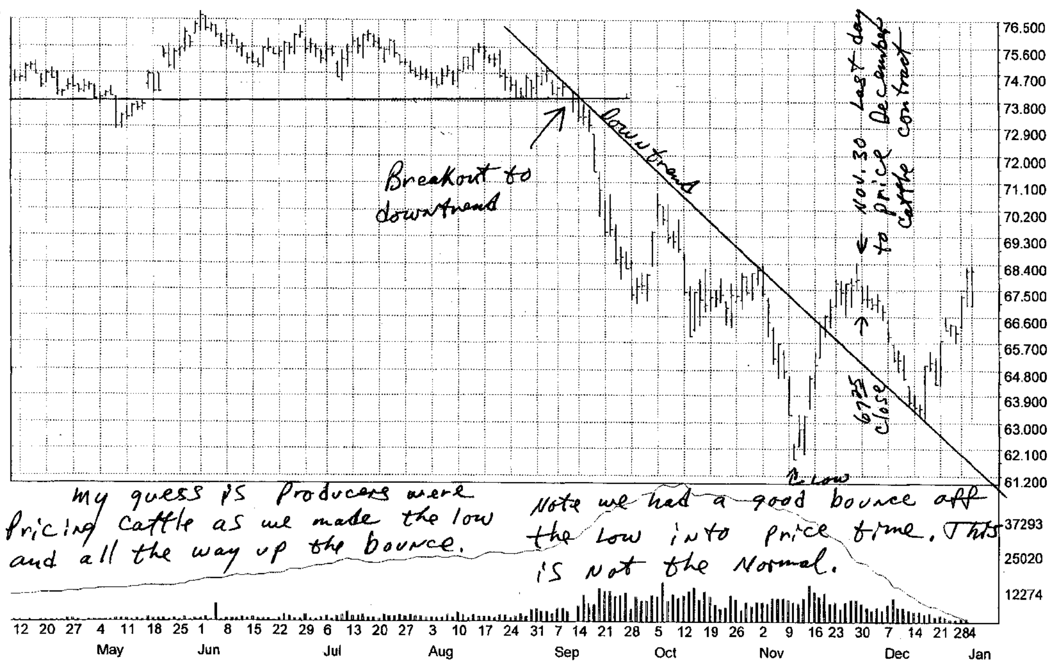
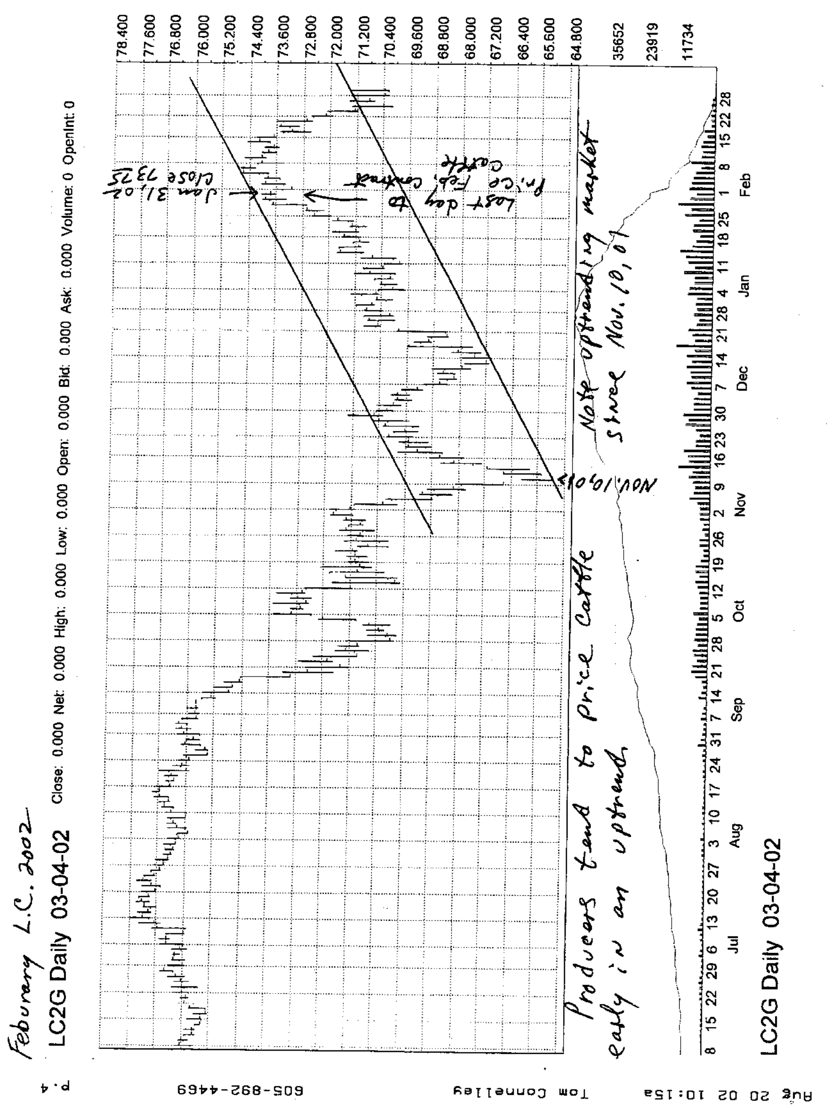
Last day to price contract cattle
Downtrend
Breakout to downtrend
Mar Apr May Jun Jul Aug Sep Oct
LC1V Daily 11-05-01
Aug 20 02 10:16a Tom Connelley 605-892-4469 p.6

December LC. 01

LC1Z Daily 01-04-02 Close: 0.000 Net: 0.000 High: 0.000 Low: 0.000 Open: 0.000 Bid: 0.000 Ask: 0.000 Volume: 0 OpenInt: 0



LC1Z Daily 01-04-02



Feburary L.C. 2002
LC2G Daily 03-04-02
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72.000
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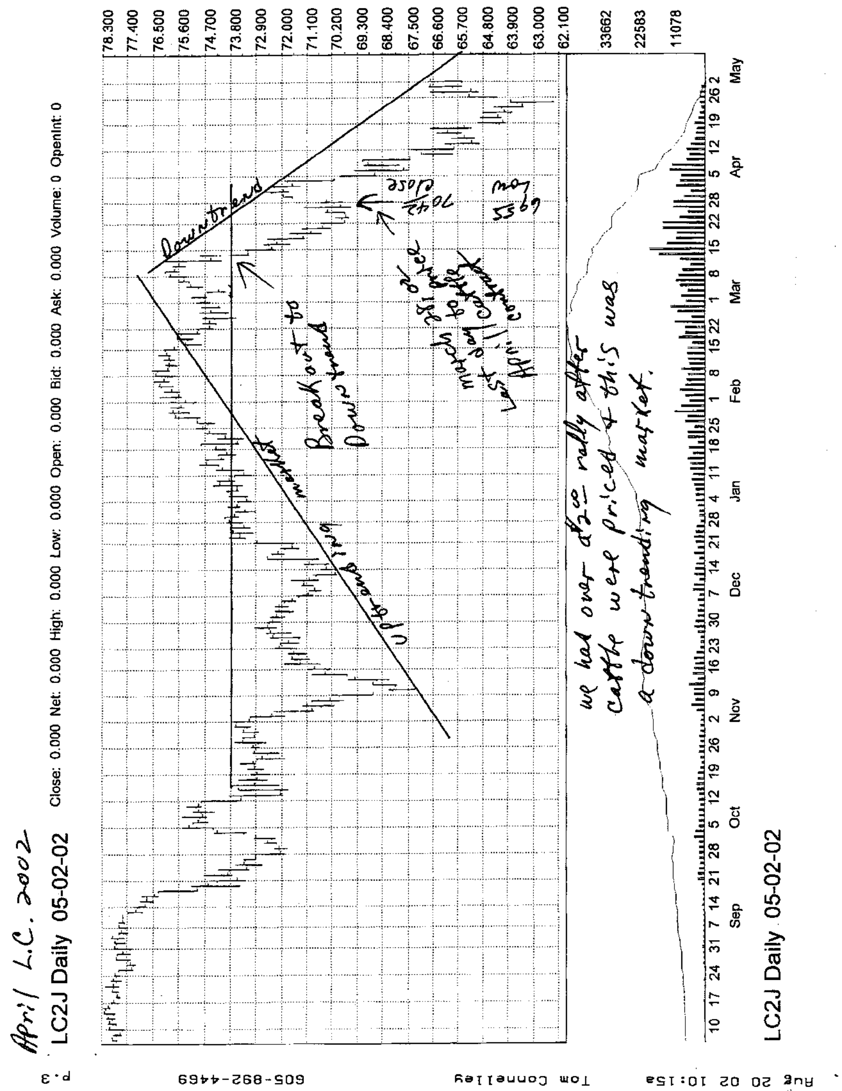
70.400
69.600
68.800
68.000
67.200
66.400
65.600
64.800
35652
23919
11734
Jan 31, 02 close 73.75
Last day to price Feb. contract cattle
Nov. 10, 01
Producers tend to price cattle early in an uptrend.
Note uptrending market since Nov. 10, 01
8 15 22 29 6 13 20 27 3 10 17 24 31 7 14 21 28 5 12 19 26 2 9 16 23 30 7 14 21 28 4 11 18 25 1 8 15 22 28
Jul Aug Sep Oct Nov Dec Jan Feb
LC2G Daily 03-04-02
Aug 20 02 10:15a Tom Connelley 605-892-4469 p.4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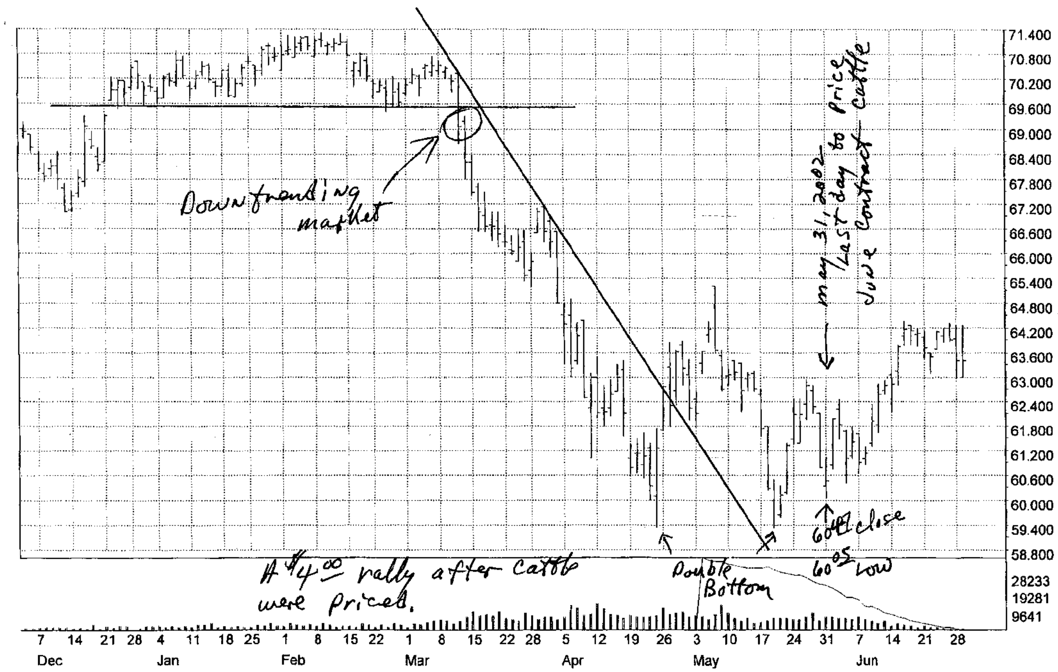
70.200
69.300
68.400
67.500
66.600
65.700
64.800
63.900
63.000
62.100
33662
22583
11078
10 17 24 31 7 14 21 28 5 12 19 26 2 9 16 23 30 7 14 21 28 4 11 18 25 1 8 15 22 1 8 15 22 28 5 12 19 26 2
Sep Oct Nov Dec Jan Feb Mar Apr May
uptrending market
Breakout to Downtrend
Downtrend
march 28, 02 Last day to price April cattle contract
70.42 close
69.55 Low
we had over $2.00 rally after cattle were priced & this was a downtrending market.
LC2J Daily 05-02-02
Aug 20 02 10:15a Tom Connelley 605-892-4469 p.3

June LC 2002

LC2M Daily 07-01-02 Close: 0.000 Net: 0.000 High: 0.000 Low: 0.000 Open: 0.000 Bid: 0.000 Ask: 0.000 Volume: 0 OpenInt: 0



LC2M Daily 07-01-02

STATEMENT OF SENATOR TOM HARKIN (D-IA)
CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
HEARING PACKING INDUSTRY COMPETITION ISSUES
COMMITTEE ON THE JUDICIARY
SIOUX FALLS, SOUTH DAKOTA, AUGUST 23, 2002

I want to commend Senator Durbin for chairing this hearing and Senator Leahy, Chairman of the Committee on the Judiciary, for scheduling it. The record of this hearing will complement the hearing record we have compiled in the Committee on Agriculture, Nutrition and Forestry, where we held the latest of a number of hearings on this topic July 16 of this year.

Widespread consolidation and vertical integration have put packers in a much stronger position to exert economic power over livestock and meat supplies and markets. Producers and consumers alike have a critical stake in this trend..The news has been filled lately with reports of how market manipulation and unfair practices have damaged consumers, market participants and our overall economy. Those concerns apply equally to livestock and meat markets as they do to energy markets or the stock market.

Both of our Committees -- Agriculture and Judiciary -- have a shared interest in aggressive enforcement of competition laws, including the Sherman and Clayton Acts, the Federal Trade Commission Act and the Packers and Stockyards Act. Senator Lugar and I strongly encouraged the appointment of a special counsel for agriculture within the Antitrust Division of the Department of Justice, which did occur. It is critically important that Justice take a far more active role in pursuing allegations of monopolistic practices and market manipulation in the packing industry.

The Packers and Stockyards Act of 1921 applies more broadly than previously enacted antitrust and trade practice legislation to prohibit anti-competitive practices and market manipulation in general. Both the USDA and the Department of Justice play a role in enforcing the Act. Given the structural changes in the livestock and meat industry, effective enforcement of the Packers and Stockyards Act is more crucial now than any time in history. Yet despite the need and the broad grant of authority in the Act, the federal government has not brought even one Packers and Stockyards Act complaint arising from a competition investigation since the beginning of fiscal 2001. The last significant case in the hog industry was the 1999 Excel case.

The current lack of enforcement of federal competition laws cannot continue. Far too many independent livestock producers have been forced out of business, and many more can see the handwriting on the wall. They have no future in the industry unless fair, open and competitive markets are restored.

We also must address packing industry structure. The Senate adopted during the farm bill debate an amendment to prohibit the ownership of livestock by packers more than 14 days before slaughter. When we got to conference the House stood like a brick to overwhelmingly oppose the packer ownership ban and we were not able to hold it. Despite this setback, this is an issue that will not fade away.

Again, I thank Senator Durbin for holding this hearing and I look forward to working with my colleagues for necessary changes in the law and with the Departments of Agriculture and Justice to obtain full and aggressive enforcement of laws already on the books.

JOHN MORRELL & CO.

STEVE CRIM
Vice President
General Manager

August 22, 2002

The Honorable Tim Johnson
United States Senate
384 Hart Senate Office Building
Washington, DC 20510-4104

Dear Senator Johnson:

Attached is written testimony to be submitted for the offical hearing record in connection with the Senate Judiciary Committee field hearing August 23.

We believe this important subject deserves a full committee hearing in Washington, as opposed to a field hearing in South Dakota where the majority of the Senators are Democratic and there are blatant political overtones just prior to an election. I respectfully must question why you, Sir, are involved in these hearings when you are not a member of the Senate Judiciary Committee. It appears that this hearing is intended more for political benefit than getting to the heart of the public policy debate surrounding the vertical integration of companies in the meat packing sector.

I also am attaching for the hearing record a study by Sparks Companies, a well-respected agribusiness research firm. This study analyzes the extremely negative impact on our economy if a ban on packer ownership were to become law.

I would like to assure you that Smithfield Foods is eager to work with Congress to discuss the issue of packer ownership of livestock and we hope that we have an opportunity at an early date in the appropriate forum.

Sincerely,

Steve Crim

Judiciary Committee News
United States Senate
Senator Patrick Leahy, Chairman

**STATEMENT OF SENATOR PATRICK LEAHY,
CHAIRMAN, SENATE JUDICIARY COMMITTEE
HEARING ON
"ENSURING COMPETITIVE AND OPEN AGRICULTURAL MARKETS:
ARE MEAT PACKERS ABUSING MARKET POWER?"
AUGUST 23, 2002**

I want to thank Senator Durbin for chairing this hearing of the Senate Judiciary Committee. The issues of concentration and competition in agriculture are extremely important. They affect producers of most commodities in nearly every region of the country.

In Vermont, agriculture is a key industry. Vermont farmers who produce a variety of agricultural products can all be affected by anticompetitive market conditions. Approximately 74 percent of Vermont's net farm income comes from dairies. For decades smaller dairy farmers have relied on their local or regional cooperatives to provide them some market power. National markets did not really exist and there was some counterbalance of the power of the larger processors. That structure has changed dramatically over the past three years. As a result, our farmers are not getting a fair share of the retail price of milk, while giant, corporate processors are raking in windfall profits as they raise prices to consumers.

In New England last year Suiza Foods merged with Dean Foods to form by far the largest milk processing company in the world. Despite the concerns so many of us expressed, the Justice Department approved the merger. The resulting milk processing company now controls almost 70 percent of the milk supply in New England. It achieved its market dominance through the merger and by buying up local dairies and then closing them down.

The new Dean Foods controls over 30 percent of all milk production nationally, in addition to having strategic alliances with other entities that expand its influence even further. Dean Foods has an alliance with Dairy Farmers of America (DFA), a massive coop now representing 22,000 dairy farmers in 43 states. Formed in 1998, the DFA was involved in a number of mergers among cooperatives, including Mid-America Dairymen, Milk Marketing Inc., and Western Dairymen Cooperative. Of course, DFA also owns Borden Foods. Dean Foods also has an alliance with Land O'Lakes that now includes a new licensing arrangement that grants Dean Foods a perpetual license to use the Land O'Lakes brand name nationally on a broad range of products. Sales through these interlocking deals between Land O'Lakes, DFA, and Dean Foods total over $12 billion annually.

Thus, a handful of affiliated firms control access to a majority of the markets for milk in this country. Opportunities for dairy farmers to market their milk independently have been all but wiped out. In addition, two coops now control access to most of the nation's processing facilities and are using this access to expand further. This is not good for dairy farmers, it is not good for other market participants, and it is not good for consumers.

As dairy farmers continue to suffer from low milk prices, Dean Foods is recording record profits. Just this month, Dean Foods reported that its profits for the second quarter of 2002 grew by 55 percent over the second quarter of 2001, due largely to plummeting milk prices. In most competitive markets, this would never happen. In a competitive market, when input costs fall, competition tends to drive consumer prices lower, thus ensuring that manufacturers do not realize windfall profits. But not so in the dairy industry -- retail prices for fluid milk are virtually unchanged this year, even though wholesale prices have fallen nearly $.50 per gallon since last September. I continue to believe that the Justice Department should investigate why lower farm prices for milk have not been passed on to consumers.

Similar concerns have been raised about the effects of consolidation in the livestock and poultry industries. That is the subject of this hearing. Concentration in the meatpacking industry is relatively high and has been rising. According to USDA, the four largest packers' share of steer and heifer slaughter rose from 36 percent in 1980 to 81 percent in 1999. Concentration in hog slaughter is lower but also is on the rise, increasing from 32 percent in 1980 to 56 percent in 1999. The disappearance of meatpacking plants and firms reduces the number of choices producers have to sell their livestock and increases concerns that the remaining firms may have greater opportunities to engage in anti-competitive or discriminatory behavior.

But the most dramatic structural changes in the livestock and poultry industries relate to vertical integration. The poultry industry is almost completely vertically integrated with poultry slaughtering facilities owning the birds from breeding through slaughter. Over 60 percent of hogs are now sold through some type of forward sales agreement. Until recently, the beef industry has been more resistant to vertical integration and coordination pressures. The trend toward greater packer control is increasing, and, according to the testimony of one of our witnesses, at times exceeds 60 percent in certain markets.

As meat packers gain even greater market power, a major concern is whether they will be able to manipulate market prices. Fewer and fewer sales are being made through cash markets. Yet cash market prices are used as a basis to determine marketing contract prices. So, for example, there would be an incentive for meat packers to depress cash market prices, thereby lowering the costs of animals purchased through marketing contracts. As the cash markets for livestock shrink, and the volume of livestock controlled by meat packers through captive supply arrangements grows, it may become easier for such manipulation to occur.

I would like to know whether the Department of Justice considers the possibility for market manipulation during the course of its merger reviews, and whether there is any ongoing effort to monitor agricultural markets to protect against such abuses. If such abuses were discovered, what remedies could the Justice Department or the Department of Agriculture impose?

For many years I have believed we need greater protections against market abuses by powerful agribusiness interests. In 1989, I asked for an FTC investigation and authored legislation, which became law, to impose massive fines on manufacturers of infant formula for anticompetitive behavior. In 1992, I authored legislation, which became law, to bar companies convicted of school lunch milk price fixing from participating in the school lunch programs.

Last year and again this year, I co-sponsored with Senator Daschle, Senator Durbin, Senator Johnson, Senator Dayton and a number of others legislation designed to enhance fair and open competition in the production and sale of agricultural commodities. Our bill, S.20, strengthens laws prohibiting anti-competitive activities currently in the Packers and Stockyards Act by broadening their scope to protect producers of *all* commodities (rather than only covering cattle, hogs, and sheep) and adding provisions related to price discrimination, whistle blower protection, and limitations on the use of "right of first refusal" contract provisions. Among its many provisions, it expands the standard of review for mergers and acquisitions to include impacts on rural communities—similar to the manner in which the Surface Transportation Board and the Federal Communications Commission consider other factors when reviewing railroad and telecommunications merger proposals.

During Senate consideration of the farm bill, I supported bipartisan efforts led by Senator Tim Johnson and Senator Charles Grassley to ban the ownership of livestock by meatpackers for more than 14 days prior to slaughter. Unfortunately, the packer ban provision was killed by House conferees while the farm bill was negotiated in conference committee earlier this year.

As the farm bill debate demonstrated, powerful interests are opposing our efforts. And so I look forward to the testimony of today's witnesses as we continue to seek new ways to address these problems and improve market opportunities for America's farmers and ranchers.

# # # # #

Testimony of Sara J. Lilygren
Senior Vice President, Legislative and Public Affairs, American Meat Institute
Before the
Senate Committee on Judiciary
August 23, 2002

Thank you, Sen. Durbin, for inviting the American Meat Institute to testify here today. AMI is the nation's oldest and largest organization representing meat packers and processors, whose business practices are governed nationally not only by the Sherman Act, the Clayton Act, the Robinson-Patman Act and the Uniform Commercial Code, but also by the Packers and Stockyards Act, a statute unique to our industry that clearly prohibits meat packers from engaging in unfair or deceptive business practices that disadvantage their livestock suppliers. To my knowledge, there is no other sector of the U.S. manufacturing or service economy in which the federal government plays such a watchdog role with respect to raw material suppliers.

And yet, ironically, as the meat and poultry industry operates with this additional, daily, government oversight of our business transactions with livestock producers, we are here today to discuss whether meat packers should receive additional scrutiny, enforcement or business restrictions in order to protect or benefit livestock producers.

Questions about the structure of the meat industry have been raised throughout AMI's 100-year existence. While some suggest our laws and enforcement of them are inadequate, I would suggest another theory: perhaps we haven't done a good job of pinpointing some of the real problems and coming up with constructive solutions that benefit everyone.

Let me try to characterize the environment in which my member companies operate today. AMI members include 250 of the nation's largest and smallest meat and poultry food manufacturers. Collectively, they produce 95 percent of the beef, pork, veal and lamb food products and 70 percent of the turkey food products in the U.S.

AMI's members have one common objective: to produce products consumers will buy. It is the consumer who determines the value of our products, which in turn determines the value of our raw materials. So we must start any discussion with the consumer. Market research tells us that U.S. consumers have diverse tastes and that 95 percent of them eat meat and poultry regularly, so there is room in the marketplace for many different meat and poultry products with many different attributes. We also know that there is a robust global appetite for U.S. meat and poultry products. We now export 9.3 percent of our beef products and 6.9 percent of our pork products, principally to Japan, Mexico and Canada. These exports have grown exponentially in the past decade, in large part because we produce what consumers abroad want to buy.

In fact, livestock producers have raised and spent hundreds of millions of dollars over the past decade through check off programs designed to build consumer demand for beef and pork. A large part of these efforts has been to send clear signals from the consuming public back to producers, so that producers can deliver the type of livestock that will yield the meat products most in demand. These efforts have had many benefits, including improved communications throughout the meat chain among retailers, packers and producers. This, too, has led to vertical integration.

In order to create the foods people want to buy, AMI's members have done many things. They have increased their coordination with livestock producers so that the raw materials they purchase produce the foods consumers want to buy. They have increased their coordination with their retail and foodservice customers, sometimes changing management or operations in order to meet their customers' needs. This increased coordination has led to increased vertical integration, which has sometimes included complete or partial ownership of some of each packer's livestock supply. Some positive outcomes of this increased coordination may be familiar to you:

Leaner Beef and Pork for Consumers. Retailers, meat packers and livestock producers heard loud and clear in the 1980s that consumers wanted leaner meats. Working together, these three sectors accomplished an average 27 percent fat reduction in a serving of beef and a 31 percent fat reduction in a serving of pork. Among the actions taken were: packers and retailers trimming fresh meats to ¼-inch of external fat; hog producers and pork packers working together to develop leaner hogs; cattlemen and meat packers petitioning USDA to create a new "Select" grade for leaner beef; and meat processors developing vast new offerings of low-fat hot dogs, luncheon meats, ham, sausage and bacon products.

Improved Risk Management Options for Producers. The volatility inherent to farming and ranching has been reduced for many livestock producers through the increased use of contracted sales with meat packers and many other creative risk management plans. The benefits to farmers were perhaps most vivid during the hog market crash of 1998, when spot market prices for an unanticipated over-supply of hogs dropped to as low as $9 per cwt. Those hog farmers with contracts had locked into much higher prices for their hogs - generally $35 and more per cwt. - and were protected from the low market prices. Packers with contracts, on the other hand, were obviously paying far over the market value for their hogs at the time. Both parties to the contract, however, benefited from the certainty provided by a steady, consistently priced, contracted supply of hogs.

Before I leave this topic of the benefits of coordination and even integration between manufacturers and their suppliers in the meat industry, I would just note that this is a trend throughout the manufacturing and service economy. It is driven largely by consumer demand for consistent product quality at the lowest possible price. The demand for low prices has led to fewer and larger retail chains in fields as diverse as home improvement products (Home Depot), video rentals (Blockbuster), food and consumer products (Wal-Mart) and fast food (McDonalds). In fact, these companies not only owe their success to these qualities and business practices, they advertise them to consumers. The consolidation at the retail level has driven consolidation at the manufacturer level - for tools, appliances, consumer goods and food products, among others. The demand for consistent product quality has led many firms to exert greater control over their supply chain. Just ask anyone who supplies products to Wal-Mart or McDonalds what that means: it means you must meet their standards or you can't sell to them. It often means you must subject your products and plants to periodic customer audits. This is the way business is done today - and the meat industry should be no exception.

I note for the South Dakotans here today that the benefits of vertical integration are bringing benefits to this state. Just last week the Wall Street Journal published a fascinating story about ValCap, a venture partially funded by the federal government in which livestock feeders, corn growers and fuel producers are joining forces to help one another earn a living. Senators Daschle and Johnson have been proponents of this vertically integrated agriculture approach. And for those of you here from Iowa, you know that your state is the home to a number of leading vertically integrated manufacturers who dominate their fields. Winnebago and Maytag are two respected firms who've formed numerous vertical alliances in recent years with both suppliers and distributors. And Gateway computers, a dominant home computer manufacturer, has now formed vertical alliances to offer Internet access and other affiliated services and products to its customers. The son of a fourth generation Iowa cattle rancher founded Gateway, by the way. The spirit of entrepreneurism is alive and well throughout this country.

Against this backdrop I have described of businesses trying to compete for the consumer's dollar, I hope you can understand why the American Meat Institute strongly opposes efforts that would make it illegal for meat manufacturers to do what the rest of the global business community is doing, which is to form relationships with suppliers of raw materials in order to produce consistent quality, lowest priced products that consumers will buy. In our view, the proposed ban on packer ownership, control or feeding of livestock would do just that. Further, we will oppose any effort to restrict meat packers who comply with existing antitrust and fair business practice laws from sourcing their raw materials in any way. It is unfair to make it illegal for the meat industry to compete with the poultry industry or any other industry for the consumer's dollar. But let us not forget the ultimate consumer during this debate.

Over the last three decades, Americans have benefited from increasing meat industry efficiency that has made meat more affordable, abundant, convenient and varied. Each year, consumers spend less of their disposable income on meat and poultry. Today, that number stands at 1.9 percent, compared to 4.1 percent in 1970. This is a trend of which we are proud - and one that provides consumers a distinct benefit. We should not rush to undo the foundations of this success without understanding the ramifications for everyone involved.

If there is consensus that the livestock market is not working properly, then we advocate a thoughtful, reasoned, fact-based approach that will help all businesses - farms, ranches, processors and retailers -- pinpoint problems and develop targeted and effective solutions.

I would be happy to answer any questions.

Ensuring Competitive and Open Agricultural Markets: Are Meat Packers Abusing Market Power?

Testimony of Bob Mack, farmer and livestock producer, Watertown SD

Thank you Senator and committee members for the opportunity to address competition in the livestock industry and how it affects myself and my friends and neighbors.

I operate my family's farms and have spent most of my life raising crops and livestock. Our farrow to finish hog operation, cow herd and feedlot allowed us to add value to our pasture, grain and hay and to more fully utilize our equipment and labor.

When faced with the loss of the largest hog packing plant in the state of South Dakota, Smithfield was convinced to purchase the plant after the state contributed millions of dollars in incentives. Not long after this purchase Smithfield bought the only other pork processor in the state and shut them down. This eliminated the only competition we had locally and took at least $5 off the value of every hog we sold. The rapid consolidation and subsequent collapse of the hog market nation wide forced 9 out of 10 hog producers in my area out of business and led us to focus more on our cow herd and feedlot operation.

At one time by working with several other feedlots we could receive bids on a regular basis from 3 or 4 packers and could get occasional bids from a couple of other packers depending on the type of cattle we had for sale and if they were in the market. Today we can get regular bids from 2 packers with occasional bids from a couple more. It also means shipping cattle as far as 700 miles to get them slaughtered. Many smaller farmer feeders are lucky if they have one packer they can get a bid from. One bid from one packer isn't competition! If we get to the point we have only one bidder we will probably be out of business. In these cases the only options are to try to get some kind of a marketing agreement, get into an alliance, or to go through a salebarn. There can be significant risks and problems with each of these options. To deliver under a marketing agreement usually means delivering cattle to be killed on a grid with the packer establishing the base price some time later. Selling through an alliance can mean buying kill slots, having to schedule cattle sometimes months in advance, not being able to get slots and not knowing what the base price is for the alliance's grid when the cattle are committed. The base prices for most cattle sold on grids or through alliances are usually established by the cattle that have been traded in the cash market. Many of these cash cattle are of lower quality than cattle sold through alliances or on a grid. Selling through salebarns has become more popular for many farmer feeders that are unable to get packer bids in the country. One of the problems with this method of selling cattle is that most fed cattle packers don't send their buyers into salebarns in some parts of the country.

We have sold cattle on forward contracts, hanging, live, through alliances, through salebarns and on grids. We have usually tried to avoid selling cattle that don't have a firm base price established at the time of sale. Part of the problem is that in addition to having less buyers available the rules keep changing. Buyers that used to buy hanging now want us to sell on a grid. One packer that we had sold cattle to on a negotiated grid now refuses to buy cattle on that same grid unless we contract the cattle to them months in advance. Some of the grids and alliances we use have changed their specifications. All of the grids have more discounts than premiums built into them. The offspring of cows currently being bred will not reach market for 2 to 3 years. How is the cow-calf producer supposed to hit a target 2 to 3 years into the future when the rules and the players are changing constantly? Ultimately losses inflicted on cattlefeeders are passed on down to the ranchers that raise the calves. Those ranchers have no where to pass their losses on to.

What can be done to ensure competitive and open markets in the livestock industry?

Forbid large packers from owning and feeding their own livestock. The livestock they own and feed are used to leverage influence over feedlots and to leverage control over cattle they don't even own. I would like to commend Senators Johnson and Grassley for taking the lead in addressing this issue.

Restrict captive supplies by requiring forward contract, formula and marketing agreement cattle to have a base price established at the time they are committed to the packer. In addition require that forward contracts are offered in an open public manner to any producers that choose to take advantage of them. I believe Senator Enzi addresses this with his Senate Bill 2021.

Revise the confidentiality provisions in Mandatory Price Reporting to provide additional information and investigate the information collected by the program but never made public, for competition and anti-trust violations.

Tougher restrictions on future agribusiness mergers. The packing industry is the one of the most concentrated industries in the country. Because they purchase a perishable commodity (fed livestock) they are able to exert a higher degree of influence than concentrated industries dealing in non-perishable commodities. Give equal weight to the affect mergers will have on suppliers to the industry instead of just the effect on consumers of the industry.

When Packers and Stockyard violations occur, involve the injured party in any negotiations or plea bargains and require that injured parties are compensated for the damages caused by the violation.

Require that investigations of the industry are done by economists and investigators that do not have any potential conflict of interest in that they have worked for the same companies they are investigating.

Review what effect the rapid consolidation of the food retailing sector is having on prices paid to producers and charged to consumers. Are "slotting fees" and other methods being used to prevent

> smaller packers and producer owned alliances from getting access to consumers? Why aren't retail prices reflecting the prices being paid to producers? Producers have always relied on lower retail prices to help clear out surplus production. This no longer seems to be happening.

Cattlemen have an innate ability to look at an animal that appears healthy to a layman and know that that animal is off feed, sick or has some other problem. This ability is part intuition, part experience. It's something they feel in their gut. They know if they don't correct the problem that the animal will probably die. They have this same feeling in their gut when looking at what is happening in the packing industry. Without strong enforcement of the laws already on the books and steps to assure that the livestock industry maintains open competitive markets, they know the livestock industry for independent producers will die.

National Association of Manufacturers

Michael Elias Baroody
Executive Vice President

August 19, 2002

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

On behalf of the 14,000 member companies of the National Association of Manufacturers, I ask that you place this letter in the record for the August 23 hearing on "Ensuring Competitive and Open Agricultural Markets: Are Meat Packers Abusing Market Power?" The NAM represents member companies in every state and in every industrial sector, and usually does not become involved in sector-specific issues. The interest of the NAM in this hearing and in this issue is the impact on antitrust law and policy.

If for no other reason, the NAM is pleased to see that the Committee on the Judiciary is asserting its jurisdiction in this area. The issue of ownership and concentration in the agribusiness sector has been raised in many ways and in many contexts over the past several Congresses. Most often, it has been portrayed as a "special" case for competition policy because it deals with agriculture and should therefore come under agriculture laws and the purview of the Department of Agriculture. This is no different from saying that ownership and concentration among petroleum companies is "special" because the issue deals with the important sector of energy and should therefore be dealt with by laws governing energy policy and administered by the Department of Energy.

The NAM was very disappointed earlier this year that the Committee on the Judiciary did not assert its jurisdiction over the competition title to the draft farm bill that was marked up by the Committee on Agriculture, Nutrition and Forestry. Although in the end the competition title was struck before being reported, the NAM would have rather seen the Committee on the Judiciary play a more active role on an issue of utmost importance to antitrust law and enforcement.

In testimony on September 28, 2000, the Clinton Administration Department of Justice pointed out that current laws are adequate to deal with ownership issues in the agribusiness sector and that these laws are vigorously applied and enforced. Because this is the case, the NAM concurs with this assertion and anticipates that the Bush Administration witness at the August 26 hearing will reinforce this message.

The NAM is a strong believer in and proponent of the antitrust laws. To the extent that there are market inefficiencies, a fair and consistent competition policy will help to ensure that

Page 2
August 19, 2002

there is a level playing field for all actors. To achieve this, however, the business community needs to have a clear understanding about the "rules of the road." Sectoralization tends to cloud such a message and should be avoided. For this reason, in its February 28, 2000, report to the Attorney General, the International Competition Policy Advisory Committee stated: "The Advisory Committee is of the view that the federal antitrust authorities are better positioned to conduct antitrust merger review than federal sectoral regulators." (Page 153.) A majority of the Advisory Committee also endorsed removing what sectoral treatment does exist. (Page 161.)

Thus, the NAM encourages any member of the Committee on the Judiciary – or any other member of the Senate – who wishes to pursue a political agenda on the issue of ownership and concentration in the meat-packing industry (or the broader agribusiness sector) to weigh carefully the opinions of the antitrust agencies and the vast majority of antitrust scholars that sectoral treatment of the antitrust laws runs counter to sound competition and public policy.

The NAM appreciates the opportunity to present these comments for the record. Please feel free to contact me or Larry Fineran, NAM vice president, Regulatory and Competition Policy, if there is a need for additional information. Larry can be reached at (202) 637-3174 or lfineran@nam.org.

Sincerely,

Michael E. Baroody

Michael E. Baroody
Executive Vice President
National Association of Manufacturers

cc: Members of the Committee on the Judiciary

STATEMENT OF

NATIONAL FARMERS ORGANIZATION

528 BILLY SUNDAY ROAD SUITE 100

AMES IA 50010

515-292-2000

SENATE JUDICIARY COMMITTEE

PRESENTED BY

DICK GORS

SOUTH DAKOTA NFO PRESIDENT

EUGENE PAUL

NFO POLICY ANALYST

AUGUST 23, 2002

Statement on behalf of the National Farmers Organization
528 Billy Sunday Rd. Suite 100
Ames, Iowa 50010

The National Farmers Organization represents independent producers nationwide in negotiating contracts and other terms of trade for grain, livestock and dairy. We are in the marketplace doing so on a daily basis. The specific purpose is to help independent producers extract the dollars they need to cashflow their operations, pay their expenses and earn a living from what they produce and sell.

We define an independent producer as one who with his or her family resides on their farm, provides day to day management, controls the marketing of the production, whose capital is at risk, and owns or wants to own that business.

Our basic premise is that an agriculture consisting of independent producers is not only desirable, but also essential for maintaining our nation's food production, rural businesses and communities, as well as infrastructure.

Almost no issue among independent livestock producers spurs more fear than the continued concentration of both their suppliers and their markets. Congress and the Executive Branch have been pitifully slow in addressing this issue in a coherent manner. Legislation limiting packer ownership of livestock would be a major step in the right direction.

Independent producers have for a long time relied on markets which were free, open and transparent. However, in a capitalistic system, it is very normal for any group or individual who has acquired power to use it. Everyone is aware that the livestock processing industry is highly concentrated and when buyers are allowed to own a portion of the supply they need to operate their plants, it is impossible to have a free, open, and transparent market.

As NFO negotiates terms of sale of livestock for our members we know that one of the key elements to a supply and demand system is the need for a demand. As we have seen over the last few years it becomes equally important to gain market access. The system has changed from marketing, to liquidations of product to keep livestock current.

Producers in the last few years have seen tightening of market opportunities. For example, Smithfield, Packerland and Moyer Beef in Pennsylvania are leaving producers with limited options for markets. When Smithfield bought Packerland Co., which was the fifth largest processing plant in the United States, it made the situation worse. The reason that this is important is that at one time Moyer and Packerland were in direct competition for fed Holsteins. They are now one and the same. This merger was almost made even worse when Smithfield attempted to foreclose on American Foods. This would have ultimately limited market access for fed Holsteins to one packer in the upper Midwest. NFO is a large marketer of fed Holsteins and could see the impact which would have occurred if that foreclosure had been completed.

It is often difficult to gauge what the true cash market is on a given day. It has become even more difficult because of lack of buyers and the fact that buyers own some of their needed supply. Add the non-negotiated contract cattle to the packer-owned cattle and one can see why market access is difficult at times.

Market access has two main elements; it can either be on a voluntary or involuntary basis. What NFO negotiators are seeing is an increase in involuntary access. This is where producers are obtaining packer contracts just so they can continue to stay in business. This only enhances the captive supply which is created through packer owned and controlled livestock. The second element, voluntary access, is the most market oriented, however, due to the growth in involuntary access, the voluntary access is very limited and often not available on terms which make true negotiation of price a tool.

The pork industry has been in this mode for quite some time. The low markets of the late 1990's forced many producers out of business. In turn it also made it more difficult to market hogs on a daily basis. Packer buyers focused on the large corporate producers to obtain needed supply while the smaller producer has to formulate their own marketing plan and establish pools just to have a market. If the plants are nearing capacity then smaller pools have difficulty gaining market access. They are forced to find other markets. It is not an easy task to open new markets when they are limited and often many miles apart. Producers have little choice but to liquidate at whatever price or hold hogs to higher weights. This has forced possible discounts for hogs, which did not meet buyers' specifications.

To sum up the situation, it is clear to NFO negotiators who market livestock for our independent producers, that a combination of packer concentration, packer formulated contracts and packer-owned livestock have a detrimental effect on the producer price.

We must remember that livestock is a perishable product and any minor manipulation in the markets can cause the value of that product to drop.

NFO is convinced that a ban on packer ownership of livestock will accomplish the following:

A. Increase competition and bidding for livestock because the packers will have to bid for supplies that they do not own.

B. Decrease market distortion because calling in packer owned supplies makes prices more volatile in ways separate from supply and demand.

C. Increase access for producers because shackle space will be freed up from packer owned livestock.

D. Eliminate preferential treatment by packers of their own livestock versus non-owned livestock.

E. Increase the opportunity for small and mid-sized producers to access the market.

In an effort to strengthen the enforcement activities of the Packers and Stockyards Administration, the following is needed:

A. Enactment of necessary funding for legal and research staffing of both the Packers and Stockyards Administration (GIPSA) and the Justice Department's Antitrust Division for agricultural issues.

B. Establishment of a Packers and Stockyards Administration/Justice Department producer advisory board to advise on the concerns and needs of independent producers. A majority of the board should be independent producers.

C. The Secretary of Agriculture and Attorney General should take the necessary steps to ENFORCE the provisions of the Packers and Stockyards Act and antitrust laws to ensure that prices are determined in open, fair and competitive markets. There needs to be control over acquisitions and mergers that negatively impact competition. A great deal of the lack of enforcement of laws to enforce competition in the marketplace, such as antitrust laws and Packers and Stockyards Act, stems from the attitude of regulators and their interpretation of the law.

   The Packers and Stockyards Act needs to be amended, to assure that poultry growers have the same protections against unfair and deceptive trade practices as do the producers of red meat. According to GIPSA, the agency that enforces the Packers and Stockyards Act, the number of complaints from poultry growers is increasing, and their authority to address these concerns is minimal. There is no justification to deny poultry growers these basic protections.

Enacting this type of legislation will improve market performance, increase competition for livestock, and improve market access for farmers. It is good for the environment, in that independent farmers are more responsive to the needs of the land and community than distant corporate offices.

Statement of Dennis Wiese, South Dakota Farmers Union President
On Behalf of National Farmers Union
To the U.S. Senate Judiciary Committee
August 23, 2002

Thank you for holding this very important hearing on "Ensuring Competitive and Open Agricultural Markets," and for asking the question, "Are Meat Packers Abusing Market Power?"

South Dakota Farmers Union strongly supports the policy that ensures competitive and open agricultural markets. With the market power falling in the hands of a few meat packers, Farmers Union sees the negative impact this is having on its membership. Clearly meat packers are abusing their market power, with both livestock producers, and consumers paying the price. Agribusiness firms are showing record profits at the same time when farmers and ranchers are struggling to survive because of erratic price trends. Tyson Foods reported increasing quarterly income and at the same time is severing its contracts with 132 hog producers in Oklahoma and Arkansas. This leaves loyal family farmers holding the bag for investments made in buildings and equipment while Tyson walks away. After combining with IBP, Tyson now controls about 18 percent of pork production, 25 percent of chicken production and 30 percent of the nation's beef production.

The South Dakota Farmers Union opposes farm-to-market production of livestock by vertically integrated non-farmer-owned processors, marketers and regional cooperatives, whether through total ownership or through the financing of a total operation. We support state and federal legislation prohibiting such vertical integration. Development of farmer-owned cooperatives for marketing and processing presents farmers with the greatest opportunity to increase market share.

The loss of family farms and other independently owned businesses is not inevitable. We believe the accelerated march toward a vertically and independently integrated production system can be turned around with action to enforce and enhance antitrust and competition laws, strengthen the regulatory system and revitalize independently owned businesses.

The Justice Department (DOJ) and the Federal Trade Commission (FTC) should require firms to submit information on joint ventures and alliances between corporations above a certain size. In many cases, businesses that participate in joint venture arrangements behave just like firms that have merged, and they should be subject to the same level of anti-trust scrutiny as mergers. The disclosure requirement should be set at a threshold sufficient to include firms that account for a significant percentage of market share at a regional level.

Congress should require USDA to collect concentration information. Currently, the University of Missouri attempts to collect information to identify the top four firms in many different commodity areas. However, this vital information is not readily available. USDA is in a position to acquire this information and make it available.

Congress should require DOJ and FTC to detail why mergers subject to antitrust review are okay, if the decision is made not to oppose the merger. This would improve accountability.
Congress should continue oversight of the mandatory price reporting law. Price reporting for cattle, hogs, lamb and meat products from those animals was approved by Congress in 1999 and the regulations promulgated by USDA in 2000. Mandatory price reporting at the national level commenced in 2001.

Congress should protect livestock producers from unfair competition and monopolistic practices by strengthening the definition of the Prohibition of Unfair and Deceptive Practices. All livestock processors should have equal access to markets that do not discriminate against family-farm livestock producers. USDA should issue administrative rules under the current authority of the Packers and Stockyards Act.

Congress should expand the role of USDA to initiate and/or participate in the review of proposed mergers in the agricultural sector and require an economic impact statement be provided detailing the impact of a proposed merger on farmers and ranchers prior to approval.

We support prohibiting packer ownership of livestock. Direct or indirect ownership allows the packers to control supply and manipulate the market so that farmers and ranchers receive less from the market. We urge restrictions be placed on the percentage of captive supply and that firm bid pricing be established in forward contracts.

We support implementation of a temporary moratorium on large agricultural mergers. The moratorium is necessary to provide Congress with time to review current law and strengthen it as appropriate to restore market competition for producers and consumers.

We support the establishment of an Office of Special Counsel on Competition within USDA to streamline and increase the effectiveness of USDA investigation and enforcement o f competition laws.

We support establishing a level of concentration that triggers a presumption of a violation of antitrust law to make it easier for the DOJ and the FTC to prevent high levels of concentration.

We support strengthening the Fair Practices Act to provide improved protection for contract producers.

We support legislation that:
Requires contracts to be written in plain language and disclose risks to producers;
Provides contract producers three days to review and cancel production contracts;
Prohibits secrecy clauses in contracts;
Provides producers with a first-priority lien for payments due under contracts;
Prohibits producers from contract termination out of retaliation;
Makes it an unfair practice for processors to retaliate or discriminate against producers who exercise rights under the proposed legislation;
Authorizes and encourages contract producers to form collective bargaining units to negotiate

with integrators.
Clearly defines and aggressively prohibits volume-based price discrimination in livestock markets; and
Ensures fairness, transparency, protection and bargaining rights for producers and restores and enhances competition for agricultural markets.

Inadequate market competition is one of the most pressing issues facing producers across the country. As the result of open-ended contracts and captive supply, farmers dependent upon the day to day spot markets are harmed most. Open-ended contracts, which on the surface appear to be producer friendly, are good examples of how meat packers abuse their market power. Recent examples of greed on the part of those in the corporate world have created untold human suffering to many hard-working Americans. Families, dependent upon investments for their livelihood found themselves sold out by those who had a concentration of corporate power.

Farmers Union and its 300,000 members nationwide do not feel it is prudent to place our trust in a few large multi-national corporations that place their singular corporate welfare ahead of America's family farmers and the security of a safe and dependable food source. We cannot and must not allow a few large corporations to further displace more farmers. We as a society cannot afford to allow all our eggs to be placed in one corporate basket.

WRITTEN TESTIMONY OF
THE ORGANIZATION FOR COMPETITIVE MARKETS
presented to the
UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY

August 23, 2002

Ensuring Competitive and Open Agricultural Markets:
Are Meat Packers Abusing Market Power?

Thank you Chairman Leahy and members of the Senate Committee on the Judiciary for allowing the Organization for Competitive Markets to submit this testimony for the record. OCM is a multidisciplinary nonprofit organization that focuses exclusively on antitrust and competition problems and solutions in agriculture. Our members consist of farmers, ranchers, academics, policy makers and agricultural businessmen.

The U.S. food industry grosses approximately $900 billion in annual sales. It is the biggest industry in the country and in the world. That money is distributed through the agricultural market infrastructure. Our family farms and ranches, as well as our rural communities, were built on that money. A perfectly competitive market would distribute that money properly. A noncompetitive market does not allow that money to flow to rural communities. Rather, dominant firms utilize their position to obstruct that monetary flow and enrich themselves far beyond the level that could otherwise be achieved without near-monopoly power. The result is an increasing rate of farm failure, increased consumer food prices, and harm to the public interest.

In this testimony we discuss the following: (1) the legitimacy of buyer power (also known as mononsony power) as a legitimate antitrust concern, (2) propose an analysis to screen industry claims of efficiency in the antitrust analysis, (3) discuss the need for greater transparency in the merger review process; and (4) outline problems and solutions to the captive supply issue in livestock agriculture.

I. The Nature of Agricultural Markets and the Need for Market Facilitating Rules

The role of government in the marketplace is to create and maintain the infrastructure for the most people and companies to engage in commerce. Two helpful analogies are the internet and the U.S. interstate highway system. The internet is not commerce or communication. Rather, it is an infrastructure that facilitates cheap and effective commerce and communication. It is not proprietary. It is accessible by most everyone, and it is very easy to access.

Similarly, the U.S. interstate highway system is not commerce. It facilitates commerce. Everyone can use it. There are many on ramps and off ramps. General Electric uses the system and so does my mother. The government maintains it and applies a set of equitable rules to the infrastructure. The payback has been incredible.

It may be efficient for four companies to acquire exclusive use of 50% of the internet or 90% interstate highway system. But it is efficient only for the companies' profitability. It is not beneficial for the country because it denies the benefits of commerce and communication to the displaced users.

The livestock marketplace must be similarly open, accessible and fair to benefit the broadest number of people. We must have rules that maintain access by all through many on-ramps and off-ramps. We must maintain inexpensive use by all under equitable terms. If a company feels it would be more efficient to exclude others from the system, that desire must be recognized as in conflict with the public welfare. We must maintain the ability for the broadest participation in commerce possible for widespread rural economic health.

Federal policy applied to the stock markets has promoted fairness, access, transparency and competition in the stock markets. The result is that 80 million people own stock, a far larger percentage of the population than of any other country, and those people can make trades easily and cheaply. Federal policy applied to the livestock markets has promoted unfairness, market closure, secrecy, and monopolistic practices.

We need to rethink the emphasis on efficiency in macro-market policy. The antitrust laws are a substantial part of that policy.

II. MONOPSONY, OLIGOPSONY, AND THE EFFICIENCY ANALSYSIS

Monopsony or oligopsony are the mirror images of monopoly and oligopoly, respectively. In other words, monopsony and oligopsony (hereinafter "monopsony") address unlawful buyer power exercised to the detriment of sellers. This is the major antitrust issue with which farmers and ranchers are concerned in the meat packing industry.

Monopsony is a legitimate antitrust concern as re-confirmed by the Second Circuit Court of Appeals in Todd v. Exxon. (Docket No. 01-7091, Second Circuit Court of Appeals, December 20, 2001). In that case, the Second Circuit determined that oligopsonistic buying power practiced by oil companies in the labor market may have unlawfully depressed salaries for employees in the industry. Unfortunately, far fewer antitrust cases have been litigated as to monopsony in comparison to monopoly.

Partial or full vertical integration by meat packers (captive supplies) substantially increases their monopsony power, to the detriment of farmers and ranchers, through depressing farm gate demand in the open market and through the ability of meat packers to engage in practices that manipulate the thinning cash market. Virtually all experts agree, regardless of whether they support or oppose captive supplies, that where dominant firms interact repeatedly in a thin market, the potential for manipulation is so great as to be undeniable. The captive supply problem is discussed in the next section.

The major problem with the antitrust analysis engaged in by some judges and the current administration is that undue weight is given to amorphous, unproven efficiency claims as a justification for an otherwise anticompetitive merger or business practice. Most antitrust claims presented in the courts involve the "rule of reason" analysis in which the anti-competitive and pro-competitive effects of a particular business practice are weighed by the decision maker, whether a judge or a jury. Most mergers reviewed by the U.S. Department of Justice Antitrust Division (DOJ Antitrust) or the Federal Trade Commission (FTC) involve a similar decision making process as staff considers anti-competitive and pro-competitive effects.

Efficiency claims are always made by the defendant (in an antitrust case) or the merging parties (in a merger review) as part of their argument that the practice or the merger is pro-competitive. The problem is that the claims of efficiency are often broad, unproven and primarily theoretical rather than specific, relevant and factual. Some judges and both the FTC and DOJ Antitrust are far too willing to accept broad efficiency claims without proof. They are also far too willing to give undue weight to those efficiency claims without determining whether alternative ways to achieve efficiencies exist and without determining whether the claimed efficiency gains would be passed on to the consumers (in the monopoly/oligopoly sense) or suppliers (in the monopsony/oligopsony sense).

This same problem of balance exists when courts and the administration review claims of anticompetitive practices involving partial vertical integration, as is the case in the meat protein production sectors. Allegations of problems arising from vertical integration are always defended by the dominant firms through broad claims of efficiencies. Those rhetorical claims, unfortunately, tend to be accepted without applying a rigorous analytical framework to the claims. Such an analytical framework is necessary to separate the proven from the unproven and to separate the relevant to the irrelevant.

The Organization for Competitive Markets requests that Congress give strong consideration to legislating an analytical framework applicable to claims of pro-competitive effects, including efficiency claims, which would apply to merger reviews and to cases in which the "rule of reason" analysis is applied. We propose the following four part test.

> First, claims of pro-competitive impacts must be articulated, supported by direct evidence rather than speculation, and proven by clear and convincing evidence. This portion of the analysis is designed to screen rhetoric from fact.
>
> Second, claims of pro-competitive impacts must be shown as directly connected to the merger or allegedly anti-competitive practice at issue. This portion of the analysis is designed to screen out efficiency claims that are unrelated to the merger or practice under consideration.
>
> Third, the proponent of claims of pro-competitive impacts must show that there are no alternative ways to achieve such impacts other than engaging in the merger or anticompetitive practice at issue. The rationale here is to seek achievement of proven efficiencies through means that are not anticompetitive. For example, efficiency gains can often be achieved in a multitude of ways, some of which do not affect competition and some of which are detrimental to competition.

> Fourth, the proponent of such claims must show that the pro-competitive effects of the merger or practice at issue are highly likely to be passed on to consumers (where monopoly/oligopoly is the concern) or to suppliers (where monopsony/oligopsony is the concern). For example, if a particular firm is or may become a monopoly seller, the structure of the industry is such that the benefits claimed are not likely to contribute to the welfare of society. Rather such benefits will be maintained within the firm.

In the absence of an analysis which will separate the relevant from the irrelevant, the U.S. antitrust laws are being effectively repealed by some courts and by the administration. By restoring balance to the equation, we can reclaim a competitive marketplace in agriculture, and in other sectors, while minimizing harm to efficiency gains or other pro-competitive effects.

III. TRANSPARENCY IN MERGER ANALYSIS

OCM is extremely concerned about the lack of transparency in the merger review process by DOJ Antitrust and the FTC. The public has no access to the facts or the analysis presented by merging parties in support of pro-competitive claims presented to justify an otherwise anticompetitive merger. Further, the public has no access to the facts, the analysis or the conclusions reached by antitrust enforcement officials considering the pro-competitive claims.

According to Dr. F.M. Scherer of Harvard University, more than half of all mergers fail to provide the projected benefits to the company or shareholders, not to mention to social welfare.[1] One study found that 57% of merged companies underperform their industry counterparts within three years of merger completion. The long term failure rate is higher.[2] Although neither DOJ Antitrust nor FTC has comprehensively studied the issue, it appears that the merger benefits are less compelling than initially claimed. Yet the pro-competitive effects were often judged to outweigh anticompetitive effects at the time the merger proposal was reviewed by antitrust authorities. The result is that any loss of competitiveness, loss of jobs in communities from plant closures, and harm to consumers or suppliers was not outweighed, to the extent initially believed if at all, by pro-competitive effects even though enforcement officials judged it so. If more than half the mergers were ill-advised, it is a minimal requirement to bring more resources to bear on future merger review through transparency and a better opportunity for public comment.

Therefore, OCM respectfully requests that legislation be enacted to require that claims of pro-competitive effects of a merger alleged by merging parties are made publicly available - including the specific claims and the data and analysis supporting the claims. The rationale for this legislation is more accountability in the merger review process. Further, if such information is available, citizens and companies that may be negatively affected by the merger will have the opportunity to present evidence opposing the claims of the merging parties. In this manner, antitrust enforcement officials will have more information, that is directly on point, from which to make a decision as to whether to challenge a merger. Additionally, public scrutiny will create an environment in which such officials will be more likely to do their job in a more rigorous manner.

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[1] Scherer, F.M., "Some Principals for Post-Chicago Antitrust Analysis," Case Western Reserve Law Review, Volume 52, (Fall 2001).

[2] Id., at 8.

IV. CAPTIVE SUPPLIES

The U.S. Department of Justice has authority over the meat packing industry under the Sherman Act, the Clayton Act and the Packers & Stockyards Act (via 7 U.S.C. §224). However, despite this authority, and despite the fact that a Special Counsel for Agriculture position exists within the department, DOJ has failed to bring any enforcement action against the industry at any time.

A. The Problems

Captive supplies of livestock are all livestock committed to packers through packer ownership and contracts more than seven days prior to slaughter.[3] The fundamental market problems of captive supplies are threefold: (1) market closure; (2) market unfairness; and (3) "gaming the system" just as Enron and Dynegy gamed the energy trading system.

1. Market closure

Captive supplies have progressed to the point where hog farmers cannot get bids or access to markets, even in states with large packing capacity, such as Iowa, Nebraska and Minnesota. Pork packers own 20 percent to 25 percent of the hogs they slaughter. That is 77,000 packer owned hogs per day at 22%. That is over 20 million hogs per year that displace family farm produced hogs. This, at its core, dampens or excludes widespread rural commerce. If we like a diverse and decentralized production system, we are not promoting it.

But what of the remaining "open market" participants? We know that about 16% of each day's slaughter is claimed to be open market, using USDA daily market news reports.[4] No one disagrees that farmers have difficulty accessing the market. But what is not widely known is that most farmers who seek bids on their hogs no longer get bids, even in Iowa which has more pork slaughter capacity than any other state. Rather, they get "slots" or "shackle space" at some time in the next seven to fourteen days. The packer tells the farmer what the price is after the hogs are delivered. That price is reported to USDA Market News Service. No bids. No competition. That is our dysfunctional open market price discovery system. We are losing much decentralized economic activity in the form of broad family farm market participation.

2. Market unfairness

To the extent participation is allowed in the markets, participants are treated unequally. Large corporate producers receive preferential contracts. For example, the large feedyards owned by Sparks, called Cattle Co., appear to have contracts with packers which allow significant price advantages over other producers of cattle. It is undisputed that producers are treated disparately

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[3] The industry, specifically most cattlemen's associations that have addressed the issue, uses the seven day rule. However, USDA-GIPSA uses a 14 day prior-to-slaughter rule. See, USDA GIPSA publication, "Captive Supply of Cattle and GIPSA's Reporting of Captive Supply," released January 18, 2002 (on the web at www.usda.gov/gipsa/pubs/captive_supply/captive.htm).

[4] This 16% contemporary figure is part of a declining trend in open market hog trading. If the current trend continues, the open market will disappear in 2004.

with regard to contract offerings, bids, and access. But it is disputed whether these practices are legitimate. If we apply basic and successful market principals to our evaluation of these activities, the answer is clear that disparate treatment is contrary to proper market operation and contrary to the public interest.

If a small farmer produces high quality hogs, he/she should get access to prices and shackle space according to quality, not quantity. If a large farmer producers high quality hogs, the same result. Size is not relevant to hog quality. Further, the transaction costs arising from purchasing from many producers, rather than a few large producers, is so small as to be insignificant. The primary goal should be fairness and access to facilitate widespread and decentralized rural commerce.

A properly functioning free market provides uniform rules for all participants on price, premiums, discounts and access. The stock market does so. Warren Buffet gets no better terms than an ordinary person when buying stock at a particular time – even if he buys 500,000 shares of GE when an ordinary person buys 50 shares. Buffet may analyze information and have better strategies to time his purchases and sales, but we have equal market access at the same price on any given time and date of trading. The same should be true in the livestock markets.

The Department of Justice has jurisdiction over the meat packing industry through the Clayton Act, the Sherman Act and the Packers & Stockyards Act. Though USDA is the primary enforcer of the P&S Act, DOJ Antitrust has prosecutorial authority through 7 U.S.C. 224. However, DOJ has never brought an antitrust case against the meatpacking industry. Rather, DOJ repeatedly claims that USDA has the jurisdiction and responsibility.

3. Manipulating or Gaming the System: The Incentive Structure

When constructing proper market rules, the proper approach is to counteract the incentives to manipulate the market or "game the system." Looking for proof of harm after-the-fact is not beneficial and this method has failed. Further, a focus on efficiency has not proven helpful and has failed.

Enron and Dynegy "gamed the system" with regard to California energy markets. They used strategies such as Death Star, Fat Boy and Get Shorty in creating fictional transactions, creating perceived shortages, and trading advantageously in the situation they created. They got wealthy, but Californians were thrown into crisis.

When undue importance is attached to a number, undue efforts are made to manipulate that number. On Wall Street, the *key number* is earnings. Shady accounting strategies are used to manipulate that number. Bernard Ebbers of WorldCom is the poster child for this scenario. But tremendous energy is expended by defenders to justify those strategies as legitimate. In the livestock markets, the *key number* is the open market price. Similarly, shady marketing strategies are used to manipulate that number. And tremendous energy is expended by defenders to justify those strategies as legitimate.

Captive supplies, such as contracted and packer owned livestock, are the raw material for market strategies equivalent to Death Star and Fat Boy. By strategically scheduling captive hogs to stay out of the market, drive the price down, and jump into the market to buy at low prices, packers make tremendous amounts of money. Farmers lose tremendous amounts of money. Yet valiant attempts are made to convince us that captive supplies are justifiable.

The fundamental principal here is that when the market is dominated by a few firms that are repeat players in a very thin market, the motive and opportunity to manipulate that thin market is so real as to be undeniable. Bob Peterson, former CEO of IBP, spoke to the Kansas Livestock Association in 1988. The following comes from the tape of his speech:

> "Our competitors are promoting contracts and seeking more. These forward contracts coupled with packer feeding could represent a significant percentage of fed cattle at certain times of the year. **Do you think this has any impact on the price of the cash market? You bet! We believe a significant impact.** Large volume forward contracting and its inevitable connection to the futures trading pit in Chicago will foster sever price distortions in the cash market. In the event that contracting becomes the wave of the future, and frankly I doubt that sharp feeders will allow that to happen, IBP will be forced to respond to the competitive pressures of the market place." (emphasis added)

Even Wayne Purcell of Virginia Tech, who opposed the packer ownership ban, understands the manipulative incentives in the current system.[5] In testimony before USDA in Denver in September, 2000, he wrote that "[w]hether buyers attempt to manipulate the cash market to which the contract price is tied is somewhat immaterial because the incentive to do so is present and is undeniable." It is this motive and opportunity, aka the "incentive structure," that should govern legislative judgment to prevent manipulation.

Past USDA studies have shown a high correlation between increased captive supplies and lower prices. The most detailed study of this relationship was published in 1999, using subpoenaed packer information with the support of USDA. That study, in the beef industry, found that "**a robust empirical relationship [between captive supplies and low prices] was found in every case.**[6] For folks who are confused, this means that when captive supplies are dumped on the market, prices drop. The economic incentive is thus shown. More captive supplies make more money for packers.

USDA explains this away saying that this correlation does not give them causation. But economists cannot achieve "causation." Rather, a major ADM-style price fixing case with testimony, hidden cameras, and the like is necessary to give causation to the extent needed by USDA. It is time for a legislative judgment to be made.

Let us quantify the economic incentive to game the system by using captive supplies to manipulate the price through an example. If packers can use captive supply to drive down the

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[5] Purcell, Wayne D., *Contracts And Captive Supplies In Livestock: Why We Are Here, Implications, And Policy Issues,* Testimony at the Denver Captive Supply Forum, dated September 21, 2000.
[6] John R. Schroeter and Azzedine Azzam, Econometric Analysis of Fed Cattle Procurement in the Texas Panhandle 46 (November 1999).

open market price by one dollar on a day, the procurement savings is $910,000 each day (assuming a daily hog slaughter of 350,000 head at 260 pounds per animal). That is $910,000 taken from farmers. On an annual basis, that is $237 million taken from farmers and transferred to packers as compared to a competitive market result. If captive supplies drive the price down by two dollars per day, we double the farmer loss and double the packer gain.

How can a dominant packer buyer game the system? The easiest way is for a packer to schedule blocks of captive supply livestock for slaughter over a period of time, pull out of the market during that time and watch the open market price fall. Then the packer can jump into the open market to buy cheaply. That cheap open market price not only saves money on the open market hogs directly, it also cheapens the tens of thousands of hogs per day that are contracted using a formula based on the open market price. If any packer buyer does not known how to do this, it is likely that any such packer buyer has moved on in his career.

Further, a packer contracts for the best hogs and, as a result, the open market becomes residual. By "residual," it is meant that the poorer, less desirable hogs are sold on the open market. The open market price reported by USDA Market News Service is, thus, the value of the poorest quality animals. The perverse result is that the poor quality hog price becomes the base price for the hogs procured under formula-price contracts ("formula price" contracts derive the sale price based on a formula which uses the open market price as the starting point).

Additionally, the futures market relies most heavily on the open market in determining price for the future. If the open market is broken, the damage is transferred to the futures markets. In other words, the captive supplies derivatively drive down the futures market because of futures traders' heavy reliance on open market price data.

Lastly, because producers selling in the open market have no realistic bid choices, they engage in "panic selling" rather than negotiation. Certainly it is difficult to negotiate when there is only one willing buyer in the region and that buyer does not bid but merely doles out shackle space with the promise of an arbitrary "price" upon delivery. The cumulative result of panic selling is not a price arising from a competitive market. From what is that post-delivery price derived from, a market? Packer gratuity? Certainly not competitive bidding.

B. Captive Supplies: The Solutions

The only solution to captive supplies is structural, not a conduct remedy. By a "structural remedy," we mean limiting or eliminating the partial vertical integration known as captive supplies. A "conduct remedy" means that we do not limit captive supplies but merely pass or enforce a law to prevent unlawful conduct that captive supplies could enable. Structural remedies are preferred because they do not require significant policing due to the fact that the ability to manipulate markets is taken away from dominant firms. Conduct remedies are not preferred because they require constant policing by regulators in a very intrusive way to be effective. Such constant policing has historically not been undertaken or effective. The following three bills are viewed by OCM as complimentary. If passed and signed by the president, they will substantially increase competition, fairness and market access.

1. Packer Ownership Prohibition

The packer ownership prohibition proposed by Senators Johnson, Grassley, Harkin, Wellstone, and Thomas is the first step in making the markets work properly and limiting the ability of packers to game the system. This legislation would take a portion of the strategic scheduling ability away from the dominant packers and make the market more responsive to true supply and demand. It would also increase access to markets by more producers.

While some studies predicted crisis from banning packer ownership, those studies can be dismissed by one simple analysis – i.e. the historical record. The studies were not based upon the historical record, but upon wildly speculative economic projections. We know that the drastic financial losses in the industry will not occur because packer ownership prohibitions have been in effect for several years in Iowa and Nebraska. The predicted losses did not occur. Those states had, and continue to have, the largest packing capacity for hogs and cattle, respectively, in the nation. Those states have as many or more producers of hogs and cattle as any state. The strength or decline in production agriculture has not been affected in a manner more drastic than other states. Yet, the percentage of family farmers producing livestock is as high or higher than other states.[7]

2. Enzi legislation on livestock contracts

Senator Enzi has proposed a bill (S. 2021) that would require all contracts to have a fixed base price at the time of the agreement and would also require open public bidding of these contracts. This bill would transform the contract market from a secret, preferential, market harming scenario into an open market in and of itself. A contract market would still allow quality specifications and risk management. But it would severely limit the ability of packers to use contracted supplies to manipulate price.

Importantly, the Enzi bill has basic requirements for the contracts similar to the futures markets. There is a relatively small volume requirement, 40 head per contract for cattle and 30 head for hogs, that allow small producers to bid on contracts while large producers bid on more contracts. However, that legislation could be improved by adding a 14 day delivery window for each contract to limit strategic scheduling by the packer to affect the spot market price.

3. Grassley-Feingold legislation on limiting captive supplies

Senators Grassley and Feingold have proposed a bill (S. 2867) that would increase transparency in the market through guaranteeing a substantial open market on every trading day. That legislation provides a minimum number of livestock that packers must slaughter in each plant on each day so the spot market, from which price discovery emanates, has sufficient volume to perform its function. The legislation also will prevent full vertical integration of the cattle and swine sectors because of that spot market requirement.

[7] See, Welch, et al., "On the effectiveness of state anti-corporate farming laws in the United States," Food Policy 26 (2001) 543-548.

Further, the Grassley/Feingold legislation defines captive supplies in a manner more in line with the industry definition. In the bill, captive supplies are all livestock slaughtered more than seven days after being committed to a packer rather than fourteen (14) days as USDA has prescribed. In sum, these three bills are complimentary in substantially addressing the whole problem.

Thank you for your interest in this issue.

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Ensuring Open and Competitive Markets: Are Meat Packers Abusing Market Power

Testimony

of the

Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America (R-CALF USA)

Before the

United States Senate Judiciary Committee

Field Hearing

Sioux Falls, South Dakota

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Submitted By

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Mr. Chairman and Members of the Committee:

I am here today as the President of the Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America R-CALF USA. R-CALF USA is a national non-profit cattle association that represents only cow/calf producers and independent stockers and feeders. Our mission is focused on representing the U.S. live cattle industry in trade and marketing issues to ensure the continued profitability and viability of independent U.S. cattle producers.

In 1999 R-CALF USA became a national membership organization and is now the fastest growing U.S. cattle association in America, with over 1450 new members joining just since the first of the year. We now have a national membership of over 6100 cattle producers in 42 states. We also have 30 affiliated organizations including 10 statewide cattle associations, 18 county cattle associations, and 2 general farm associations.

Our association's rapid growth is a direct reflection of the growing awareness and concern among U.S. cattle producers for the chronic and severe problems associated with our cattle markets.

I commend Chairman Leahy and this Committee for holding this hearing. The preservation of an open and competitive cattle market is of paramount concern to my membership and the Senate Judiciary Committee's initiation of this investigation reveals the Committee's concern that our markets may no longer be competitive.

Introduction

The importance of the live cattle industry alone, not including the beef processing sector, both to agriculture in the United States and the overall U.S. economy is difficult to overstate. The single largest sector in agriculture for more than 40 years, the live cattle industry currently has more than one million operators and has generated more than $30 billion in agriculture revenues annually for the last dozen years. During the past several years, however, this vitally important sector of the overall beef industry and the American economy has been in a state of substantial economic crisis, a condition that persists today. Financially, the live cattle industry overall has incurred more than seven consecutive years of substantial losses.

The live cattle industry is an integral sub sector of the three-sector U.S. Beef Industry. The three sectors include the live cattle industry, beef processing industry, and beef retailing industry. If the market is competitive, product value is progressively added within each independent sector, beginning first with the production sector – the live cattle industry.

Historically, our live cattle markets have been responsive to various forces impacting each of the three beef industry sectors. Live cattle markets have responded both positively and negatively to such beef retail sector factors as consumer perceived convenience, quality and trust. Live cattle markets have also responded both positively and negatively to such processing-sector factors as domestic supply levels, export demand, and import volumes. Finally, live cattle markets have been responsive to factors within its own industry such as domestic supply levels, quality and consistency attributes, and breed preferences. Of utmost importance in this discussion is the fact that our live cattle market has historically responded, both positively and negatively, to all of the aforementioned factors. While these factors persist today, new forces have recently entered the marketplace and these new forces are undermining the competitiveness of our markets and are threatening the very survival of the independent U.S. cattle producer.

Historical Indicators of a Competitive Live Cattle Market

As shown in Figure 1, retail beef prices and live cattle prices shared a synchronous relationship for the 24-year period from 1970 through 1993. This synchronous relationship was substantiated by a mid-90s study commissioned by the Cattlemen's Beef Board and conducted by Cattle Fax. The significance of this synchronous relationship is profound. Because retail beef prices are predicated on consumer buying preferences, the harbinger of competition, the value attached to beef is known to be attributable to legitimate market forces. Although the live beef processing industry is sandwiched between the consumer and the live cattle industry, so long as the live cattle market rose and fell in synchrony with the retail beef market, the live cattle industry had confidence that competitive market signals were the controlling factor in the pricing of live cattle. According to data reported by the USDA-ERS, the spread between live cattle prices and retail prices increased from $.36 in 1970 to $1.29 in 1993, a 358 percent increase over this 24-year period.

In Figure 2, the progressive addition of profits, beginning with the value received by the live cattle producer, then the value captured by the beef processor, and finally the value attributable to the retailer is shown. Consistent with Figure 1, the relationship between the respective values captured by the three industry sectors for the 24-year period from 1970 through 1993 can also be characterized as synchronous. Notable, however, is the ever-widening spread between the respective values captured by each sector. According to data provided by the USDA-ERS, in 1970, for example, the percentage share of the consumers' beef dollar captured by the live cattle industry was 64 percent. By 1993, the live cattle industry's share had decreased to 56 percent, an 8 percent decrease over this 24-year period.

The foregoing two indicators: a synchronous relationship between live cattle prices and retail beef prices and a dominant live cattle industry share of the consumer's beef dollar, are the historical indicators evincing that competition was the controlling factor in the progressive addition of value within each sector of the beef production chain, albeit with a recognizable trend suggesting that the sectors downstream of the live cattle industry were progressively capturing greater value than was the live cattle industry.

Several factors can be identified as contributors to this trend marked by the capture of greater value by the beef processing and retailing sectors during this period, including increasing imports, increasing concentration (the General Accounting Office reported in March of 2002 that the four largest packers already controlled 36 percent of the market by 1980), and increasing concentration in the retail sector. However, it is R-CALF USA's belief that during this period, from 1970 through 1993, market competition was still the predominant force influencing live cattle prices.

New Forces Entered the U.S. Cattle Market Prior to 1994 that Threatened Competition

R-CALF USA believes that 1994 marks the year in which the packing industry first realized it possessed considerable buying power and it began exercising this newfound buying power in the marketplace. Several factors culminated in the early 90s to provide this buying power to the meatpacking industry:

1. According to the March 2002 GAO report "Economic Models of Cattle Prices" the packing industry achieved a concentration level in which the four largest meatpackers accounted for 72 percent of all steer and heifer slaughter in the U.S., and by 1999, this level increased to 81 percent. The GAO reported "no other manufacturing industry showed as large an increase in concentration since the U.S. Bureau of the Census began regularly publishing concentration data in 1947."

2. By the mid-90s, the meatpacking industry had introduced new tools into the market place that provided it with both alternatives to procuring their live cattle inventories from the open, cash market, and the ability to control ever-increasing numbers of live cattle inventories. These new tools included formula pricing, forward contracts including basis the board forward contracts, marketing agreements, joint ventures, and alliances. In addition, packers began purchasing and feeding their own light-weight cattle (packer-owned cattle)

3. According to the January 11, 2002, GIPSA report "Captive Supply of Cattle and GIPSA's Reporting of Captive Supply," cattle procured using the above-mentioned procurement tools but not delivered to the packer within 14 days were "captive supply" cattle. GIPSA generally refers to cattle that are committed to or are owned by a packer before they are ready for slaughter as captive supplies. While a relatively new procurement practice, GIPSA reported that by 1990, over 20 percent of all the steers and heifers slaughtered by the four largest packers were captive supply cattle. This percentage increased to over 25 percent in 1999. However, following its review of its 1999 data, GIPSA announced it had underreported the captive supply levels of 1999 and issued a corrected percentage of 32.3 percent. R-CALF USA's analysis of GIPSA's data indicates that by 1999, packer owned cattle accounted for approximately 8 percent of all the steers and heifers slaughtered by the four largest packers, accounting for approximately 2 million head of cattle.

4. The supply sensitive domestic cattle industry was subjected to a significant increase in imported beef and live cattle, contributing to increased domestic supplies. In 1980, imports of live cattle as a percentage of total cattle slaughter were approximately 2 percent. By 1993, the percentage grew to over 6 percent. In 2001, live cattle imports represented approximately 7 percent of the 26.1 billion pounds of U.S. production. These imports of live cattle, particularly the imports of Canadian fed cattle directly to domestic packing plants (numbering approximately 1 million head in 2001) afford U.S. packers with inventories having similar affects on the domestic cattle market as domestic captive supplies.

Indicators of a Disruption in the Competitive Functioning of the Cattle Market

By 1994, the effects of the forgoing radical changes that occurred in the structure of the U.S. cattle industry: an unprecedented market concentration level, the deployment of new cattle procurement tools leading to captive supplies, and an increase in imported live cattle that function similar to captive supplies, culminated to reveal a significant disruption in the competitive functioning of the U.S. live cattle market. This significant disruption can be detected using the following four indicators:

1. Referring again to Figure 1, it is readily discernable that the synchronous relationship historically shared by retail beef prices and live cattle prices was ended. Cattle prices fell precipitously from 1994 until hitting a 12-year low in 1998. Meanwhile retail beef prices, although faltering slightly, did not experience a price decline any way near the magnitude experienced by the cattle industry. This 1994 through 1998 disruption represents an "Adjustment" in the historical relationship between retail beef prices and live cattle prices. Although both retail and live cattle prices began strengthening again after 1998, the "Adjustment" effectively severed the live cattle market from receiving the consumer demand signals reflected by the retail price of beef. This is evidenced by the profuse spread between live cattle prices and retail beef prices, which in 1998 reached $1.46 per pound. In just the six-year period following 1993, the live to retail spread increased by 88 percent. By July of 2002, this spread has increased to over $1.93 per pound. If the spread between live cattle prices and retail beef prices were the same as it was before the 1994 "Adjustment," fed cattle prices in July would have been $83 per cwt., not the $63 per cwt actually received as reported by USDA-ERS. Using this indicator alone, this equates to a loss to U.S. producers of over $240 per head on a 1200-pound animal.

2. Referring again to Figure 2, it is readily discernable that from 1994 on, both packers and retailers captured a disproportionate share of the consumers beef dollar when contrasted with the competitive, pre-"Adjustment" period. As stated earlier, in 1993 the live cattle industry's share of the consumer beef dollar was 56 percent, representing the dominant share. The appropriateness of this dominant position can be readily justified by the relative costs and corresponding value that a competitive market previously assigned to the live cattle industry prior to the market disrupting "Adjustment" occurring in 1994. Today, the USDA-ERS reports that the live cattle industry's share of the consumer beef dollar had fallen to less than 42 percent in July of this year, constituting a complete reversal of the respective share of the consumers' beef dollar. Using this indicator alone, this equates to a loss to U.S. producers of $245 per head on a 1200-pound animal.

3. Since the mid-90s, while both domestic and export demand for beef began strengthening, the U.S. live cattle industry has been in a significant state of decline, a situation that has adversely affected numerous rural communities across the nation. According to the June-July, 2001 USDA Agricultural Outlook, domestic cattle inventories have b... falling since 1996 as cattle producers have been liquidating their herds. The repo... estimated the calf crop for 2001 was likely the lowest since the 1950s, and USDA projects that the calf crop for 2002 will probably be even smaller. Ironically, between

1996 and 2000, a period marked by a decline of U.S. inventories, cattle imports into the United States grew by 11 percent as reported by USDA in their August, 2001 Agriculture Outlook.

4. Since 1992, the packers' per head margin has increased an incredible 133 percent. As revealed by Figure 3, meatpackers not only avoided the substantial losses experienced by U.S. cattle producers, they have profited tremendously. According to data generated by the Livestock Marketing Information Center, per head margins for the beef packing industry increased from $62.28 in 1992 to $145.20 per head in 2001.

5. Consumers have not seen a reduction in the price of retail beef that a competitive market would predict when input costs associated with the final product are drastically reduced. Referring again to Figure 1, from 1993 to 2001, live cattle prices fell from $.77 per pond to $.72 per pound, a $.05 per pond decrease. During the same period, retail beef prices climbed from $2.93 per pond to $3.38 per pound, a $.45 per pound increase. Based on USDA-ERS data, live cattle prices for July 2002 had fallen to $.63 per pound, a decline from 1993 prices of 18 percent. Retail prices for July 2002 were $3.29 per pound, an increase over 1993 prices of 12 percent. Again, a competitive market would not predict this outcome, especially not in the long-term.

The Meat Packing Industry Readily Admits it is Acquiring Greater Control over the Live Cattle Industry

In written testimony before the July 16, 2002 United States Senate Agriculture Committee hearing on the packer ownership ban, the meatpacking industry's trade association, the American Meat Institute, testified, "Demand for consistent quality product has led many firms to exert greater control over the supply chain." In its written testimony before the hearing, the National Cattlemen's Beef Association (NCBA) testified that the Sparks study was the only known "empirical evaluation of the proposed ban on packer ownership," and it attached the executive summery of the Sparks study to its testimony. The NCBA along with the National Pork Producers Council commissioned the Sparks study which is replete with admissions that the beef packing industry is acquiring greater control over the U.S. live cattle industry through vertical integration. Specifically, the Sparks study commissioned by the NCBA admits:

1. "Packers use ownership of livestock to help control unit costs in a variety of ways. If this management tool is restricted, unit costs can be expected to increase (without increasing the value of the final product)."

2. "The pressure to reduce costs force the search for low-cost livestock supplies (often at the expense of producer returns)."

3. "For many meat packers, integration between the packing and feeding stages of livestock production is seen as an effective vehicle to reduce market risk exposure and loss of such a valuable tool increases their costs . . ."

4. "Vertical integration often attracts investors because of the negative correlation between profit margins at the packing stage and the feeding stage."

The Packers and Stockyard Act of 1921 Prohibits Meat Packers From Controlling Prices

The Packers and Stockyard Act of 1921 (Act) enumerates unlawful practices of meat packers. It appears to specifically prohibit any actions that would have the effect of controlling prices. Relevant unlawful practices enumerated in the Act include:

1. "Sell or otherwise transfer to or for any other person, or buy or otherwise receive from or for any other person, any article for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly in the acquisition of, buying, selling, or dealing in, any article, or of restraining commerce; or"

2. Engage in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly in the acquisition of, buying, selling, or dealing in, any article, or of restraining commerce; or"

It would appear that the NCBA commissioned Sparks study provides documentation that "Packers use ownership of livestock to help control unit costs in a variety of ways . . . " If the Committee believes as I do that the unit costs that Sparks refers to is the price packers pay for live cattle, then I would urge the Committee to cause the packing industry to immediately halt all practices that help them control the unit costs of live cattle.

Are Meatpackers Abusing Market Power?

I have attempted to demonstrate to the Committee that competitive market forces are no longer the controlling factor in the establishment of prices received by U.S. cattle producers under the current structure of the U.S. cattle market. I have further attempted to demonstrate that a wedge has been driven within the beef industry that effectively excludes both consumers and cattle producers from participating in and enjoying the benefits of a competitive marketplace where consumer demand signals drive both the production and price of our cattle.

Although GIPSA is the responsible agency for helping to guard against unfair and anticompetitive practices by meat packers, the March 2002 GAO report cited a 1996 GIPSA study in which GIPS reportedly could not conclude that our industry was competitive. And, I am unaware of any subsequent attempts by the agency or any other agency to determine if it is.

I am testifying today that our markets are not competitive, that packers have and are interfering with the competitive forces in our markets to control the unit price of their number one input cost – the live cattle raised and marketed by my members. And, I have identified the tools presently used by the meat packing industry to accomplish this objective.

There is no greater evidence that our markets are not competitive than to witness the record prices that you as consumers are paying and the tremendous losses producers are experiencing

There is no greater evidence that our markets are not competitive than to look at strong consumer demand for beef on the one hand while witnessing the high number of cattle feeders exiting this industry on the other.

There is no greater evidence that our markets are not competitive than to look at the relationship between both retail and boxed beef prices and fed cattle prices.

There is no greater evidence than that our markets are not competitive than to look at the U.S. cattle producers lost share of the consumer's beef dollar.

Mr. Chairman and Members of the Committee, on behalf of the thousands of cattle producing members of R-CALF United Stockgrowers of America, I'm here to tell you that meatpackers are abusing market power and they are threatening the independence of our U.S. cattle producers. I urge you to take decisive and immediate action to correct this situation.

RECOMMENDATIONS

R-CALF USA firmly believes there is ample evidence that our markets are not competitive. We are convinced that the use of packer owned cattle and other captive supply sources are the tools used by the concentrated packing industry to strategically disrupt the competitiveness of our markets, and, we are convinced that the problem has grown beyond the capabilities of USDA to address. We, therefore, believe Congress should immediately take the following steps:

1. Prohibit packers from owning livestock.
2. Conduct an immediate investigation into the additional cause or causes of why our markets are unresponsive to competitive market signals. Include the following issues as topics for the hearings held in conjunction with the investigation:
    a. Senator Mike Enzi's captive supply amendment that would require a fixed base price in formula contracts and would require contracts to be traded in open, public markets.
    b. Senator Charles Grassley's amendment that would protect our cash cattle market from further thinning.
    c. Packers' use of imports and their affect on the cattle market in light of then-ITC Chair Lynn M. Bragg's 1999 statement that packers are using imports to suppress domestic live cattle prices.
    d. Interstate shipment of state inspected meat, along with the need to establish minimal performance standards, so state inspected packing plants can expand their presently constricted marketing area.
    e. Restricting use of the USDA quality grade stamp to only meat derived from animals born, raised, and slaughtered in the United States.
    f. Need for increased price transparency in cattle markets.
    g. Needed reform of the Commodities Future Markets.
3. Re-introduce the Agriculture Competition Title including the following provisions:
    a. Establishment of an Office of Special Counsel for Competition Matters, whose duty would be to investigate and prosecute violations of the Packers and Stockyards Act.

b. Provide for the appointment of outside counsel for claims arising from the Packers and Stockards Act.
c. Prohibit unfair or deceptive acts or practices in agricultural commerce.
d. Prohibit confidential contracts.
e. Provide for recovery of attorney fees to enforce the Packers and Stockyards Act.

4. Direct USDA and ITC to update and improve the economic models used to explain and forecast cattle and beef prices, and provide assistance to through necessary funding.

America's cow/calf producers, independent stockers and feeders, and consumers are being unjustly excluded from the benefits our free market economy promises. I respectfully urge this Committee to immediately and decisively remove the known barriers preventing our participation.

Thank you for your consideration.

Department of Justice

STATEMENT

OF

DOUGLAS ROSS
SPECIAL COUNSEL FOR AGRICULTURE
ANTITRUST DIVISION

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

ANTITRUST ENFORCEMENT
AND THE MEATPACKING INDUSTRY

SIOUX FALLS, SOUTH DAKOTA

AUGUST 23, 2002

Good afternoon, Mr. Chairman and members of the Committee. I appreciate the opportunity to discuss antitrust enforcement in the agricultural marketplace, and in particular the role of antitrust enforcement in ensuring that the livestock slaughter markets are competitive.

In recent years, agricultural producers and others have expressed concern about competitive conditions in the agricultural marketplace, about the impact on farmers of particular mergers and acquisitions, and about levels of concentration in agriculture generally. We take those concerns very seriously. The Antitrust Division has been very active in recent years in the agriculture industry, and has brought a number of enforcement actions of importance to producers and consumers, some of which I will describe shortly. Antitrust Division officials have also traveled to various places around the country to meet personally with producer groups, and have met and spoken with individual producers and farm organizations and testified at hearings in Washington and in the field to hear producers' concerns directly and to improve everyone's understanding of how the antitrust laws operate. And I am happy to be here today as a part of those efforts.

There are three basic kinds of violations of the antitrust laws. First, the antitrust laws prohibit conspiracies to suppress competition. Second, they prohibit the use of predatory or exclusionary conduct to acquire or hold onto a monopoly. Third, they prohibit mergers that are likely to substantially lessen competition in a market. The ultimate goal in each instance is to promote competition as a means of ensuring that consumers get the benefit of competitive prices, innovation, and efficiency, free from artificially imposed restraints. I will describe each of these types of violations in a little more detail in a minute.

The antitrust laws apply in the same way in every industry, with a very few exceptions where their application is limited by specific statute; an exception important for agriculture is the Capper-Volstead Act, which permits agricultural producers to market their products jointly through cooperatives. A number of industries are also regulated by government agencies under statutes that go beyond the antitrust laws to establish additional, industry-specific rules for appropriate behavior in the marketplace; for example, the livestock, meat-packing, and poultry industry is regulated by USDA's GIPSA. When I talk about the antitrust laws, I mean the laws that we enforce at the Antitrust Division -- the Sherman and Clayton Acts. I do not include the Packers and Stockyards Act, which is enforced by GIPSA rather than by DOJ. The Packers and Stockyards Act is a fair trade practices and payment protection law that promotes fair competitive environments for the livestock, meat, and poultry industries.

While we often speak of consumers as the targeted beneficiary of antitrust enforcement, producers also benefit, by having healthy incentives to provide the best products and services they can, with the expectation that they will be able to do so free from anticompetitive interference. And the overall U.S. economy benefits, as the products and services desired by consumers are produced more efficiently, in greater quantities, and at competitive market prices.

In this regard, let me emphasize that we do look at so-called "monopsony" concerns -- the potential for competition to be diminished by anticompetitive conduct or merger at the buyer side that adversely affects sellers. If buyers obtain market power through merger or restrain trade, and thereby depress prices for the inputs they purchase below competitive levels, producers of those inputs will have depressed incentives to produce, which will result in reduced quantities of those inputs available for consumers compared to what would be available in a competitive market. So a focus on promoting competition is entirely compatible with our taking enforcement action in a monopsony case when the facts warrant.

We are very much aware of the trends toward increasing concentration in some agricultural sectors. In particular, the steer-heifer side of the cattle slaughter market has been highly concentrated for some time, with four meatpacking firms now controlling over 80 percent of the market. Lamb slaughter is also quite concentrated. Hog slaughter, and processing for crops such as corn, wheat, and soybeans, are also moderately concentrated, at least at the national level, and may be more concentrated in some local areas. High concentration in a market is not in and of itself a violation of the antitrust laws. On the other hand, a high level of concentration increases the potential for antitrust scrutiny. It is an important backdrop in all of our analyses.

What the Antitrust Laws Prohibit

A minute ago, I referred to three different types of antitrust violations. Let me state them more specifically. First, it is a violation of section 1 of the Sherman Act for separate firms to agree among themselves not to compete with each other, but instead to join forces against consumers or suppliers. Second, it is a violation of section 2 of the Sherman Act for a firm to monopolize or attempt to monopolize a market. Third, it is a violation of section 7 of the Clayton Act for a firm to merge with another firm or acquire its assets if to do so would be likely to substantially lessen competition in any market. I'd like to describe each of these types of violations in a little more detail, to give you an idea of the kinds of factual evidence we look for to support enforcement action.

Collusion

The first type of antitrust violation, when firms that are holding themselves out to the public as competing against each other instead agree with each other to unreasonably restrain competition among themselves, is often referred to as collusion. Collusion is a willful subversion of the normal operation of free markets, and can result in serious harm to consumers, suppliers, and the economy. It virtually always results directly in inflated prices to consumers and denial of choices in the marketplace; indeed, that is its purpose. The most common types of collusion are agreements to fix prices, agreements to allocate markets, and agreements to boycott particular customers, suppliers, or competitors.

Price fixing can include agreeing on the specific price, or rigging a specific bid, but it can also include agreeing to increase or depress price levels, or agreeing to follow a formula that has the intended effect of raising or depressing prices or price levels. Allocation of markets can include agreeing to divide up geographic areas to avoid competition, or agreeing to divide up customers or suppliers within an area, or agreeing to divide up a sequence of bids. Group boycotts can include any agreement among competitors that they will deal with their customers or their suppliers only on particular terms in order to suppress competition.

It is important to remember that with any of these forms of collusion, proving a case requires evidence of an agreement among competitors. It is not enough to show merely that two meat packers, for example, bid a similar price, or that some packers go to some auction barns or feed lots and other packers go to other barns or feed lots. What would concern us is if there are additional facts, such as patterns of bids over time, or patterns of attendance at various auction barns or feed lots, that don't make competitive sense -- that can't be explained as part of normal competitive behavior. Needless to say, if we learned that two or more packers were discussing with each other what price they intend to bid, or which auction barns or feed lots they intend to buy from, we would definitely be concerned.

Let me describe a few collusion enforcement actions we have brought in recent years in the agricultural sector.

Lysine. The first one I'll mention is the Division's criminal prosecution of Archer Daniels Midland and others, beginning in 1996, for participating in an international cartel organized to suppress competition for lysine, an important livestock and poultry feed additive. The cartel had inflated the price of this important agricultural input by tens of millions of dollars during the course of the conspiracy. ADM pled guilty, and was fined $100 million -- at the time the largest criminal antitrust fine in history. Other participating corporations, two Japanese and two Korean firms, were also prosecuted and assessed multi-million-dollar fines. And three ADM executives were convicted for their roles in the cartel; two of them were sentenced to serve 36 and 33 months in prison, respectively, and fined $350,000 apiece for their involvement, and the other executive had 20 months added to a prison sentence he was already serving for another offense.

Vitamins. In 1999 we prosecuted Swiss pharmaceutical giant F. Hoffmann-La Roche Ltd. and BASF Aktiengesellschaft of Germany, for their roles in a decade-long worldwide conspiracy to fix prices and allocate sales volumes for vitamins used as food and animal feed additives and nutritional supplements. The vitamin conspiracy affected billions of dollars of U.S. commerce. Hoffmann-La Roche and BASF pled guilty and were fined $500 million and $225 million, respectively. These are the largest and second-largest antitrust fines in history. Six former executives from the two firms agreed to submit to U.S. jurisdiction, to plead guilty, to serve time in a U.S. prison, and to pay substantial fines for their roles. This investigation has resulted in 24 corporate and individual prosecutions to date, including convictions against Swiss, German, Canadian, Japanese, and U.S. firms, and convictions of 11 American and foreign executives who are serving or have served time in federal prison and another executive who received two years' probation; another executive agreed to plead guilty and is awaiting sentencing.

MCAA. The third enforcement action I'll mention is the Division's prosecution, brought in June 2001 under AAG James' leadership, against Dutch chemical company Akzo Nobel Chemicals BV, along with an Akzo Nobel executive of Swedish citizenry. They were charged with participating in an international price fixing and market allocation scheme involving the chemicals monochloroacetic acid and sodium chloroacetate -- collectively known as MCAA -- which are used to produce herbicides among other things. The United States consumes $50 million worth of MCAA each year. The company pled guilty and agreed to pay a $12 million criminal fine, and the company executive was sentenced to three months in federal prison and a $20,000 fine. In March of this year, French-based chemical conglomerate Elf Atochem S.A. pled guilty to participating in the same scheme and agreed to pay fines totaling $8.5 million. An Elf Atochem executive also pled guilty, and agreed to serve 90 days in federal prison and pay a $50,000 fine, and two weeks ago another Elf Atochem executive pled guilty and agreed to the same sentence.

Cattle Procurement. On a smaller scale, we also successfully prosecuted two cattle buyers in Nebraska a few years ago for bid-rigging in connection with procurement of cattle for a meat packer, after an investigation conducted with valuable assistance from USDA's GIPSA, which was investigating some of the same conduct under the Packers and Stockyards Act. Both individuals pled guilty and were fined and ordered to make restitution to the victims. This case differed from the others in that the direct victims of the conspiracy included agricultural producers in their role as sellers rather than as consumers. While sellers generally do not figure prominently as victims of collusion as often as buyers do, the somewhat unusual structure of the agricultural marketplace -- with relatively more producers selling to relatively fewer packers and processors -- presents more possibilities for sellers to be victims. And the Antitrust Division keeps a lookout for violations of this kind and will prosecute them when the facts warrant.

Let me return to the Capper-Volstead Act for a minute. As I mentioned, this law allows producers of agricultural commodities to form processing and marketing cooperatives -- in effect to engage in joint selling at a price agreed to by the producer members of the co-op -- subject to certain limitations enforced in the first instance by USDA.

In that connection, I want to mention efforts in recent years by some cattle producers to organize cooperatives to slaughter and process their own beef for the wholesale market. Not only would such a cooperative most likely be protected under the Capper Volstead Act, but if established meatpackers attempted to drive it out of business by cutting off access to transportation or to wholesale markets, that would raise serious antitrust issues and we would certainly want to investigate.

Monopolization or Attempt to Monopolize

Let me now turn to the second type of antitrust violation, monopolization or attempt to monopolize. In the meatpacking area, monopolization might involve a packer with a monopoly attempting to drive rival packers out of business by illegally interfering with their ability to engage in the business. Under section 2 of the Sherman Act, it is not necessary to prove an agreement among two or more firms. One firm can illegally monopolize by itself.

But it is important to understand how rarely we see a true case of monopolization. Monopolization means more than just that a firm has engaged in restrictive conduct. It requires that the firm have a monopoly -- and that means an extremely high market share all to itself -- and that it engaged in the restrictive conduct in order to acquire or maintain the monopoly. Or, in the case of attempted monopolization, the firm must stand a "dangerous probability" of acquiring a monopoly as a result of the restrictive conduct. And for a "dangerous probability," the courts generally require, for starters, that the firm involved in the restrictive conduct already have a quite large market share -- a 50-percent share for a single firm might not be enough, a 60-to-70 percent share may be enough, depending on the circumstances. That's not the four-firm combined share familiar to agricultural producers from USDA publications and elsewhere; that's the share for a single firm. And even a large market share might not be enough, if other factors indicate that the restrictive conduct is unlikely to succeed in creating a monopoly.

Just as important, section 2 monopolization means more than just that the market is highly concentrated. Under our antitrust laws, a firm may lawfully have a monopoly, as long as the firm has not acquired it or maintained it illegally. So both things -- very high market share, plus restrictive conduct to exclude competition -- must be present. One or the other by itself is not enough.

Let me emphasize that monopolization requires demonstrating that the conduct is harming competition, not just that it is disadvantaging rivals. It is quite rare that we encounter it. And I don't have any recent cases to cite you in agriculture. But if we ever did find it in agriculture we would take appropriate enforcement action as warranted by the facts.

Mergers

The third type of antitrust violation, a merger or acquisition that is likely to substantially lessen competition in a particular product market and geographic market, has a different legal standard from the other two in that it does not require proof of anticompetitive conduct that has already occurred. Here, the principal focus is not on whether the merging parties have engaged in wrongful conduct, but on whether the merger would change the market structure to such a degree that competition would likely be substantially lessened. The Clayton Act enables us to prevent anticompetitive mergers before they are consummated, to prevent harm to the competitive market structure that would otherwise result but would be difficult to fix after the fact. The remedy we seek for a merger that violates the Clayton

Act is to sue to stop the merger, or to insist that it be modified to remove the cause for antitrust concern.

Merger reviews require a careful analysis of the markets involved. The Antitrust Division analyzes mergers pursuant to Horizontal Merger Guidelines developed jointly by the Department of Justice and the Federal Trade Commission. The analysis is aimed at determining whether the merger is likely to create or increase market power, or to facilitate the exercise of market power, in any market. The Merger Guidelines define market power as the ability of a seller or coordinating group of sellers to profitably maintain prices above competitive levels for a significant period of time, or the ability of a buyer or coordinating group of buyers to depress prices below competitive levels and thereby depress output.

An important first step in analyzing a merger is to determine the scope of the product markets and geographic markets that would be affected by it. Once we know the size and shape of an affected market, we can then determine how big the various firms' market shares are, and more accurately predict how that market would be affected by the restructuring that would result from the merger.

The scope of a geographic market is generally defined by the smallest geographic area in which a hypothetical firm, assuming it faced no competition in that area, could make a small but significant change in price stick. Usually, we are looking at that firm as a seller, and determining the smallest area within which the firm's customers would be unable to thwart the firm's inflated pricing by going outside that area to purchase -- unable to, that is, because it would be economically impractical to travel to or receive shipments from outside that area. But, as our Merger Guidelines expressly note, we also look at the firm as a buyer, and determine the smallest area in which sellers to the firm would be unable to thwart the firm's depressed prices by selling to others outside that area -- unable to, that is, because it would be economically impractical to travel or ship outside that area. (Product markets are defined in a similar fashion, focusing on an array of products rather than a geographic area in order to determine which products are close enough substitutes for each other to be considered in the same market.)

A decision as to the dimensions of a market can sometimes be reached by examining recent buying and selling patterns in the marketplace. But the decision can also depend on a variety of other, more subtle factors, because the ultimate question is not how far the buyers and sellers have traveled or shipped in the past, but how far they could or would travel or ship in response to anticompetitive price changes.

Once we have defined the market, we turn to the question of market concentration and how it would be affected by the merger. There is no automatic threshold of market concentration that will always result in a determination that a merger would violate section 7 of the Clayton Act. Other factors also play an important role in analyzing the impact of the merger -- such as other features of the market that make anticompetitive effects more likely or less likely; and the ease or difficulty of entry into the marketplace by new competitors who could neutralize any anticompetitive potential.

But market concentration is the first factor we look at, because as a market becomes highly concentrated, not only are price fixing and other collusion easier to coordinate; there is also a dampening effect on competitive rivalry, even in the absence of collusion.

In the recent past, the Antitrust Division has carefully reviewed a number of mergers in the agricultural sector, including mergers among meatpackers. Virtually all of the increase in market concentration among competing steer-heifer packers since 1988 has resulted from internal growth rather than acquisition. In 1993 and 1994, however, we received reports that Cargill's large meat-packing subsidiary Excel was looking into acquiring Beef America. Both of these packers were in the top five, and our concerns that competition might be adversely affected by the merger led us to open an investigation. We aggressively questioned Excel and others in the marketplace, clearly communicating our concerns. A Cargill executive has publicly stated that our investigation convinced them to abandon the merger.

While we have not openly challenged any meatpacking mergers recently, we look carefully at each of them. And we have challenged a number of transactions involving other agricultural products or inputs that would have otherwise harmed producers.

Monsanto/DeKalb. The first merger challenge I'll describe is the 1998 challenge to Monsanto's proposed acquisition of DeKalb Genetics Corporation, which would have significantly reduced competition in corn seed biotechnology innovation to the detriment of farmers. Both companies were leaders in corn seed biotechnology and owned patents that gave them control over important technology. We expressed strong concerns about how the merger would affect competition for seed and biotechnology innovation. To satisfy our concerns, Monsanto spun off to an independent research facility its claims to agrobacterium-mediated transformation technology, a recently developed technology used to introduce new traits into corn seed such as insect resistance. Monsanto also entered into binding commitments to license its Holden's corn germplasm to over 150 seed companies that currently bought it from Monsanto, so that they would be free to use it to create their own corn hybrids if they chose.

Cargill/Continental. In 1999 we challenged the proposed acquisition by Cargill of Continental's grain business, which would have significantly reduced competition in the purchase of grain and soybeans from farmers in a number of local and regional markets. The parties were buyers of grain and soybeans in various local and regional domestic markets, and also sellers of grain and soybeans in the United States and abroad. We concluded that the proposed merger could have depressed prices received by farmers for grain and soybeans in a number of regions of the country; we were also concerned that the transaction could have had anticompetitive effects with respect to certain futures markets.

To resolve our competitive concerns, Cargill and Continental agreed to divest a number of facilities throughout the Midwest and in the West, as well as in the Texas Gulf. We insisted on divestitures in three different geographic markets where both Cargill and Continental operated competing port elevators: (1) Seattle, where their elevators competed to purchase corn and soybeans from farmers in portions of Minnesota, North Dakota, and South Dakota; (2) Stockton, California, where the elevators competed to purchase wheat and corn from farmers in central California; and (3) Beaumont, Texas, where the elevators competed to purchase soybeans and wheat from farmers in east Texas and western Louisiana.

We also required divestitures of river elevators on the Mississippi River in

East Dubuque, Illinois, and Caruthersville, Missouri, and along the Illinois River between Morris and Chicago, where the merger would have otherwise harmed competition for the purchase of grain and soybeans from farmers in those areas.

This relief was designed to ensure that farmers in the affected markets would continue to have alternative buyers to whom to sell their grain and soybeans. In this case, the focus of the competitive problem was the so-called "monopsony" concern -- that is, that the merger would harm producers as *sellers*.

Case/ New Holland. Next I'll describe our 1999 challenge to New Holland's proposed acquisition of Case Corporation, which would have significantly reduced competition in the sale of tractors and hay tools to farmers. The parties manufactured and sold four-wheel- and large two-wheel-drive tractors (the Versatile and Genesis lines, respectively) that are used by farmers for a variety of applications, including pulling implements to till soil and cultivate crops. They also manufactured and sold a variety of hay and forage equipment, including square balers and self-propelled windrowers. We concluded that the transaction would significantly lessen competition and lead to farmers having to pay higher prices and accept lower quality for this essential equipment.

The parties agreed to significant divestitures in order to address our concerns. Those divestitures included New Holland's large two-wheel-drive agricultural tractor business, New Holland's four-wheel-drive tractor business, and

Case's interest in a joint venture that makes hay and forage equipment.

Monsanto/ Delta & Pine Land. In 1999 we challenged Monsanto's proposed acquisition of Delta & Pine Land, which would have significantly reduced competition in cotton seed biotechnology. The merger would have combined the two largest cotton seed companies, which we concluded would have anticompetitively harmed farmers raising cotton. Monsanto abandoned the proposed acquisition after we advised that we were prepared to challenge the merger in court.

Suiza Foods/ Dean Foods. Finally, let me describe our challenge last December to Suiza Foods' proposed acquisition of Dean Foods. After an extensive investigation, we required Suiza Foods to change its originally proposed acquisition of Dean Foods in two significant ways. First, we required Suiza to divest 11 milk processing plants in 8 states (Alabama, Florida, Indiana, Kentucky, Ohio, South Carolina, Virginia, and Utah) to preserve competition in markets for milk sold at school and at other retail outlets. Second, we required Suiza to modify its supply contract with the cooperative Dairy Farmers of America Inc. (DFA), who would also own half interest in National Dairy Holdings, L.P., the new firm to which the processing plants were being divested, to ensure that dairies owned by the merged firm in the areas affected would be free to buy their milk from sources other than DFA.

Taken as a whole, these enforcement actions provide a good picture of our merger enforcement efforts in agriculture-related industries. The Antitrust Division carefully reviews agricultural mergers for their competitive implications, and files suit if a merger is likely to lead to anticompetitive prices -- whether anticompetitively high prices for products purchased by farmers, or anticompetitively low prices for products sold by farmers. The Division's concerns are not limited to traditional agricultural products, but extend also to biotechnology innovation. And, while the Division is open to proposed restructuring that can enable the rest of the merger to proceed, the Division is prepared to challenge a merger outright if necessary to address the competitive problems.

Coordination with USDA and Others

The Antitrust Division has a long-standing cooperative relationship with USDA, through which we have provided assistance to each other in a number of respects. Division attorneys and economists investigating particular mergers have made extensive use of the wealth of information about agricultural markets that USDA collects in the ordinary course of its work. USDA has also contacted the Division to provide other useful information regarding major agriculture-related mergers we were investigating, and has forwarded investigative leads to the Division, such as the one resulting in the prosecution of the two cattle buyers in

Nebraska for price-fixing. The Division has assisted USDA by consulting on studies USDA has conducted regarding competition-related aspects of agricultural markets, such as the red meat studies a few years ago, as well as on USDA's recent efforts to revise its investigative processes at the Grain Inspection, Packers and Stockyards Administration.

In August 1999, the Division entered into a memorandum of understanding with USDA, along with the FTC, to memorialize this working relationship and to reaffirm our commitment to work together and exchange information as appropriate on competitive developments in the agricultural marketplace.

Last year Assistant Attorney General James designated the Assistant Chief of the Chicago Field Office to be a special point of contact for USDA for criminal matters. The Assistant Chief maintains regular contact with USDA's Office of the General Counsel and Office of the Inspector General. In addition to receiving and responding to inquiries and complaints from USDA relating to potential criminal violations of the antitrust laws, the Assistant Chief conducts antitrust detection training sessions for agents of USDA's Office of the Inspector General.

The Antitrust Division also works with other relevant federal agencies and state attorneys general on specific matters of common interest. For example, the Division worked closely with the Commodities Futures Trading Commission and several states during the investigation of the Cargill/Continental merger.

Role of Antitrust Division in the Agricultural Marketplace

Let me close with a few caveats about antitrust enforcement. The responsibility entrusted to us as enforcers of the antitrust laws is not to design the best possible structure for the marketplace. The antitrust laws are based on the notion that competitive market forces should play the primary role in determining the structure and functioning of our economy. Our job is to stop the specific kinds of private-sector conduct I listed at the beginning of my testimony from interfering with those market forces.

We are law enforcers, not regulators. We do not have the power to restructure any industry, any market, or any company, or to stop any practice, except in a precise and focused fashion as necessary to prevent or remedy specific violations of the antitrust laws that we can prove in court. Our authority rests ultimately on our ability to bring enforcement actions in court, and when we bring an action, it is the court that decides whether the antitrust laws are being violated in the particular instance, and whether the remedy we are seeking fits the violation. And the court's decision depends on the particular facts in evidence. Therefore, we bring an enforcement action in court only when we are in possession of factual evidence that gives us good reason to believe that there is an antitrust violation.

While the antitrust laws play an important role in helping keep markets competitive, they are not going to, and should not be expected to, address all of the complex issues facing American agriculture in this time of change. That is why the government continues to focus on a broad range of agriculture policy issues.

Conclusion

Mr. Chairman, as I do whenever I make a presentation such as this one about our work, I would like to urge anyone who believes they have information that could be relevant to our enforcement activities to contact us. As a law enforcement agency, we treat conversations with us in confidence. If the information leads us to conclude that the antitrust laws have been violated, we will take appropriate enforcement action. We take seriously our responsibility to protect the marketplace --including the agricultural marketplace -- against anticompetitive conduct and against mergers that substantially lessen competition. As I hope I have made clear, the Division has a record of acting in this important sector when the antitrust laws are violated.

I would be happy to try to answer any questions the Committee may have.

South Dakota Cattlemen's Association

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August 23, 2002

Dear Senate Judiciary Committee,

South Dakota Cattlemen's Association has been very concerned about the level of concentrations in the meat packing industry for several years. In 1999 we passed the following resolution,

> **<u>Resolution No. 1999-12 Packer Concentration</u>** - Whereas, There is concern about packer concentration leading to monopolistic tendencies in the packing industries; therefore, be it
> ***Resolved,*** That SDCA Opposes mergers or acquisition by large packers."

We are also very concerned about the increased concentration in the retail aid of the meat businesses and passed the following resolution in 2002,

> **<u>Resolution No. 2000-02 Retail Consolidation</u>** - Whereas, The consolidation of retail grocery outlets, by narrowing the purchase power, has created an integrated pricing system detrimental to livestock producers in general; therefore, be it
> ***Resolved,*** That retail buyers of beef products be scrutinized under the Packers and Stockyards Act for manipulation and collusion in buying practices."

We are also concerned with the large level of "captive supply" that packers have available to them. These large levels, often over 50% of the supply, **further reduce competition** in the live cattle market.

We have four resolutions in our policy book that addresses various aspects of captive supply:

> **<u>Resolution No. 2000-04 Captive Supply</u>** – Whereas, A truly free marketing system whereby prices are established on a competitive basis is essential to the cattle industry in South Dakota; Whereas, An increasing number of cattle, particularly in some contract months, are being packer fed or sold on a contract formula or private arrangements or other captive supply basis; and Whereas, The state of South Dakota has many smaller cattle feeders who may be at a disadvantage under some of these arrangements; therefore, be it
> ***Resolved,*** That the SDCA requests that the Packers and Stockyards Administration closely monitor these sales to ensure that the free market system is not being compromised.
>
> **<u>Resolution No. 2000-07 Value Based Marketing</u>** – Whereas, A value based marketing system would be a desirable objective and would reward superior beef carcasses; and Whereas, There is some concern about price discovery under the value based system; therefore, be it
> ***Resolved,*** that the SDCA supports the value based marketing concept as long as price discovery can be developed from a competitive marketing perspective.
>
> **<u>Resolution No. 1999-13 Packer Feeding</u>** – Whereas, Packer owning and feeding of livestock is damaging to the competitive pricing of harvest ready cattle; therefore, be it
> ***Resolved,*** That SDCA supports a national ban on packer owning and feeding of livestock acquired more than 14 days prior to slaughter, unless the packer is a cooperative where members raising the livestock maintain a beneficial interest in the livestock. Packers currently feeding livestock should have a reasonable length of time to divest themselves of their livestock feeding enterprises.

Resolution No. 1998-07 Negotiated Grid Pricing – Whereas, The SDCA believes that value based marketing, wherein the value of individual animals is determined by their carcass merit, is a desirable objective. It will be one of the driving forces to bring about positive change in the industry; Whereas, There are many alliances and other arrangements that are doing an excellent job of providing information back to the producers to help him become more consumer focused, however, most of the alliances and grid formulas in use today require the producer to commit the cattle to a packer prior to the base price being set. Many grids use next week's top or next week's average in determining their base price; Whereas; Cattle that are sold in this manner are a major portion of the captive "supply" controlled by packers. Large captive supplies have a downward bias upon market price; and Whereas, SDCA believes that the alliances and grids would work even more effectively if the base price were negotiated prior to the sale of the cattle; therefore, be it
Resolved, That the SDCA believes that all cattle sold on formula and grid pricing structures should have the base price negotiated by the buyer and seller prior to the cattle being committed or scheduled.

Our resolutions are developed at our annual convention and membership meetings many of them organized at the county level. The resolutions are the opinion of the majority of our members. Our membership is very concerned about the high amount of concentration in the beef packing industry. The high level of "captive supply" only serves to increase the market power that packers can wield. By securing these supplies of cattle without entering the cash market, packers can continue to keep their plants full for much of each week without having to negotiate the prices on them.

Many feeders and producers in our industry can share the blame for our "captive supply" problem, because each of them has willingly entered the formula or non-negotiated arrangements on their own free will. While the arrangements may be beneficial to an individual producer and while the market effect of one producer signing an agreement may be small, the additive effect of many producers entering these arrangements can be huge. We feel that these non-negotiated pricing arrangements have a definite downward bias on the market by reducing the level of competition.

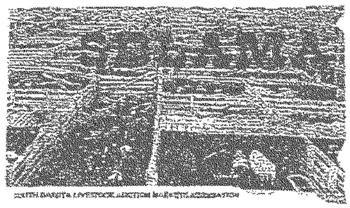
We request that the Senate Judiciary Committee take a very thorough look at the price discovery structure in the meat industry and ensure that the existing Packers and Stockyards Act and existing anti-trust laws are being fully enforced. We would also request that the committee consider new legislation to help correct our problems such as, the packer feeding ban and the proposal to require at least 25% of each day's supply be bought from the "cash market."

We appreciate your attention to these important matters. The South Dakota Cattlemen's Association serves 1,300 plus members and can be reached at 605-869-2272. Please contact us, if we can be of assistance.

Respectfully,

Merrill Karlen Jr.

Merrill Karlen, Jr.
SDCA President



SD Livestock Auction Markets Association

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Executive Director..................................Jerry Vogeler
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August 23, 2002

The Honorable Tim Johnson
324 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Johnson: One page transmitted to Fax #: 202-228-5765

Thank you for your leadership on open and competitive markets. We are particularly pleased that you were able to have a hearing of the Senate Judiciary Committee in South Dakota. We ask that you submit this letter for the record of the August 23, 2002, Senate Judiciary Committee Hearing.

At our annual meeting, our members adopted or re-affirmed our position on the following issues. We ask your help with these matters.

- **Senate Investigation:** We request a United State Senate investigation of collusion in the cattle market.
- **Packer Ban:** We support federal legislation to prohibit packer control of livestock. This law would help to restore open and competitive markets and prohibit a practice that packers use to suppress price to producers.
- **USDA's Quality Grade Stamp:** We support efforts to limit the use of USDA's quality grade stamp to beef and lamb born and produced in the United States.
- **"Country of Origin" or "USA Produced" meat labeling for all beef:** We support country of origin or "USA Produced" meat labeling for all beef, lamb and mutton. Meat from the United States must come from livestock that is born, raised and fed in the United States. We applaud your success in gaining approval of this provision. Please monitor the regulations to ensure compliance with the intent of those advocating this law.
- **Interstate shipment of meat from state inspected locker plants:** We support laws and regulations that allow interstate shipment of meat from state inspected locker plants.

  Currently, state inspected lockers are prohibited from selling meat in surrounding states. The law blocks competition in the meat business. We ask that you restore competition.
- **Mandatory Price Reporting:** We support mandatory price reporting. An open and competitive market must have price transparency.

  The packers give several arguments against mandatory price reporting. What do the packers have to hide? Packers oppose mandatory price reporting because they make more money not reporting prices than by reporting prices. Producers need an open and competitive market.
- **Restore Fair Trade Through Support of R-CALF:** We strongly encourage you to take every step possible to support R-CALF's position on fair trade. We need fair trade, not free trade.

We look forward to your comments on these matters.

Sincerely,

Jerry Vogeler

Jerry Vogeler, Executive Director

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South Dakota Pork Producers Council
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Mr. Chairman and Members of the Senate Judiciary Committee:

I am Ric Morren, a hog producer, cattle producer, and grain farmer from Beresford, SD. I am also the President of the South Dakota Pork Producers Council (SDPPC). South Dakota Pork Producers are pleased to provide written testimony today on the topic of meatpacker concentration and vertical integration of the hog industry. We want to thank this committee for having this hearing and facilitating what will hopefully, be productive discussions.

As a pork producer, I am aware that the industry of Agriculture is constantly changing. Factors such as global competition, new technologies, and consumer demands are but a few of the factors that are rapidly changing the U.S. pork industry. However, if you asked the majority of pork producers which issue concerns them the most in South Dakota, it would be vertical integration, and further concentration of the pork industry. As a result, in 1999 the State Delegates of the South Dakota Pork Producers Council adopted a position that the SDPPC agrees that corporate packers involved in feeding and owning of livestock is detrimental to free enterprise and should be banned. Also, the delegate's position was further clarified again back in 2000 when the SDPPC adopted a resolution saying that it opposes further consolidation of the packer industry.

Senator Tim Johnson's (SD) legislation passed by the senate banning packers from owning and feeding livestock had the support of many producers in this state. However, the SDPPC took the position that the word "control" may have unintended consequences that would adversely impact independent pork producers. Approximately 76% of all the hogs in the U.S. are in some type of market arrangement. If contracts were suddenly deemed illegal and removed from the structure producer's use to market their product, then we are negatively impacting the very producers we are trying to protect. Secondly, the fact that the poultry industry was excluded in this legislation concerns the SDPPC.

We recognize there are many types of hog operations. However, if current trends continue, we will soon be faced with an industry of a handful of large operations and fewer and fewer independent producers. We must find a solution.

One option may be instead of banning packer ownership completely, we could limit the total number of market animals each packer can own, or stop further concentration by keeping the level of hogs owned and fed by packers at current levels without allowing them to expand. That would stop the growth of packer ownership of livestock but it would not harm the producers who are already in a contract relationship with the packer. After all, once facilities are built to custom feed for a packer who owns the livestock, it is going to be financially devastating to the producer to dissolve his relationship with the packer. Also, consideration must me given to farmers to be able to utilize whatever

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options are available to them in order to stay in the business of farming. Otherwise, we will further perpetuate the concentration of the industry and end up with fewer and fewer producers.

Lastly, by limiting, the growth of packer ownership of hogs as opposed to forcing them to divest; we will not disrupt the structure of the hog industry. Producers depend on packers for the processing of their animals, and packers depend on producers for a steady supply of animals to process. We must not risk accepting one "unintended consequence" of upsetting this structure such as losing slaughter capacity. That alone would be devastating to the producers.

We appreciate the opportunity to provide our comments to this committee. Thank you.

Ric Morren
President, South Dakota Pork Producers Council

TESTIMONY OF
SOUTH DAKOTA SHEEP GROWERS ASSOCIATION

TO THE UNITED STATES SENATE JUDICIARY COMMITTEE FIELD HEARING

ENSURING COMPETITIVE AND OPEN MARKETS IN AGRICULTURE: ARE MEATPACKERS ABUSING MARKET POWER?

SIOUX FALLS, SOUTH DAKOTA
AUGUST 23, 2002

On behalf of the SD Sheep Growers Association, I thank you for the opportunity to address you and offer this written testimony about packer concentration. I will briefly give you our opinion on this subject. Those of us who raise sheep for a living have long felt that we are always at the mercy of the meat packing industry. The lamb market has always been very volatile, and it seems to get worse with each passing year. The market prices on fat and feeder lambs will move extremely fast both directions, although it goes down much faster than it moves up. And by moving, I mean it can drop the price anywhere from five to ten cents a pound in a week. This can make a huge difference in a producer's paycheck. If you happen to miss the sale one certain day, you may well end up sacrificing a large part of your profit for the year.

When sheep producers try to find out why the market for their Lambs has fallen so fast and so much, they run into a blank wall for the most part. However, it seems that most of the blame is usually traced back to the meat packers. We ask the sale barn operators and the Lamb buyers and they always tell us that the fat Lamb market has fallen for some reason. When packers want to cheapen the price of Lambs, all they do is stop purchasing Lambs from the feedlot for a while. This creates a temporary backlog and consequently the feedlots are reluctant to buy more Lambs until they move the ones that are ready to kill.

A perfect example of this occurred during the spring and summer of 2001. Lamb prices had been quite good and steady during January through March, but in April they started to slide a bit. We thought this was strange as April and May traditionally are the strongest times to sell Lambs because of the Easter holiday and the shortage of Lambs to slaughter. This market just kept moving down and at a very fast rate. By August, our Lambs had lost 50% of their value. Of course this was devastating to many producers and nearly put some out of business. We all did our best to try to find out what happened, as we had never seen the market fall like this. When we talked to various people down the chain of Lamb production, we learned that meat packers were refusing to kill lambs for feeders. Some feeders had lambs that were ready to slaughter for two months but the packers would not take them. They were still killing lambs, but we believe these were lambs that they owned or controlled somehow.

The SD Sheep Growers Association held a crisis meeting during August of that year. People from both Sen. Johnson's and Sen. Daschle's offices attended. Some of the points that were strongly stressed were that packer ownership of livestock should be banned and an investigation should be launched to find out what happened. As I recall, USDA was instructed to investigate this matter but nothing came of it. I do not think it has even taken place yet, which is very disappointing to us, as it seems that the meat packers have won again.

There are five packers that kill most of the lambs in America. They have kept merging until you have a situation where a few people control all the money that is being made by selling meat. And there is a lot of money being made off the hard work of sheep ranchers. They make it extremely difficult for small independent packers to get a foothold in the industry. Anyone who tries usually finds that they cannot sell the product to retailers because the big packers undercut the price and get the contract for themselves. They usually do this with foreign meat, which they can purchase cheaper than we can raise it. This is a huge problem within our industry and I can only see it getting worse in the future. If we don't come up with a way to limit imports to a reasonable level the sheep and cattle producers may not be able to afford to raise meat in our own country.

To sum things up, lamb packers have shown us their ability to manipulate the market at any time they want to. In addition, they have shown that they are more than willing to do this when they feel the need to raise profit margins. We truly are at the mercy of them; they hold our incomes and our futures in their hands. Anything that can be done to reduce the amount of power that they hold over all the people of this nation should be implemented as soon as possible.
Thank you very much for the opportunity to address you, and for hearing the concerns that I have raised.

Jack Orwick
President
SD Sheep Growers Association

Ensuring Competitive and Open Markets in Agriculture:

Are Meatpackers Abusing Market Power?

Testimony of:

The South Dakota Stockgrowers Association

Before the
United States Senate Judiciary Committee Field Hearing

Sioux Falls, South Dakota

August 23, 2002

Mr. Chairman and Members of the Committee:

Thank you for allowing the South Dakota Stockgrowers Association the opportunity to testify before the Senate Judiciary Committee. Please carefully review our comments and feel free to contact us with any questions. You may call President Bill Hutchinson at 605-259-3418, Vice President Ken Knuppe at 605-833-6665 or Executive Director Carrie Longwood at 605-342-0429. We look forward to hearing from you.

Introduction:
The South Dakota Stockgrowers Association is a membership-driven, pro-active organization consisting primarily of cattle producer members. However, additional sectors of the cattle industry are also represented in our association by members who are backgrounders, feedlot operators, feed company representatives, auction market owners and university staff. Members work together toward our common goal of "promoting and protecting South Dakota's cattle industry." Each of our 1300+ members is allowed an equal opportunity to initiate and influence policy.

Cattle Industry vs. Beef Industry
South Dakota Stockgrowers Association members are vocal about issues affecting the cattle market. Support for mandatory country of origin labeling and the ban on packer-owned livestock is overwhelming. The voice of the U.S. cattle producer should be regarded as one independent of the "beef industry" and vice versa. Although cattle producers are a step in the process of beef production, we often don't benefit from policy that might be good for the "beef industry." For example, when a packer sources cattle from a foreign country at half the current U.S. price for fat cattle, this benefits the "beef industry" because the packer will be able to buy low and sell high. This doesn't, however, benefit the cattle industry because it waters down the market for U.S. fat cattle and depresses our prices toward the foreign price.

Congressional Influence:
The South Dakota Stockgrowers Association Board of Directors works willingly with both our Congressman and our Senators to encourage national policy that benefits the cattle industry. Our national parent organization, R-Calf USA, relies on South Dakota Stockgrowers Association members to influence our congressional delegation to support policy that would help restore competition to the U.S. cattle market. Although the South Dakota Stockgrowers Association doesn't send a hired lobbyist to Washington, DC, R-Calf USA lobbyists, including Bill Bullard represent our views. Members have traveled to Washington to testify and are willing to do so again.

Member Efforts:
Our members have participated in Price Crisis Meetings, testified and commented on policy changes and new laws, contacted senators and representatives from across the U.S., even visited with President Bush concerning market issues.

Why We Do It:

We don't engage in these discussions because we enjoy the fight, but rather because we have no other choice if the U.S. cattle industry is going to survive. Our livelihoods are at stake and we intend to win this battle so we can continue ranching, supporting our families and supporting South Dakota.

South Dakota Stockgrowers Association Policy:

Country of Origin Labeling

WHEREAS: Origin is defined as the country where the product was born, raised and processed.

THEREFORE BE IT RESOLVED: The South Dakota Stockgrower Board of Directors supports country of origin labeling where cattle must be born, fed and processed in the United States.

BE IT FURTHER RESOLVED: The South Dakota Stockgrowers Board of Directors also supports company of origin labeling for all food products to the end consumer.

Imports of cattle, cattle products and other animals and products.

BE IT RESOLVED: The Animal Health Committee ***strongly encourages*** the USDA, in preparation for any risk assessment in a response to a request to import animals or animal products to the U.S., notify cattle industry organizations and state animal health officials including but not limited to: the South Dakota Stockgrowers, R-Calf and the S.D. state veterinarian.

BE IT FURTHER RESOLVED: The SDSGA strongly encourages the USDA to request concerns regarding such risk assessment from the SDSGA, R-Calf and state animal health officials.

BE IT FURTHER RESOLVED: The SDSGA strongly encourages the USDA to include industry representation from the SDSGA and R-Calf in the development of any such risk assessment decisions.

Cattle Chapter and Competition Title

WHEREAS: The USDA and Federal Government actions directly or indirectly influence the cattle industry,

THEREFORE BE IT RESOLVED: The SDSGA supports the cattle chapter and the competition title as proposed by R-Calf USA.

Mandatory Price Reporting Act

WHEREAS: The SDSGA supports the Mandatory Price Reporting Act.

WHEREAS: As long as details are not divulged on individual transactions, all prices should be reported in compliance with the act.

WHEREAS: Any change to MPR should move it toward real-time reporting of prices similar to the stock market and Boards of Trade.

THEREFORE BE IT RESOLVED: Confidentiality restrictions inserted by the Office of Management and Budget in the MPRA of 1999 should be removed.

Imports/Domestic Food Supply

WHEREAS: On September 11, 2001, this nation was attacked by terrorists, resulting in the deaths of thousands of Americans and the destruction of property in untold proportions.

WHEREAS: America is prepared to engage in a protracted effort to eradicate terrorism on the level of a state of war.

WHEREAS: This great nation's strength lies in the character of its people, its ability to unify in times of crises and the richness of its natural resources.

WHEREAS: One of the greatest threats to America's security is the safety of its food supply.

WHEREAS: The United States Congress has the power to immediately close our borders to the importation of food products to ensure Americans of a safe, domestically-grown food supply.

THERFORE BE IT RESOLVED: The SDSGA will immediately begin work to direct both Congress and President George W. Bush to concentrate all of their present power and authority toward achieving American independence of other countries for the supply of all food products through the reduction or elimination of all food imports including but not limited to meat and live animals.

BE IT FURTHER RESOLVED: The SDSGA will also work to direct both Congress and President Bush to support immediate legislation to direct the U.S. Forest Service, Bureau of Land Management, U.S. Fish and Wildlife Service, Environmental Protection Agency and the National Park Service to concentrate their present authority toward achieving full and complete access to, and utilization of this nation's renewable natural resources.

Policy of the South Dakota Stockgrowers Association Board of Directors:
(Members will vote in September whether or not to adopt as Member Policy)

Captive Supplies

Be it resolved that: The South Dakota Stockgrowers Association Board of Directors believes that captive supplies of livestock are the largest marketing problem in the livestock industry and should be ended. Captive supplies include packer owned livestock and other sales where the livestock are not negotiated and priced prior to delivery.

Senate Market Investigation

Be it resolved that: The South Dakota Stockgrowers Association Board of Directors calls upon the United States Senate to hold a comprehensive investigation into competition in the wholesale and retail red meat markets. The investigatory body should have subpoena power, possess full funding to hire legal counsel, and pursue any legal action recommended.

Concentration in the Meat Packing Industry

Whereas: The South Dakota Stockgrowers Association Board of Directors believes that competitive problems in the livestock industry are caused, in large part, by the concentration of the large meat packers and retailers.
Be it resolved that: The South Dakota Stockgrowers Association Board of Directors supports a break up of the dominant firms in meatpacking and retail food sales to remedy the concentration issue.

Farm Bill Conference Committee

Be it resolved that: The South Dakota Stockgrowers Association Board of Directors hereby expresses its extreme disappointment in the Farm Bill Conference Committee because it did not include the Competition Title in the Farm Bill.

Litigation Support

Be it resolved that: The South Dakota Stockgrowers Association Board of Directors hereby expresses its strong support of the plaintiffs and attorneys in the Pickett v. IBP class action case, as well as to the plaintiffs and attorneys in the newly filed civil court actions entitled Murdoch v. Excel and Lueking v. ConAgra.

USDA Grade Stamp

Be it resolved that: The South Dakota Stockgrowers Association Board of Directors advocate that the USDA grade stamp should be denied to red meat products that are not born, raised and slaughtered in the United States.

Moratorium on imported beef and cattle

Be it resolved that: The South Dakota Stockgrowers Association Board of Directors encourages the United States to impose a two-year moratorium on all imports of beef and cattle due to hazards of biosecurity and food safety.

Congressman John Thune
Senate Judiciary Committee

Hearing on Ensuring Competitive and Open Agricultural Markets: Are Meat Packers Abusing Market Power
August 23, 2002

Thank you, Mr. Chairman, for allowing me to testify today on the lack of competitive and open agricultural markets. As South Dakota's lone Member of the House of Representatives, I want to welcome you. The farmers and ranchers of this state appreciate your willingness to come to South Dakota to hear from them.

South Dakota producers tell me they want closer scrutiny of large agribusiness mergers. I understand why. Farming, food processing and food retailing industries are moving toward fewer and larger operations. Vertical integration, such as ownership or tight control of more than one phase of production and marketing by a single firm, is more common. Agri-businesses, such as seed, chemical, transportation and biotechnology companies are also consolidating.

The agricultural marketplace has changed rapidly in recent years. As Members of Congress, it is our job to protect those who provide food for our country and the world. As I travel South Dakota talking to producers, I hear the concerns about the choke-hold big business has on family farmers. In conversations with lawmakers, I have proposed that Congress thoroughly examine existing antitrust statutes, and consider how those statutes are being applied and whether agencies and courts are following the laws according to congressional intent.

There are laws on the books that prohibit monopolistic or anti-competitive practices. The very purpose of our antitrust statutes, namely the Sherman Act and the Clayton Act, is to protect our suppliers from anti-competitive practices that result from market dominance. Unfortunately, these laws are failing our family farmers and are not preventing such activities from occurring. Congress needs to do more to stop anti-competitive practices.

South Dakota farmers and ranchers have been a catalyst for legislative proposals to defend agricultural producers in this changing marketplace. I have worked with them to develop a four-point plan to foster more competition for South Dakota farmers and ranchers through country of origin labeling, banning packer ownership of livestock, modifying our antitrust laws, and increasing spot market purchases.

H.R. 1121 The Country of Origin Meat Labeling Act

As you know, the 2002 Farm Bill included country of origin meat labeling legislation. This provision starts a two-year voluntary program to label beef, pork, lamb and other agricultural commodities. At the end of two years, this program will become mandatory. Throughout my tenure in Congress, I have worked for country of origin labeling because I believe that our producers will be better able to compete in both the United States and across the world with an USA label. I am happy that I was able to convince the House farm bill conferees to agree to this provision in the final version of the farm bill. Our farmers and ranchers raise the highest quality products in the world and need to be recognized with the "Made in the USA" label.

H.R. 3810 The Livestock Ownership Fairness Act

The second legislative solution to fostering competition for producers is banning packer ownership. When comparing Tables 1 and 2 at the end of my testimony, you will see that the largest producers of pork in this country are also the largest packers. In my opinion, the independent farmers and ranchers should be the producers of pork, beef and lamb. If we ban packer ownership of livestock, while continuing to allow forward contracting and other risk management tools, we empower our farmers and ranchers in the marketplace. That's why I introduced this legislation with Congressman Nussle of Iowa. Regrettably, this legislation was not included in the 2002 Farm Bill, but I will not stop fighting to protect small producers by enacting this legislation.

H.R. 1526 The Agriculture Competition Enhancement Act

My third proposal has the most relevance to your committee, Mr. Chairman, and has been referred to your counter-parts in the House. The Agriculture Competition Enhancement Act, or the ACE Act, would prevent large agri-business entities from merging with each other if it would reduce competition in the agriculture marketplace. Additionally, the ACE Act would require the Department of Agriculture (USDA), the department that knows agriculture, to review proposed mergers to determine the merger's effects on prices and whether the merger would result in significantly increased market power. The USDA would also be assigned the task of determining whether the merger would increase the potential for anti-competitive actions or predatory pricing. Producers would be allowed to comment on the merger, and USDA would incorporate those comments in a report detailing its findings. The Department of Justice, the agency ultimately responsible for enforcing antitrust laws, then would consider the report in its review of the merger.

This legislation would also require that the Department of Justice have an Office of Special Counsel for Agriculture, which would be responsible for handling agriculture antitrust issues. Our farmers and ranchers need someone at the Department of Justice looking out for them.

When you look at Table 3, you see that the top five pork processors have almost 65 percent of the market share. This surely cannot be a competitive atmosphere for our independent producers. It is clear that we need to make changes to our antitrust laws to protect our farmers, ranchers and rural economies and preserve the rural way of life we all hold so dear.

H.R. 5247 The Livestock Packer and Producer Fairness Act

Finally, right before the August recess, I introduced with Congressmen Latham and Ganske of Iowa a new and innovative approach to fostering competition for independent farmers and ranchers. This idea originated with South Dakota producers, as well as your colleague, Senator Grassley of Iowa.

The Livestock Packer and Producer Fairness Act would guarantee that independent producers have a share in the marketplace while assisting the Mandatory Price Reporting system. The proposal would require that 25 percent of a packer's daily kill come from the spot market. As a result, the market would have consistent, reliable information, improving the accuracy and transparency of daily prices. In addition, independent livestock producers would be guaranteed a competitive position due to the packers need to fill the daily 25 percent spot market requirement.

This legislation is designed to complement banning packer ownership of livestock and price reporting. The intent of this proposal is to improve price transparency and hopefully the accuracy of the daily Mandatory Price Reporting data.

Together these four proposals provide a comprehensive approach to protecting agricultural competition for South Dakota farmers and ranchers. The purpose of our current antitrust laws is to guard competition for the benefit only of *consumers*. Our antitrust laws are *not* intended to keep our agricultural producers in the market. We need to take these steps to ensure a marketplace for our independent producers.

In closing, Mr. Chairman, I want to thank you for bringing this hearing to South Dakota. My constituents and I share a concern for the future of the agricultural marketplace and our rural economy. I appreciate this opportunity to discuss my plan to fight to the growing epidemic of market concentration.

TESTIMONY OF TYSON FOODS, INC.
SUBMITTED TO THE SENATE JUDICIARY COMMITTEE
AUGUST 23, 2002

Thank you Senator Durbin and other members of the committee for allowing us to submit this written testimony for today's hearing in Sioux Falls.

The Tyson Foods family of companies is the world's largest processor and marketer of beef, chicken and pork. We produce a wide variety of brand name, processed food products and are the recognized market leader in almost every retail and foodservice market we serve. Tyson Foods has 120,000 team members and more than 300 facilities and offices in 30 states and 22 countries.

Our IBP, inc. subsidiary, based in South Dakota, depends upon independent livestock operations of all sizes to supply our plants with cattle and hogs. In other words, we rely on a successful livestock industry in order to stay in business. Our company has no interest in becoming a big player in the livestock feeding business and would probably be affected less by legislation prohibiting packer feeding of livestock than most of our major competitors. However, we believe such additional government regulation will produce unintended consequences and be detrimental to the livestock industry.

In this document, we would like to provide an overview of IBP's livestock buying practices, the changing structure of our industry, and explain what some of the unintended consequences of additional governmental restriction would include.

Marketing Arrangements

Virtually all the cattle and hogs IBP buys are purchased on either a daily cash market basis or through marketing arrangements with livestock producers.

According to economists, livestock producers participating in marketing arrangements "believe they are better paid for the quality of their animals and see advantages from reduced price risk." These types of arrangements are not unusual. There are many raw material commodities traded on a contractual or formula basis, in addition to a spot or barter basis. The list includes such items as potatoes, petroleum, bananas and corn.

All of our beef marketing arrangements were initiated by cattle producers, not IBP. They came to us because they wanted a more efficient way of marketing their cattle. Rather than concentrating time following the cash market, dealing with buyers and customers every day, they wanted an ongoing fair pricing system based on current market conditions which would also reward them for quality improvements and allow them to concentrate their efforts on reducing their own costs.

Since most of these transactions are grade and yield sales, it gives cattle producers the incentive to raise higher quality cattle.

Some producers are compelled to seek contracts in order to obtain financing as a condition of their lender. Frequently lenders encourage producers to enter into a relationship with a packer that assures shackle space for the livestock, thereby reducing price risk exposure. Many lenders would prefer producers use packer contracts to eliminate basis risk and margin call risk.

IBP's Real Time Market Value (RTMV) program was introduced in January 2000 as a way to provide greater rewards for livestock producers who raise superior quality cattle. The carcass merit buying system more accurately reflects value, since the premiums and discounts are frequently adjusted to reflect changing wholesale beef prices. The RTMV program uses a grid pricing system with the base price determined by the ongoing cattle market. Base prices for Choice Yield 3 carcasses are determined by the actual cost, adjusted for quality and grade, of the cattle IBP buys on the spot market.

Over the past 15 years, IBP has had a variety of different types of marketing agreements with pork producers. Initially, producers asked for these arrangements to reduce the burden associated with day to day hog marketing. This trend has continued with producers seeking new ways to fashion long-term arrangements. Pressure from banks providing financing for producers has prompted our company to expand the variety of arrangements offered, including the introduction of longer term arrangements *(with more formalized contracts, necessary to satisfy banking requirements).*

Benefits to producers include a more orderly marketing of market-ready hogs, assured shackle space, and -- depending upon the type of contract -- a more stable cash flow. The benefit to IBP is a more stable flow of high quality hogs to our plants -- enhancing our efforts to operate them at optimal capacity and efficiency.

Our menu of contracts ranges in length from those which can be immediately terminated upon notice, to fixed terms up to 10 years.

Opponents of marketing agreements or "captive supply" claim when packers don't like the live price they will pull in their "captive supply"of livestock, exit the cash market and lower the cash price for the week. In regard to IBP, this statement is completely untrue. Under our marketing agreements the producer, not IBP, chooses the week when his livestock are ready for processing. If you take a moment and think about this allegation, it doesn't make any sense. Most marketing agreements are based on grade and yield payments. A producer with a marketing agreement is not going to allow the packer to call livestock in before they are ready, since the grade and yield would be lower, thereby reducing the price he would receive.

A survey of economists at four universities found that marketing agreements between cattle feeders and packers are growing and will continue growing in use. They report the primary reasons feeders enter marketing agreements are to capture higher prices for high-quality, high-yielding cattle and to retrieve data on carcass performance.

According to a January 2002 report by eight university economists, "The livestock and meat industry is becoming increasingly sophisticated...Consumers demand more product choice, high quality and consistency...To meet these evolving demands, beef and pork producers and processors have found it necessary to make substantial investments and market changes in how they organize and coordinate their businesses...These long-term investments and changes in producer and packer linkages are beginning to show measurable benefits to the beef and pork industries..."

The economists note "Success in global beef and pork markets…did not occur until the 1990s when contracts, vertical integration, alliances and other means of achieving product consistency and quality control came into use."

They also reported the traditional pricing system failed to accomplish such coordination and quality control is the primary reason that vertical integration, alliances, grid, partnerships, producer-owned cooperatives and contracts were developed. "Often initiated by producers, vertical alliances are the mechanisms used to improve coordination and quality control and ensure producers are compensated for true value of their cattle or hogs," they wrote.

The increase in linkages in the beef and pork industries is "attributable to the advantages to both parties, from contracts willingly signed by both parties. A recent survey of beef and pork packers identified the ability to secure high quality animals and a more consistent quality as the most important reason motivating use of marketing contracts and/or livestock ownership," the economists reported.

Cattle feeders link with beef packers to improve price risk management, access more financing options, guarantee a fair price and shackle space for the cattle, improve the opportunity for carcass quality premiums, obtain carcass information and reduce marketing costs.

"Prohibiting such linkages will result in reduced coordination, efficiency, and global competitiveness of the beef and pork sectors," according to agricultural economists at Purdue University. They also stated increasing vertical coordination, increases the "ability of information to flow quickly and unambiguously along the supply chain, thereby permitting quick responses to changes in consumer preferences through new requirements and specifications rather than through price incentives alone."

Livestock & Meat Industry Structure

Despite the changes in the number of producers selling livestock through marketing arrangements, there has been no significant change in packer profit margins. A Cattle Buyers Weekly analysis of IBP's results since it went public in 1987 shows the following: In the 14 years to 2000, its net margin averaged 1.05%. In the 10 years from 1987 to 1996, it averaged 0.88%. In the 10 years from 1991 to 2000, it averaged 1.23%. The worst margin was 0.01% in 1991. The best margin was 2.16% in 1999. IBP's net margin in 2000 was 1.3%.

Over the past 30 years the share of the consumer dollar received by the packer has remained relatively consistent, between approximately 9% and 13%. Those opposed to captive supplies and packer ownership of livestock claim the share of the consumer dollar the producer receives has gone down while the share the packer/retailer receives has gone up. They make this claim in an effort to make you think the packer is receiving more and that the increase is due to captive supply. While the percentage the retailer has received has gone up in recent years because of the development of more value-added products, as noted above, the packers' share has remained relatively constant.

There has actually been a higher rate of consolidation in cattle feeding than in the meatpacking industry. According to statistics compiled by Cattle Buyers Weekly, the nation's top 30 feedlots have increased their capacity by 21% over the past five years. Meanwhile, the total daily capacity of the nation's top 30 packers has declined by 3.4% over the past five years.

In the U.S. the top five supermarket chains are responsible for almost 50 percent of all grocery sales in the country. Food manufacturers are consolidating to match retailers' needs. Some are teaming with retailers to access markets and consumer data.

Retailers want suppliers with expertise and resources to actually handle stores' inventory management. This changes the way we will do business. It is no longer only about producing a commodity and selling it at the best price possible. It is about producing what the consumer wants. It is a high-value game versus a commodity game.

According to officials with Rabobank, one of the world's leading agribusiness and food banks, agriculture is moving producers and processors toward "virtual integration" in which they are forming production alliances and systems. This will be driven by processors who are getting tremendous pressure from the foodservice and retail sectors to produce the right thing.

This virtual integration is also being driven by the desire of industry participants to reduce market and supply volatility.

Unintended Consequences

Legislation restricting packer involvement in livestock production will contribute to more industry consolidation. Without some degree of packer participation, some plants may be forced to close. In addition, such a measure will probably make large corporate farms even bigger, since they are the ones who would likely buy any livestock operations packers are forced to divest.

Such a measure also potentially jeopardizes forward contracts and other marketing alliances or agreements that benefit producers. This could endanger the future of some livestock producers, whose lenders restrict or refuse to provide financing unless the producer has some kind of marketing alliance or arrangement with a packer.

Another unintended consequence is the glut of livestock that will hit the market if packers are forced to divest their livestock operations. This sudden increase in supply would reduce livestock prices. It is also likely that packers would have to sell their livestock operations at a discount in order to meet the deadlines established in the new law. This would subsequently depress the value of non-packer-owned livestock operations.

Some people claim a packer ban will help the family farmer. However, just the opposite is probably true. A banker recently testified at a livestock industry convention that the elimination of packer ownership and subsequent sale of their livestock operations would require an additional $300 million in equity or more from an industry that is already equity-depleted. In other words, there would be even more competition among producers for already limited loan money. This would make it more difficult for some livestock producers to secure the financing they need to stay in business.

We respectfully encourage members of the committee to support cooperative efforts by industry participants to find solutions to market-based issues, rather than implementing legislation that could potentially damage those it purports to help.

Testimony of
James Van Der Pol
Independent Hog Producer
Chippewa County, MN

Ladies and Gentlemen of the Committee, I have made the majority of my livelihood since I began farming in 1977 with hog production. For the first twenty years, I never lost money on the hogs, though sometimes it was close. But things changed. In the mid-nineties, Dakota Pork of Huron, South Dakota, which was buying most of my production was bought by Smithfield Foods which immediately closed it when there was talk of state ownership and keeping the processor open for small farmers.

My son and daughter-in-law joined us on the farm in 1997; consequently we built two hoop houses for hog finishing and tripled the hog production from 60 litters per year to 180. Most production was done in pastures seasonally, while the hoops enabled us to produce a certain number of hogs year around. Our first full year of production was 1998.

In the fall of 1998, when most of our first year of expanded production was ready hog prices dropped to eight cents per lb. Now it takes fifteen cents worth of feed to produce a lb of pork. Every lb the pigs put on was costing us seven cents out of pocket just on feed. We were hemorrhaging money. We started calling everyone we knew or had ever heard of who bought pigs to try to get rid of them. We finally found a Hmong butcher interested in lightweight hogs who bought most of what we had left.

And what did the industry have to say? It is not us, they said. We are innocent. It's the shortage of shackle space, they said. That's what drives the price down. As long as I live, I will remember that series of excuses out of the industry in 1998 in the light of what they had done to my hog buyer a few years earlier. We should have seen the handwriting on the wall when Dakota Pork closed. We see it now.

We now operate under the assumption that the commodity market is the enemy. We do whatever we can to minimize that commodity market's access to our farm's production. In 1999, we started direct marketing our hogs, purchasing a trailer and freezers with which to run a monthly delivery route into the Twin Cities, 130 miles from the farm. In 2000, we started moving into a few small grocery stores with our own label. We have built this meat business to the point where it uses about 40% of the farm's hog production. The remaining 60% is sold to a specialty company which pays a premium for our husbandry methods and meat quality. Only the cull sows are exposed to the commodity market now and we are working to fix that.

We didn't stop there. We are converting the farm from row crops to grass for our replacement heifer grazing business. We are not interested in selling commodity corn any more than commodity pork.

1998 was a very expensive lesson for us. At age 50, my wife and I lost at least ten years worth of equity and work in several weeks' time. Any hope of a conventional retirement is gone for us. My son and daughter-in-law had a very rocky start to their farming careers and are angry and suspicious of everything and everyone connected with farming. We all are exhausted, having worked seven day weeks for four years now to try to build our company's sales in a very adverse environment.

Even though our dependence upon commodity production is not what it was, we know very well that if the meat industry is not brought under some control they will do to our meat licencing and business just what they are doing to commodity producers. We are pleased with our two Senators, Mr. Dayton and Mr. Wellstone for their move against packer ownership of livestock. This bill needs to pass.

I stand before you a very angry man. I am angry because my government fails in what should be a central task for a democratic government in a market economy. It has failed, and is failing to restrain the powerful so that others might survive. It is this failure that is decimating rural America. We should not have to think of our own government as an enemy. You folks have the power to do something about that. Please use it!

I thank you for your attention.

TESTIMONY OF

UNITED STATES SENATOR PAUL D. WELLSTONE

BEFORE THE SENATE JUDICIARY COMMITTEE ON ENSURING COMPETITIVE AND OPEN AGRICULTURAL MARKETS

AUGUST 23, 2002

Mr. CHAIRMAN. I would like to thank you for holding this hearing regarding the impact of consolidation on America's family farmers. In my travels around Minnesota and around the country I have found that family farmers rank the lack of a competitive market-place as the central factor to explain the price crisis that is devastating rural America.

It seems we have come full circle on the issue of packer ownership of livestock. I recall, nine months ago offering an amendment in the Agriculture Committee to prohibit meat-packers from owning livestock for 14 days prior to purchase for slaughter. That was during the Committee mark-up of the Farm bill, and though we were not successful at that time, we did eventually pass the ban on packer ownership during full Senate consideration of the Farm bill – and it passed twice. Unfortunately, after months of fighting, we were not able to retain the provision that prohibits packers from owning livestock.

However that was not a conclusion. The ban on packer ownership has strong support in the country-side – at every farm gathering I attend the packer ban on ownership of livestock is at the top of the agenda. That's a testimony to the grassroots citizen politics of groups like the National Farmers Union and the Land Stewardship Project, and it also speaks to the urgency of this issue for independent producers across this country.

What we currently see packers doing, all too often, is retaining a ready supply of hogs or cattle and then holding that livestock, which is ready for slaughter, for the sole purpose of dumping it onto the market to counter any increase in market prices. We are currently are allowing packers to exercise a form of supply management solely for their own benefit and to the detriment for family livestock producers. This is an anti-competitive practice – a direct manipulation of what should be an open supply and demand market.

Minnesota family farmers and ranchers indicate to me that the most critical problems in agriculture today is the growing, unabated trend of agribusiness consolidation and concentration. This is supported by recent poll done by the Nebraska Institute of Agriculture. Seventy two percent (72%) of farm households agree that packer ownership should be prohibited.

While many farmers clearly see a need to gain control over the explosion of corporate agribusiness, many do not comprehend just how concentrated agricultural markets have become. In the past decade and a half, an explosion of mergers, acquisitions, and anti-competitive practices has raised concentration in American agriculture to record levels. In the meat processing industry alone, the top four processing firms for beef, pork and chickens control from 55 to 87 percent of the US market. And according to University of Missouri economist Dr. Glenn Grimes, 83 percent of hogs nationwide are committed to packers through ownership or contract arrangements.

The effect of this surge of concentration is that agribusiness conglomerates have increased their bargaining power over farmers. When farmers have fewer buyers to choose from, they have less leverage to get a good price. Anybody who has been to an auction knows that you get a better price with more bidders. Moreover, when farmers have fewer buyers to choose from, agribusinesses can more easily dictate conditions that farmers have to meet.

This is the point of the ban on packer ownership. The bill hardly eliminates vertical integration, which creates numerous problems for family farmers, but it would prohibit one of the most harmful practices that vertical integration allows. The packer ban seeks to attack just one facet of the devastating vertical integration trend, by giving independent producers a better chance to compete for a fair price, rather than having to compete with hogs or cattle owned by the packer.

In addition to the packer ban on owning livestock I believe other steps are necessary to restore competition for independent livestock producers. I think we ought to take another look at the Senate's original Farm Bill Competition Title. While some provisions within the competition title, such as mandatory country-of-origin labeling and certain provisions concerning confidentiality clauses in contract production, were included in the Farm bill, provisions that were aimed to ensure fairness, transparency, access, and enhanced competition in agricultural mark[illegible] [illegible]ssential

In addition, it seems clear to me that USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA) has not adequately protected farmers from the unfair packer and processor conduct that has accompanied the structural changes occurring in the agricultural sector. A GAO report released in 2000 highlighted deficiencies within GIPSA and recommended actions for GIPSA to improve its investigations of competitive practices. Thereafter, Congress appropriated funding to enable GIPSA to reorganize. Yet, this has not translated into positive results in terms of the number of cases filed by GIPSA.

Finally, I believe we need to take a hard look at our current anti-trust laws which I believe have failed to address concerns of livestock producers in the marketplace. Growing concentration in many levels of the food chain has created an imbalance in bargaining power between a few corporations who buy livestock or grain and several producers who sell livestock or grain. The relative lack of buyers means the buying side of the market has much more power than the selling side.

Mr. Chairman. It boils down to whether we want independent producers in agriculture, or if we will yield to concentration and see farmers and ranchers become low wage employees on their own land. If we continue to stand idle and watch control of the world's food supply fall into the hands of the few, consumers will be the real losers in terms of both retail cost and food safety. If we want to sustain a vibrant rural economy and a thriving democracy, we need urgent reform, anything less will jeopardize the future of America's family farmers.

WORC

Western Organization of Resource Councils

Testimony of Shane Kolb

for the

Western Organization of Resource Councils

Friday, August 23, 2002

Unites States Senate Judiciary Committee

Sioux Falls, South Dakota

On behalf of the Western Organization of Resource Councils (WORC), I would like to thank Chairman Leahy, the other members of the Judiciary Committee, and Senator Johnson for holding this hearing in South Dakota. I am Shane Kolb. I ranch near Meadow, in Northwestern South Dakota. I am the Chairman of the WORC's Agriculture and Food Issue Team. WORC is a network of grassroots organizations from seven states that include 7,000 members and 45 local community groups. I am a member of Dakota Rural Action, WORC's member group in South Dakota.

WORC appreciates the opportunity to submit testimony on meatpacker concentration, the abuse of market power by packers, and solutions that will restore open and competitive markets in agriculture. WORC, Dakota Rural Action and WORC's other member organizations have led the effort to publicize the extent of packer concentration and vertical integration, to identify the adverse effects of concentration and integration on market competition, and to promote constructive, practical policies to restore competition.

In South Dakota, we are in a severe drought. Due to poor cattle markets, ranchers have had to increase the size of their herd and push pastures to the limit in order to keep their operations afloat. If there was true competition in the markets, ranchers would not have to put undo stress on pastures because of increased herd size and they would be able to survive a periodic drought. As it is, with drought conditions equal to those of the 1930's and no competition in the markets, many ranchers won't survive. We could lose an entire generation of ranchers because of this situation.

Meatpackers are acquiring an increasing percentage of the cattle and hogs they slaughter through arrangements known as "captive supplies" – livestock that packers either own themselves, or control through contracts with farmers and ranchers. These livestock are called *captive* because they are tied to one packer instead of being subject to normal market forces of supply and demand.

Four companies control 59% of all U.S. hog slaughter and 81% of U.S. fed cattle slaughter[1]. In such a concentrated market, buyers (the packers) can use captive supplies to manipulate markets

[1] USDA, *Assessment of the Cattle and Hog Industries, 2000.*

– much as Enron is alleged to have used its dominant market share and unregulated forward contracts to manipulate energy markets. The estimated cost to family farmers and ranchers from the increased use of captive supplies amounts to more than $1 billion per year for cattle alone.[2]

WORC and its member groups have been working to identify problems in our livestock markets and to develop solutions since the late 1980's, when our members became concerned about the rapid increase in market concentration. The share of U.S. fed steer and heifer slaughter held by the top four packers had recently shot up above 80%. Our members, other cattle producers, and leading economists expressed concerns that such high levels of market concentration, in combination with increasing vertical integration in the form of packer ownership of cattle and forward contracting, threatened the continued openness and competitiveness of cattle markets.

For the next several years, we worked to bring this problem to the attention of the Justice Department, USDA, and our members of Congress. In the spring of 1994, fed cattle prices dropped precipitously. Anecdotal evidence and market reports suggested that the use of captive supplies by packers increased dramatically at the same time. In response, WORC organized meetings in auction yards and town halls across the Great Plains. Out of those meetings, WORC developed a moderate, common sense proposal to deal with the problem of captive supplies, without banning forward contracts outright.

In 1996, WORC submitted this proposal as a Petition for Rulemaking on Captive Supply Procurement Practices to the Department of Agriculture, seeking adoption of rules under Section 202 of the Packers and Stockyards Act. USDA has never acted on the petition's recommendations. The straightforward rules proposed in the petition would serve as a remedy for two kinds of anticompetitive practices:

- The potential for price discrimination and undue preferences in violation of Section 202, subsections (a) and (b) of the Packers and Stockyards Act; and
- The potential for intentional or effective price manipulation in violation of Section 202, subsection (e).

The petition asked USDA to adopt rules to require forward contracts for procuring cattle for slaughter to contain a firm base price that can be equated to a fixed dollar amount on the day the contract is signed, and to require forward contracts, and cattle owned or fed by packers, to be offered for sale in an open, public market.

More than 1,600 cattle producers and consumers, responding to a Federal Register notice seeking comments, supported WORC's proposal; they outnumbered opponents by 33 to 1. Organizations supporting the proposal represent hundreds of thousands of producers and consumers. The minority report of Secretary Glickman's Advisory Committee on Agricultural Concentration supported the proposal, as did the Secretary's National Commission on Small Farms.

After years of meetings, studies, and accumulated evidence, culminating in a forum on captive supplies sponsored by USDA's Grain Inspection, Packers and Stockyards Administration in Denver in September of 2000, the proposal still languishes at USDA. Under the last two Administrations, USDA has refused to either approve or reject the petition, or to release documents related to it. USDA has taken no other steps to update its regulations to deal with

[2] WORC estimate based on analysis of USDA figures by Oregon State University Prof. Catherine Durham.

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changing marketing practices and tools developed by packers and feeders, a need Congress anticipated and provided for when it enacted the Packers and Stockyards Act in 1921.

Instead, USDA has stumbled around blindly, occasionally attempting to enforce its antiquated rules on a case-by-case basis – and usually losing. As a result, USDA has taken no action at all to effectively address the discriminatory and manipulative effect of captive supplies, despite the clear language of Section 202 of the Packers and Stockyards Act.

Of course, the problem has not gone away. The percentage of cattle acquired by packers through contracts without negotiated prices and through outright packer ownership has continued to increase.[3] A survey of feedlots in Iowa, Kansas, Nebraska and Texas found that 23 percent of respondents cattle were sold under marketing agreements in 1996, 52 percent were sold under such agreements in 2001, and respondents expected 65 percent to be sold through marketing agreements in 2006[4] marketing. On Wednesday of this week, USDA's Agricultural Marketing Service reports indicate that less than one-third of the cattle committed to U.S. plants for slaughter were acquired through contracts with a negotiated price. Sixty-eight percent were acquired under a formula agreement, with no base price negotiated; another three percent were acquired through forward contracts based on futures prices. Seventy-three percent of these cattle were committed under agreements giving the packer control over the date of delivery.[5] Control of this much supply and the date on which they will be slaughtered, confers the power to manipulate cash market prices on packers. Through strategic use of those captive supplies, packers can drive down the cash market – which, in turn, becomes the base price for most of those captive supply contracts.

In effect, these formula agreements, in which control is transferred to the packer before a price is negotiated, amounts to packer ownership of cattle, except the packer doesn't have to go through all the bother of feeding them or paying interest on a bank loan. There is no justification for these kinds of agreements. They do nothing to reward producers for quality; most of the cattle delivered under these contracts bring 50 cents or a dollar per hundredweight over some future cash market price, whatever their quality. Moreover, payment of premiums and discounts for quality can be accomplished through contracts that have a negotiated, fixed-base price.

Neither do these contracts lower risk for the producers who enter into them. Of course, they are assured of getting just above the average market price, or even the "top of the week", but they increase the chance that the average market price will be lower than a competitive price. If

[3] USDA's Packers and Stockyards Administration and Agricultural Marketing Service do not agree on how to define or measure captive supplies, but it is indisputable that captive supplies have increased.

[4] Schroeder, Lawrence, Ward and Feuz, *Fed Cattle Marketing Trends and Concerns: Cattle Feeder Survey Results*, p. 1.

[5] USDA Market News, NATIONAL DAILY DIRECT SLAUGHTER CATTLE - COMMITTED and DELIVERED CATTLE - Summary for Wednesday, Aug 21, 2002; http://www.ams.usda.gov/mnreports/lm_ct106.txt. Forty-nine percent of the cattle delivered to plants were acquired through formula agreements, and 49% were negotiated, according to USDA's market news.

insufficient competition is costing you $5 per hundredweight, it is of small consolation that you're getting 50 cents more than the poor slob who had to sell in the cash market.

After nearly ten years of increasing strategic use of captive supplies by packers – ten years of increasingly dysfunctional markets – it should be no surprise to anyone that the packers' share of the consumer's retail beef dollar has increased at the expense of the farmers and ranchers who raise cattle. The farm share of the consumer dollar was 60% twelve years ago. It fell to just 42% in May and June of this year. Put another way, the producer's gross share of the money consumers spend on cuts of choice beef at retail has declined 30%. USDA has failed to address the market imbalances and dysfunctions that allow packers and retailers to capture such large, increasing, and unwarranted shares of the consumer beef dollar.

The Packers and Stockyards Act says that it is unlawful for a packer to "engage in or use any unfair, unjustly discriminatory, or deceptive practice or device." Packers unfairly and unjustly discriminate against some producers by offering and agreeing to forward contracts and marketing agreements only with select producers, and in failing to offer them openly and publicly. Packers' use of such contracts with prices based on thin cash markets, which they can and do influence, is an unfair and deceptive practice or device, but USDA has not enforced the law.

The Act says a packer may not give "undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever." Current marketing agreements and forward contracts often give preference to some cattle feeders over others with access to markets and timely slaughter. Packer-ownership of cattle supplies gives undue preference to the stockholders of packing companies with access to markets and timely slaughter. These practices violate the Act, but USDA has not enforced the law.

The Act says packers may not "engage in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly." The packers' strategic use of captive supplies, and the use of forward contracts and marketing agreements without a fixed base price, has had the effect of manipulating or controlling prices, in violation of the Act.[6] But USDA has not enforced the law.

In the face of these failures by USDA, WORC asks this Committee to reinvigorate the Packers and Stockyards Act by adopting amendments to the Act. Since USDA will not use the tools Congress gave it in 1921, Congress must act to give USDA new tools, and then closely monitor how it uses them.

We urge this Committee, the Senate and the Congress to end the price-manipulating abuses caused by what Iowa State economist Neil Harl calls the "deadly combination" of high market concentration and vertical integration in our cattle markets. We urge adoption of Senator Johnson's legislation to ban packer ownership of livestock, and Senator Enzi's bill, S. 2021, to take the "captive" out of captive supplies.

[6] This was demonstrated by USDA's own Red Meat Concentration study, which shows that formula base-priced marketing agreements are associated with much lower cash market prices than are fixed base priced forward contracts.

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Banning packer ownership is a critical reform, which WORC strongly supports, but it deals with only one part of the problem. It does not address the secret, Enron-style forward contracts and marketing agreements through which most hogs and nearly half of all cattle are transferred from producers to packers[7]. Senator Mike Enzi (R-Wyoming) introduced S. 2021, the Captive Supply Reform Act, to address these other kinds of captive supplies – *without* prohibiting their use.

S. 2021 would make two reforms to restore open, fair competition to the market for livestock contracts. S. 2021, the Captive Supply Reform Act, would:

- Require a fixed base price in formula contracts.
- Require that contracts be traded in open, public markets – no more secret deals.

Most marketing agreements for cattle and hogs do not contain a negotiated price. Instead, the price is based on a reference price that the packer can influence – such as the price it will pay for non-contract livestock out of one of its plants next week. The Captive Supply Reform Act would end this price-manipulating practice by requiring contracts and agreements to have a fixed base price. It *would allow* contracts to be based on futures market prices, and it would not affect any premiums, discounts, or other adjustments now used in many forward contracts and marketing agreements.

S. 2021 would restore competition by making packers (and livestock producers) bid against each other to win a contract. Forward contracts and marketing agreements allow packers and producers to coordinate supply and reduce risk, but as they are currently negotiated – in secret, with all of the bargaining power on one side – they unjustly depress prices and reduce market access for small and independent producers. S. 2021 would require such contracts to be traded in open, public markets (such as an electronic market) to which all buyers and sellers could have access. The bill preserves the benefits of forward contracts and marketing agreements, while eliminating characteristics of current contracts that lead to price manipulation and price discrimination.

The Committee and the Congress should be aware that these reforms – the Captive Supply Reform Act, and the ban on packer ownership – are what cattle producers want.

* A survey of cattle feeders by the *High Plains Journal* for the Kansas Cattlemen's Association found that, 90% believe that consolidations and mergers have eliminated competition, and 92% believe that packers should not be able to own or feed cattle.

* Cattle feeders surveyed by Schroeder, Lawrence, Ward and Feuz agreed that
    - Cash market bids by packers are lower when packers have cattle contracted;
    - Base prices in marketing agreements should be negotiated, rather than based on future cash price reports or plant averages;

[7] Per January 2000 study by University of Missouri/National Pork Producers Council, cited in GIPSA report, *Assessment of the Cattle and Hog Industries, Calendar Year 2000*, p. 26)

Packers should not be permitted to own and feed cattle.[8]

Respondents were split, but slightly disagreed with the statement that "packers should not be allowed to contract or form marketing agreements with feeders and cattle owners."

The Captive Supply Reform Act and legislation banning packer ownership respond to these expressed preferences by cattle feeders – to end packer ownership, and to reform but not prohibit contracts and marketing agreements.

We urge the United States Senate and the Congress to adopt Senator Enzi's Captive Supply Reform Act and Senator Johnson's proposed ban on packer ownership of cattle. We encourage this Committee and the Senate Agriculture Committee to use your investigative powers to collect the evidence that USDA has been unable or unwilling to collect from packers, and to exercise stringent oversight of USDA's enforcement of the Packers and Stockyards Act.

Attached for the record in this hearing are:

- WORC's petition for rulemaking as published in the *Federal Register*, Vol. 62, No. 9, Tuesday, January 14, 1997;
- Statement of Shane Kolb for the Western Organization of Resource Councils at the USDA Forum on Captive Supplies, Denver, Colorado, September 21, 2000;
- Section by section analysis of S. 2021, the Captive Supply Reform Act.

[8] Schroeder, Lawrence, Ward and Feuz, *Fed Cattle Marketing Trends and Concerns: Cattle Feeder Survey Results*, p. 8.