

# CRS Report for Congress

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## **Livestock Marketing and Competition Issues**

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# Livestock Marketing and Competition Issues

## Summary

Changes in the structure and business methods of livestock and meat production and marketing — sometimes referred to as consolidation, concentration and/or vertical integration — have long generated interest and controversy in Congress. Few dispute that the meat industry has changed significantly in recent decades. USDA still considers beef cattle production (farm level) to be among the least concentrated agricultural sectors. However, just four firms slaughtered 71% of all U.S. cattle in 2004. In 1985, the then-top four packers accounted for 39% of all cattle slaughter, according to industry and USDA statistics. Four firms slaughtered 64% of all U.S. hogs in 2004, compared with 32% in 1985.

Live hog production itself has seen sweeping changes over the past 25 years. The number of U.S. farms with hogs declined from 667,000 in 1980 to 67,000 in 2005; those remaining have become much larger and less diversified. Operations with at least 10,000 hogs now represent less than 1% of all producers but more than half of total U.S. production, USDA reports. Many hogs today are sold through production contracts, where a pork processor might provide the pigs and other inputs, and a contracting producer (farmer) provides facilities and labor.

Debate has revolved around the impacts of such changes on farm prices, consumers, global competitiveness, and the traditional U.S. system of independent farms and ranches. Inherent in these questions is the role government should play in monitoring and regulating agricultural markets.

Some groups believe that federal officials have not enforced existing laws designed to prevent anti-competitive behavior, and/or that the laws themselves should be strengthened to better address today's market realities. Others assert that present competition and antitrust policies remain adequate and effective. They believe that the sector's structural changes are a desirable outgrowth of other factors such as technological and managerial improvements, changing consumer demand, and more international competition.

A number of bills now pending before Congress would address one or more of the perceived "competition" problems in livestock markets, their sponsors maintain. For example S. 818 and H.R. 4713 would prohibit packer ownership or control of cattle supplies except for just before slaughter. S. 960 and H.R. 4257 would strictly limit what packers could stipulate in forward contracts with producers. S. 2131 and portions of S. 2307 would prevent or discourage the use of mandatory arbitration clauses and/or confidentiality clauses in contracts. S. 2307 also would require a new USDA special counsel for competition matters to oversee enforcement of the Packers and Stockyards Act and other antitrust laws, among other provisions.

Some analysts expect these or other so-called competition bills to become the basis for a proposed competition title in a new farm bill, which lawmakers may write in 2007 to replace (or extend) provisions of the last omnibus bill, the Farm Security and Rural Investment Act of 2002 (P.L. 107-171). This report will be updated if significant developments ensue.

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# Livestock Marketing and Competition Issues

## Introduction

Farmers and ranchers have had to adjust to significant changes in the structure and business methods of the livestock and meat sector in recent decades. At the farm level, animal production in general and hog production in particular have undergone significant consolidation since 1980. Beef and pork packing (slaughtering) and processing have consolidated rapidly since 1980 into fewer and larger plants. As an industry consolidates, it can become highly concentrated, with a relatively small number of firms accounting for most production or sales.

The successive stages of cattle and hog production, processing, and marketing also are becoming more carefully managed and aligned, often referred to as vertical coordination or, in its most advanced form, vertical integration, where most stages are owned or financially controlled by a single entity.

Some farm constituencies assert that these structural changes have undermined the more “traditional” U.S. system of smaller-scale, independent, family-based farms and ranches; created closed markets with less price transparency; eroded farmers’ negotiating power; and contributed to lower prices paid to farmers. These groups believe that federal officials have not enforced existing laws designed to prevent anti-competitive behavior, and that the laws themselves should be strengthened to better address today’s market realities.

A number of bills now pending before Congress would address one or more of these perceived problems in livestock markets, sponsors maintain, which they often broadly term “competition issues.” Some analysts expect these or similar legislative proposals to become the basis for a proposed competition title in a new farm bill, which lawmakers may write in 2007 to replace (or extend) provisions of the last omnibus bill, the Farm Security and Rural Investment Act of 2002 (P.L. 107-171).

Others assert that present competition and antitrust policies remain adequate and effective. They believe that the sector’s structural changes are a desirable outgrowth of other factors such as technological and managerial improvements, changing consumer demand, and more international competition. Many of the changes in business relationships along the livestock and meat marketing chain have brought U.S. consumers the ample variety of high-quality, low-priced products they now enjoy, it is argued. New laws or more aggressive interpretation of existing laws will stifle private investment and innovation, and make the industries less competitive, defenders of current policies argue.

## Structural Trends

### Changes in the Beef and Pork Industries

Although observations about concentration and vertical integration are often ascribed to the meat and poultry sector as a whole, individual industries within the sector do differ in how they are structured and function. The following discussion focuses primarily on the beef and pork industries.<sup>1</sup>

**Beef Production.** Most U.S. beef cattle are born, bred and pastured on a large number of widely dispersed, often small-sized farms and ranches, called cow-calf operators. These operators keep some heifer calves from each year's crop for breeding herd replacement; the rest generally are sold at from 6 to 12 months of age to feedlots (or sometimes to an intermediary known as a backgrounder who readies them for feedlots). These lots fatten them to slaughter weight and sell them to the packing houses.

Cow-calf operations that hold fewer than 100 cows are responsible for more than half of all U.S. marketings, statistics indicate. "A number of small herds providing calves to feedlots and backgrounding operations is a key component of the cattle industry," notes an American Farm Bureau Federation (AFBF) report (footnote 1). "While other components of agriculture in crops and livestock have seen noticeable concentration in larger operations, cattle remains structurally diverse."

A relatively small number of feedlots, on the other hand, fatten and market a significant portion of fed cattle (those ready for slaughter). During 2005 the top 10 companies had the capacity to feed more than 3.1 million cattle in 55 feedlots, representing about 23% of the approximately 13.7 million cattle on feed on January 1, 2005. The top 30 operations could feed more than 5.6 million head or 41% of all cattle on feed.<sup>2</sup> Nonetheless, the U.S. Department of Agriculture (USDA) counted a total of more than 88,000 lower-capacity (less than 1,000 head) feedlots in 2005.

Beef packing is much more concentrated than cattle production. Four firms slaughtered 81% of all young cattle (steers and heifers) in 2004, and 71% of U.S.

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<sup>1</sup> This section is based in part on: Barkema, Alan, and others, "The New U.S. Meat Industry," *Economic Review* of the Federal Reserve Bank of Kansas City, Second Quarter 2001; O'Brien, Doug, *Developments in Horizontal Consolidation and Vertical Integration*, National Agricultural Law Center and The Drake Agricultural Law Center, January 2005; American Farm Bureau Federation, *Making American Agriculture Productive and Profitable*, December 2005; and various reports from USDA's Economic Research Service (ERS), including *Structural Change in the Meat, Poultry, Dairy, and Grain Processing Industries*, March 2005.

<sup>2</sup> "Feeding Sector Consolidates," *Cattle Buyers Weekly*, December 5, 2005, and USDA/National Agricultural Statistics Service (NASS), "Cattle on Feed," at [[http://www.nass.usda.gov/Statistics\\_by\\_Subject/index.asp](http://www.nass.usda.gov/Statistics_by_Subject/index.asp)]. Another statistical illustration of recent change: feedlots that could hold more than 32,000 cattle each accounted for less than a third of all cattle marketed in the leading cattle feeding states in 1980; by 2005 these large feedlots were marketing approximately half of all U.S. fed cattle (USDA data).

cattle of all types. In 1985, the then-top four firms claimed 50% of all steer/heifer slaughter and 39% of all cattle slaughter.<sup>3</sup> Recent concentration numbers approach those of the early 1900s when 50% to 75% of the market was dominated by five firms which slaughtered several species.<sup>4</sup>

Another way the federal government weighs concentration is the so-called Herfindahl-Hirschman Index (HHI), which is considered to be a more comprehensive measurement than the four-firm percentage cited above. An industry with an HHI below 1,000 is considered to be unconcentrated. An industry with an HHI between 1,000 and 1,800 is considered to be moderately concentrated; an HHI above 1,800 is highly concentrated. The beef packing industry reached the highly concentrated level by the mid 1990s; its 2003 HHI was 1,842.<sup>5</sup>

**Table 1. Top Packers — 2004**

Cattle Slaughter		Hog Slaughter	
<i>Company</i>	<i>Market Share*</i>	<i>Company</i>	<i>Market Share*</i>
Tyson	25.6%	Smithfield	26.1%
Cargill	20.5%	Tyson	18.5%
Swift	15.3%	Swift	10.8%
National	9.5%	Cargill	8.9%

**Source:** Cattle Buyers Weekly.

\* Market share: percentage of total number of U.S. commercial cattle and hog slaughter.

**Pork Production.** Hog production has experienced perhaps the most sweeping changes over the past 25 years. The number of U.S. farms with hogs declined from 667,000 in 1980 to 67,000 in 2005; those remaining have become much larger and less diversified. The average 1980 farm with hogs had less than 100 head and likely raised them from birth to slaughter weight as part of a more diversified crop-livestock operation. In 2005, the average hog farm had more than 900 head and might typically specialize in a single stage of hog production, such as finishing, according to USDA. Operations with at least 10,000 head now represent less than 1% of all producers but more than half of total U.S. production, USDA reports.

<sup>3</sup> The 2004 figures are from *Cattle Buyers Weekly*, October 31 and December 6, 2005. The 1985 figures are from various USDA data sources.

<sup>4</sup> USDA/ERS, *U.S. Beef Industry: Cattle Cycles, Price Spreads, and Packer Concentration*, Technical Bulletin No. 1874, April 1999.

<sup>5</sup> Barkema; and USDA, Grain Inspection, Packers and Stockyards Administration (GIPSA), *Assessment of the Cattle, Hog, and Poultry Industries, 2004 Report*, April 2005.

In fact, the hog production segment of the industry now has about 30 key firms, plus several hundred additional “significant” operators.<sup>6</sup> Rapid adoption of vertical coordination methods (see below) drove much of the consolidation in the hog industry, particularly during the 1990s, when farm prices declined to historic lows, causing tens of thousands of small operators to cease raising hogs. From 1993 to 1998 alone, U.S. farms with one or more hogs declined by nearly half, from 218,060 to 114,380, according to USDA. Six large producers — Smithfield, Premium Standard Farms, Seaboard, Prestage, Cargill, and Iowa Select — together accounted for nearly 30% of U.S. hog production in 2003.<sup>7</sup>

In hog packing in 2004, four firms slaughtered 64% of all U.S. hogs, compared with 32% in 1985. The HHI for the hog slaughter industry climbed above 1,000, the numerical threshold for moderately concentrated (see above) during the 1990s.<sup>8</sup>

## Vertical Coordination and Contracting

Also apparent in the red meat industry in recent decades is the trend toward vertical coordination of production with processing and marketing. The Barkema article has characterized this trend as “... supply chains — tightly orchestrated production, processing, and marketing arrangements stretching from genetics to grocery. Supply chains bypass traditional commodity markets and rely on contractual arrangements among the chain participants to manage the transformation of livestock on the farm to meat in the cooler.”

This business model was pioneered in agriculture by the poultry industry, which began to integrate shortly after World War II.<sup>9</sup> Poultry producers were “the clear leader” in delivering nutritional and convenient products to consumers while at the same time sharply controlling costs, according to Barkema. The hog industry has been closely following in poultry’s footsteps. Now typical are contract production arrangements with large integrators who may provide the genetics, pigs and other inputs, and a contracting producer (farmer) who provides facilities and labor.

For those who raise livestock, all of these changes have meant fewer options for selling for cash at auctions or other open markets, and more pressure to enter into a longer term arrangement with a buyer and/or processor. Generally these arrangements take the form of agricultural contracts, which USDA defines as agreements between farmers and their commodity buyers that are reached before harvest or the completion of a livestock production stage.

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<sup>6</sup> Informa Economics, *Special Report: The Changing U.S. Pork Industry*, November 1, 2004, at [<http://www.informaecon.com/LVNov1.pdf>]. Informa is an economics consulting firm.

<sup>7</sup> Informa.

<sup>8</sup> Barkema; and GIPSA.

<sup>9</sup> Although this CRS report focuses primarily on beef and pork, references are made to the poultry sector when pertinent, particularly since this sector competes with beef and pork for the consumer dollar.

Contracts can govern the terms for a promised transaction such as date of delivery, the expected price, and other specifications. Contracts enable a farmer to shift some financial risk to the buyer, cushion widely fluctuating price swings, and guarantee an outlet for production. In return, buyers gain a reliable and uniform supply of raw material. Consumers also benefit through lower prices, consistently higher quality, and a wider array of convenient products, it is argued. “The growth in contracting has come largely at the expense of spot (or cash) markets, where farmers retain full autonomy and receive prices based on prevailing market conditions and product attributes at the time of sale,” USDA observes.<sup>10</sup> It distinguishes two types:

- **Production contracts** are when the farmer provides a service to the contractor who usually owns the commodity. The farmer’s payment may resemble a fee for service rather than a payment for the commodity’s value. For example, in poultry production, processing companies provide the chicks, feed, veterinary services, transportation and production specifications, to farmers who raise the chicks for the companies, usually in facilities the farmers own.
- **Marketing contracts** emphasize the value of the commodity rather than the farmer’s services. They can specify in advance the basis for the price that will be paid, the quantity to be delivered and where, and product attributes, but the farmer retains major management control and ownership of the commodity until delivery.<sup>11</sup>

In 2003, contracts (production or marketing) covered 47% of all livestock production value, up from 33% in 1991-93. This compares with 31% of all crop production in 2003 and 25% in 1991-93, according to USDA (see table 2 for breakout by selected commodity).

Examining the data more closely, use of production (as opposed to marketing) contracts in the hog industry grew sharply from 29% of production value in 1994-95 (1991-93 data not available) to over 50% in 2003, according to USDA. In cattle production, production contracts grew from 15% in 1994-95 to 25% in 2003. Poultry has long been raised by farmers under contract with a processing firm; today the value of production under contract is approximately 85-90%. Marketing rather than production contracts are the prevalent types in dairy with more than 50% produced under a marketing contract in 2003. Regardless of commodity type, larger farms tend to use contracts much more than smaller farms, USDA and the Farm Bureau study note.

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<sup>10</sup> USDA/ERS. “Agricultural Contracting: Trading Autonomy for Risk Reduction,” *Amber Waves*, February 2006.

<sup>11</sup> *Amber Waves*.

**Table 2. Contract Share of U.S. Production, Selected Commodities**

(Percent of Production Value Under Contract)

Commodity	1994-95	2003
All Livestock	42.9	47.4
Cattle	19.0	28.9
Hogs	31.1	57.3
Poultry & Eggs	84.6	88.2
Dairy	56.7	50.6
All Crops	25.4	30.8
Corn	13.9	14.3
Wheat	6.2	7.6
Sugar Beets	83.7	95.5
Fruits	64.2	68.1

**Source:** USDA/ERS, *Agricultural Contracting Update: Contracts in 2003*, Economic Information Bulletin No. 9, January 2006.

## Historical Context

Concerns about the growing market power of large corporations in general, and of meat packers in particular, were widespread by the late 1800s and culminated, by the early 1900s, with the passage of several major antitrust laws, including the Sherman and Clayton Acts (see below).

These laws notwithstanding, five large meat packers were continuing to make agreements that set prices and divided their territory and business, effectively barring others from entering the market. The so-called Big Five — Armour, Morris, Swift, Cudahy and Wilson — had exercised monopolistic control over the livestock industry by owning and/or controlling public stockyards, transportation and distribution, slaughter plants, and even retail outlets, according to a 1917-18 investigation by the Federal Trade Commission (FTC). The Commission reportedly found that the Big Five's share of interstate slaughter was 75-82% of the cattle market, 77% of calves, 61% of hogs, and 86% of sheep and lambs.<sup>12</sup>

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<sup>12</sup> Rosales, William E. "Dethroning Economic Kings: The Packers and Stockyards Act of 1921 and Its Modern Awakening." *Journal of Agricultural & Food Industrial Organization*, Vol. 3, 2005. Other sources for the historical material in the section are: Lauck, Jon. "Concentration Concerns in the American Livestock Sector: Another Look at the Packers (continued...)"

Threatened with government legal action, the Big Five in 1920 agreed to a consent decree whereby they would refrain from: owning any interest in a stockyard; owning retail meat markets or cold storage facilities except for their own products; or entering other food processing and marketing sectors (like fruits and vegetables, fish, grain products, and so forth). Still, there was continuing dissatisfaction in Congress with the performance of the markets.

## Relevant Authorities and Agencies<sup>13</sup>

### Packers and Stockyards (P&S) Act of 1921

Passage of the P&S Act in 1921 was “in response to concerns that, among other things, the marketing of livestock presented special problems that could not be adequately addressed by existing antitrust laws.”<sup>14</sup> Parts of the Act, as amended (7 USC §181 *et seq.*) prohibit unjustified discriminatory practices, as well as certain, specific activities that might adversely affect competition. As stated in 7 USC §192 of the Act, it is unlawful for a packer or poultry dealer to: “engage in or use any unfair, unjustly discriminatory, or deceptive practice or device; give undue/unreasonable preference/advantage to [persons or localities]”; apportion supply among packers in restraint of commerce or create a monopoly; trade in articles to manipulate or control prices, if such apportionment tends to restrain commerce or to create a monopoly; or conspire to apportion territory, or sales, or to manipulate or control prices.

The Secretary of Agriculture has assigned regulatory responsibility for the Act to the Department’s Grain Inspection, Packers and Stockyards Administration (GIPSA). GIPSA does not have a direct antitrust authority, and the P&S Act does not provide the agency with premerger review authority. The agency’s role, however, is to maintain fair competition regulations. GIPSA is authorized to initiate and conduct investigations of alleged violations in the livestock industry, but generally not in the poultry industry. A violator of GIPSA regulations may, after a hearing before a USDA administrative law judge, be served a “cease and desist” order, and civil fines may be imposed.

If a packer disregards an order or refuses to pay fines, GIPSA may refer the case to DOJ, which can enforce the order/fine through court action. According to GIPSA,

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<sup>12</sup> (...continued)

and Stockyards Act,” October 2004, and Pittman, Harrison M. “Market Concentration, Horizontal Consolidation, and Vertical Integration in the Hog and Cattle Industries: Taking Stock of the Road Ahead,” August 2005, both National AgLaw Center research articles accessed at [<http://www.nationalaglawcenter.org/research/#marketconcentration>].

<sup>13</sup> Portions of this section are from CRS Report RS20562, *Merger and Antitrust Issues in Agriculture: Statutes and Agencies*, by Jerry Heykoop.

<sup>14</sup> Government Accountability Office, *Packers and Stockyards Programs: Continuing Problems with GIPSA Investigations of Competitive Practices*, March 9, 2006 testimony before the Senate Agriculture Committee.

most violations are corrected voluntarily by the individuals or firms when a violation is brought to their attention. Except for serious violations, disciplinary action tends to be the last resort, and is imposed only after substantial efforts to obtain compliance have failed.

## General Antitrust Laws

Several laws, which cover but are not specific to agriculture, prohibit certain activities, such as mergers and acquisitions that may restrict market access or suppress competition. These laws are the **Sherman Act (15 USC §§1-8)** and **Clayton Act (15 USC §12 et seq.)**. In addition, Title II of the **Hart-Scott-Rodino (HSR) Act (15 USC §18)** requires parties to file notification of proposed mergers or acquisitions if the action will trigger certain size and/or ownership criteria set forth by HSR.

Such notifications must be made to the agencies that administer these laws [the Department of Justice (DOJ) and the Federal Trade Commission (FTC)], which have 30 days to review them and to determine the need for any further information. (USDA's role here is advisory.) Mergers or acquisitions likely to substantially lessen market competition are a violation of Section 7 of the Clayton Act. DOJ or FTC merger review is intended to prevent anti-competitive conduct before it occurs. The principal focus during merger review is not on the merging parties, but on whether the merger would change the market structure to such a degree that competition likely would be substantially lessened. The pre-merger remedies DOJ/FTC might seek with respect to a proposed merger that would violate Section 7 of the Clayton Act are either filing legal action to stop the merger, or else conditioning federal approval on modifications to remove perceived antitrust concerns [e.g., divestiture by one or another party of assets/operations that duplicate or overlap those of the other part(ies)]. Negotiating such changes often is seen as in the interests of all parties, because going to court can be expensive, time-consuming, and risky.

Two other classes of anti-competitive behavior may be subject to findings of antitrust unlawfulness. First, a violation of Section 1 of the Sherman Act (collusion) can occur when separate firms agree among themselves not to compete with each other; this would include such matters as the prices to be paid for product resources or prices charged to consumers. Second, a violation of Section 2 of the Sherman Act (monopolization or attempt to monopolize) can occur in several ways, including the use of predatory practices and/or exclusionary conduct. (See CRS Report RL31026, *General Overview of United States Antitrust Law*.)

## Agricultural Cooperative Protections

The **Capper-Volstead Act (7 USC §§291-292)** confers limited exemption from antitrust liability to farmer cooperatives, both for their existence and their joint processing and marketing of their commodities. The Act specifically states, in part: "Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products

of persons so engaged.”<sup>15</sup> USDA may, but has never utilized its power to, file complaints against cooperatives that monopolize or restrain competition to the extent that the price of any agricultural product is “unduly enhanced.”

This law and farmer antitrust immunity are among the topics now under review by the Antitrust Modernization Commission, an expert panel established by Congress in 2002 (P.L. 107-273; §§11051-60). The commission is to report its findings to Congress and the President by Spring 2007.

The **Agricultural Fair Practices Act (AFPA; 7 U.S.C. 2301 *et seq.*)** was enacted in 1967 to protect farmers from retaliation by handlers (buyers of their products) because the farmers are members of a cooperative. The act permits farmers to file complaints with USDA, which can then institute court proceedings, if they believe their rights under the law have been violated.

## Selected Current Issues and Legislation

### Research on Competition and Price Impacts

Have increased market concentration and vertical integration, including production contracts, made livestock markets less competitive and depressed farm prices? Answering this question might help lawmakers in deciding future competition policy. After Congress in 1991 provided funding for one of the most extensive recent examinations of meatpacking concentration, GIPSA contracted six projects to five universities. It also helped researchers collect, organize and analyze livestock transaction data over several years, according to an Oklahoma State University fact sheet.

Among the consistent findings from the six projects were that:

- A few major cattle feeding states including Texas, Nebraska and Kansas represent the core geographic market for fed cattle and price discovery;
- All other areas are linked to this market center, although the strength of the linkage diminishes as plants are located farther from the core (where the highest cattle prices are paid by packers);

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<sup>15</sup> 7 U.S.C. §291. According to the National Agricultural Law Center, “Although there is no universally accepted definition, a cooperative can be defined as a legal business entity created under state law that is owned and operated for the purpose of benefitting those individuals who use its services. A farmer cooperative can serve one or more functions including but not limited to providing loans to farmers, supplying information pertinent to agricultural production, selling inputs necessary to agricultural production, bargaining on behalf of its members, providing transportation services, and marketing agricultural products for its members.” See [<http://www.nationalaglawcenter.org/readingrooms/cooperatives/>] for more information on agricultural cooperatives.

- Larger and more efficient packers appeared to be passing back some of their efficiency gains to the feeders, with higher prices paid for larger sale lots of cattle and to the largest feedlots;
- Higher prices were paid by larger packers with larger slaughter capacities and high plant utilization, and higher prices were paid for cattle purchased closer to their plants;
- Higher prices were paid for marketing agreement cattle relative to cash market cattle, but lower prices were paid for contract cattle relative to cash market cattle.<sup>16</sup>

A related Oklahoma fact sheet also summarizes the price impact research:

Concentration in meatpacking is high, especially for fed cattle slaughtering and fabricating. We must not lose sight of the fact that concentration has increased in part as meatpacking firms increased industry efficiency. Research to date suggests price impacts from packer concentration have been negative in general, but small. Also, research shows that efficiency gains from moving to fewer and larger meatpackers have more than offset any market power impacts. Use of captive supply methods remained reasonably stable from 1988 to the mid-1990s. Captive supply usage has a seasonal component and can vary widely from plant to plant and week to week. Evidence suggests captive supplies increased in the last half of the 1990s. Buyers and sellers use captive supplies for various reasons but most believe they are beneficial or they would not be used. Research suggests that larger plants make greater use of captive supply procurement methods to keep plant utilization high. Evidence suggests larger plants use captive supplies strategically, i.e., increasing the use of captive supplies as cash market prices and price variability increased. Price impacts from captive supplies have been negative in general but small.<sup>17</sup>

Other research has documented either negative or positive price impacts, with each study's outcome dependent upon what assumptions were used and what particular aspect of livestock marketing was examined. Noting the particular controversy over whether contracts and other marketing arrangements besides open cash transactions could lead to abuse of market power, a USDA official commented:

Typically, contract prices for cattle and hogs are tied to the spot market price. As a result, as more animals are sold through contracts or other arrangements and fewer through the spot market, the actual number of transactions on which contract payments are based becomes smaller. This "thinning of the market" is often alleged to increase the ability of large buyers to manipulate prices. Research on this issue has been mixed.<sup>18</sup>

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<sup>16</sup> Ward, Clement E., Oklahoma Cooperative Extension Service, "Summary of Results from USDA's Meatpacking Concentration Study" (fact sheet F-562), last edited December 2004. This and other fact sheets on livestock pricing research and information may be accessed at [<http://pods.dasn.okstate.edu/docushare/dsweb/View/Collection-236>].

<sup>17</sup> Ward, "Packer Concentration and Captive Supplies" (fact sheet F-554), last edited December 2004. "Captive supply" generally refers to animals that are either owned by, or committed to, a meat packer except for the short time just before slaughter.

<sup>18</sup> Link, James E., March 9, 2006, testimony before the Senate Agriculture Committee.

## Legal Action: *Pickett v. Tyson Fresh Meats, Inc.*

The U.S. Supreme Court could soon decide to hear what many analysts consider to be a landmark legal case under the P&S Act. In *Pickett v. Tyson Fresh Meats, Inc.*, a group of cattle feeders in 1996 sued Iowa Beef Packers (IBP), now part of Tyson, for violating the P&S Act, reportedly the first class action certified for producers against a packer under in the Act's long history.<sup>19</sup> Following eight years of litigation, a jury in early 2004 agreed with producer arguments that the packer had used captive supplies to control the supply of cattle available on the market, thereby causing lower cattle prices. The jury set damages at more than \$1.2 billion. However, the federal judge in the case set aside the verdict on the grounds that the jury had insufficient evidence to find that Tyson had no legitimate business reason for using captive supplies.

The plaintiffs appealed, but a U.S. Court of Appeals in August 2005 upheld the lower judge's decision. The appeals court rejected the plaintiffs' argument that there was a violation of the P&S Act. "If a packer's course of business promotes efficiency and aids competition in the cattle market, the challenged practice cannot, by definition, adversely affect competition," the court declared.<sup>20</sup> The plaintiffs and their supporters have asked the U.S. Supreme Court to review the case. A decision could clarify the intent of the P&S Act, one supporting group stated.<sup>21</sup>

## Proposed Legislation in the 109<sup>th</sup> Congress

**Packer Ownership/Captive Supply.** Producers facing fewer buyers for their livestock frequently express concerns about "captive supply," meaning animals that are either owned by, or committed to, a meat packer except for a short period directly before slaughter. When packers buy fewer animals on the spot (open cash) market, reported prices may no longer accurately reflect the preponderance of prices paid, it is argued. Reduced transparency (i.e., prices and terms that all market players can view equally), works to the disadvantage of the far larger number of producers trying to sell their livestock to the relatively few packers who buy them, it is argued.

In the 109<sup>th</sup> Congress, a measure by Senator Grassley (S. 818) and Representative Boswell (H.R. 4713) would amend the P&S Act to make it unlawful for a packer or its representative, except within 7 working days of slaughter, to "[o]wn or feed livestock directly, through a subsidiary, or through an arrangement that gives the packer operational, managerial, or supervisory control over the livestock, or over the farming operation that produces the livestock, to such an extent

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<sup>19</sup> *Pickett v. Tyson Fresh Meats Inc.*, 11<sup>th</sup> Cir., No. 04-12137.

<sup>20</sup> *Pickett v. Tyson Fresh Meats Inc.*, as reported in *Daily Report for Executives*, August 24, 2005. Some discussion of the case also is from Domina, David A., "Proving Anti-Competitive Conduct in the U.S. Courtroom: The Plaintiff's Argument in *Pickett v. Tyson Fresh Meats, Inc.*," *Journal of Agricultural and Food Industrial Organization*, Vol. 2, 2004; as well as Rosales and O'Brien.

<sup>21</sup> "Producers ask Supreme Court to hear Pickett/IBP appeal," *Feedstuffs*, March 6, 2006.

that the producer is no longer materially participating in the management of the operation...” Producer cooperatives and smaller packers would be exempt.

Bill opponents counter that evidence of price manipulation is lacking, and that a ban could reverse many of the efficiency gains made by the livestock industry in recent years through closer packer-producer alliances. In the 107<sup>th</sup> Congress, during floor action on its version of the 2002 farm bill (S. 1731), the Senate approved a similarly intended amendment that conferees deleted from the final version.<sup>22</sup>

**Other Contract Terms.** A number of other bills attempt to address what their sponsors view as inequities in contracting between agricultural producers and those who buy their commodities. Identical bills introduced by Senator Enzi (S. 960) and Representative Pomeroy (H.R. 4257) would make it unlawful under the P&S Act for packers to use forward contracts that are based on a formula price, or that do not contain a firm base price. The bills also would limit the size of all contracts to no more than 40 cattle, 30 swine, or equivalent groups of other livestock, and would require packers to offer contracts for public bidding open to all traders. Senator Enzi and other supporters argue that packers now can use formula pricing arrangements to avoid participating in a more transparent open market and to unfairly change the prices they pay producers after a sale is made.

Bill opponents assert that packers use these and other contracting arrangements to ensure a steady supply of animals to keep high-capacity plants operating efficiently; such arrangements also allow for necessary price adjustments for quality, grade, or other market-prescribed factors. These types of bills would hurt producers too, because many of them use contracts or other marketing agreements with packers to limit their own exposure to price volatility and to obtain capital, opponents add.

A 2005 bill by Senator Grassley (S. 2131) would amend the P&S Act to prevent use of mandatory arbitration clauses in contracts, which greatly limit farmers’ avenues for resolving disputes with agribusinesses, bill supporters argue. The bill mirrors a 2001 floor amendment to the farm bill (S. 1731, §1046) that was adopted by the Senate but was deleted by conferees. Portions of a bill (S. 2307) introduced by Senator Harkin would amend the AFPA to: discourage mandatory arbitration and confidentiality clauses in contracts; require that each contract clearly state such prescribed terms as its duration, termination date, and payment factors; and give producers rights to cancel contracts, among other provisions.

**Livestock Mandatory Price Reporting (LMPR).** LMPR was first passed in 1999 to address some producers’ concerns about low livestock prices, industry concentration, and the availability of accurate market information. The original authority, Title IX of P.L. 106-78, USDA’s FY2000 appropriations, lapsed briefly on October 22, 2004, but President Bush signed legislation (P.L. 108-444) extending the program through September 30, 2005, when it again expired. The program is currently operating on a voluntary basis, as the 109th Congress considers whether to reauthorize LMPR, for how long, and what if any changes should be made. Taking

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<sup>22</sup> See also CRS Report RL31553, *Livestock: A Proposed Ban on Ownership and Control by Packers*, by Jerry Heykoop.

differing approaches in September 2005, the House approved a bill (H.R. 3408) to extend LMPR for five years and to amend hog reporting provisions, while the Senate approved a simple one-year extension (S. 1613). (See CRS Report RS21994, *Livestock Price Reporting: Background*.)

**USDA Enforcement and Management.** S. 2307 also would require a new USDA special counsel for competition matters to oversee enforcement of the P&S Act and other antitrust laws, authorize USDA to promulgate regulations defining the types of deceptive acts or practices in agricultural commerce that will be prohibited, and stipulate new enforcement procedures. Among other things, S. 2307 would relieve producers affected by an unfair practice under the P&S Act of a requirement that they prove predatory intent, competitive injury, or likelihood of injury.

Sponsors of this proposal say stronger enforcement authorities are needed in part because GIPSA officials have largely failed to enforce existing laws. They point to a recent report by the Department's Office of Inspector General (OIG) which concludes that GIPSA has not been able to adequately oversee and manage its investigative activities. GIPSA had difficulties defining and tracking investigations, planning and conducting complex investigations, and making agency policy, OIG found. For example, databases are incomplete, and investigations are often broadly defined to count even routine letters to companies and monitoring of publicly available records, OIG said. USDA's general counsel had not filed an administrative complaint on anti-competitive practices since 1999, due to GIPSA's failure to refer cases — although agency staff were considering dozens of investigations at the time, OIG concluded.<sup>23</sup>

The OIG report was discussed at a hearing on GIPSA's management of the P&S Act, which was convened on March 9, 2006, by the Senate Agriculture Committee. At the hearing, GAO also testified that in 2000 it had "identified two critical factors that detracted from the agency's ability to investigate anticompetitive practices in livestock markets": (1) investigations were being planned and conducted by economists without formal involvement of attorneys from USDA's Office of General Counsel (OGC), resulting in a lack of legal perspective on potential violations; and (2) the agency's investigative practices were not suited for the more complex competition-related concerns recently being raised. Moreover, USDA has not fulfilled promises to implement the 2000 GAO recommendations — such as integrating OGC attorneys into GIPSA investigations, and improving more effective management procedures for approving and reviewing investigations.<sup>24</sup>

At the Senate hearing, GIPSA's new administrator said that USDA generally agrees with and is implementing the OIG recommendations, such as the development of a management structure for receiving, reviewing, and acting on policy issues and internal requests for guidance; clarification of agency policy directives on investigations versus routine regulatory activities; and encouragement of GIPSA legal specialists to work more directly with OGC. At the March 9, 2006 hearing,

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<sup>23</sup> *Grain Inspection, Packers and Stockyards Administration's Management and Oversight of the Packers and Stockyards Programs*, OIG Audit Rept. No. 30601-01-Hy, January 2006.

<sup>24</sup> GAO, March 9, 2006 testimony before the Senate Agriculture Committee.

Agriculture Chairman Chambliss asked for a progress report in 90 days on implementation of the OIG recommendations.

The agency also was asked about the status of a “top-to-bottom review of the P&S Act and its regulations” that USDA had stated in 2003 it would undertake “to help ensure that the P&S Act continues to help assure a healthy, efficient, fair, and competitive market for everyone competing in today’s livestock, meatpacking, and poultry industries.”<sup>25</sup> USDA had sought \$500,000 for the review in its FY2004 budget request. Congress did not subsequently specify that the money be spent — although it did not explicitly prohibit such an expenditure, either.

However, Congress did provide \$4.5 million in P.L. 108-7 (consolidated appropriations resolution for FY2003) to GIPSA for a packer study. Accompanying report language stated that the funds, to be available until expended, should be used for a “study on the issues surrounding a ban on packer ownership,” with the results reported within 24 months of enactment. This deadline was February 20, 2005. GIPSA has contracted with a private firm, RTI International, to conduct what it is now calling the Livestock and Meat Marketing Study. The study will broadly examine marketing practices in the livestock and red meat industries. “The overall objective was to develop foundation information to understand economic changes occurring, why they are occurring, what changes are likely to occur in the future, and their implications for market participants and the structure of the livestock and meat industries.”<sup>26</sup> RTI was seeking, by April 14, 2006, detailed transaction data — some of it being required by GIPSA — from meat packers and processors and others.

## **A Farm Bill “Competition Title”?**

The *Pickett* case has loomed over efforts by a number of producer and allied groups that want a so-called competition title to be included in an omnibus 2007 farm bill. Many provisions of the Farm Security and Rural Investment Act of 2002 (P.L. 107-171, the 2002 farm bill) expire in 2007.

In legislative activity leading to enactment of the 2002 farm bill, the Senate Agriculture Committee had voted in November 2001 to delete a competition title from the omnibus farm bill (S. 1628) proposed by its chairman, Senator Harkin. During subsequent floor action on the bill, the Senate did approve a number of individual “competition” amendments. Although several of these amendments were dropped by House-Senate conferees in early 2002, two amendments were retained in the final version (H.Rept. 107-424). One gives producers the right to discuss their contracts with family members and advisors. The other extends some new P&S Act protections to swine producers with production contracts. Conferees also included in the final farm bill a new program requiring many retailers to provide country of origin labeling (COOL) for red meat and several other commodities. Since then,

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<sup>25</sup> Hawks, Bill, Under Secretary for Marketing and Regulatory Programs, February 24, 2003, letter to the Honorable Tom Harkin.

<sup>26</sup> GIPSA, “Livestock and Meat Marketing Study,” accessed March 16, 2006, at [<http://www.gipsa.usda.gov/GIPSA/webapp?area=home&subject=Imp&topic=ir-mms>].

Congress has twice postponed mandatory meat COOL and now appears divided on whether it should be implemented.<sup>27</sup>

Many observers believe that the debate over a competition title will be replayed when Congress takes up consideration of a new farm bill in 2007. Whether there will be wider support in the Senate and House Agriculture Committees than in 2002 remains to be seen.

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<sup>27</sup> Though COOL has been raised by some as relevant in the competition debate, it is not discussed here; see CRS Report 97-508, *Country-of-Origin Labeling for Foods*, by Geoffrey S. Becker.