Testimony of

Mr. Joseph Sabring

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Before the Antitrust Subcommittee of the U.S. Senate Committee on the Judiciary
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Thank you Mr. Chairman, and Senator Kohl for the opportunity to appear here today to share the view of John Morrell and Smithfield Foods about the best course for federal policy with regard to the structure of the meatpacking industry, and, to briefly answer some of the questions you and your colleagues may have about the pending acquisition of certain assets of Farmland Foods by Smithfield Foods.

I am Joe Sebring, President of John Morrell, an Ohio based company that produces processed meats and fresh pork. John Morrell is a wholly owned and independently managed subsidiary of Smithfield Foods. John Morrell & Co. owns four subsidiary companies: Curly's Foods, Iowa Quality Meats, Mohawk Packing Company, and Saratoga Specialties. John Morrell and Smithfield are part of the great American agricultural tradition of producing the highest quality food in abundance to feed our country and the world. Many of us at Smithfield companies come from families where the traditions of the farm and the land are deep, and we hope that you will keep that in mind as you make decisions about our company and our industry, and the farmers and ranchers who work with us every day.

This hearing and much recent debate is about vertical coordination and how much vertical coordination should be permitted. Since the days of Teddy Roosevelt there has been consensus in our country that vertical coordination should be permitted until it goes too far. When it goes too far, we have in place nearly a century's worth of laws that provide the means for our government to rein it in. Our company and our industry are already subject to the restrictions on anticompetitive practices contained in the Sherman Act, the Clayton Act, the Robinson-Patman Act the Federal Trade Commission Act, many state laws and key provisions of the Uniform Commercial Code. We are happy to live by those rules, as others do, and even to comply with another law that applies only to our industry: the Packers and Stockyards Act. That law is designed to prohibit meat packers from engaging in business practices that are unfair to their livestock suppliers. We believe that is regulation enough, that there is ample capacity for enforcement of those laws and that there is no reason to place even more restrictions on our industry that are not applied to others who are competing in the global economy. A ban on packer ownership of hogs would be devastating to our industry and to those who contract with us to supply hogs.

Smithfield and Farmland

Smithfield has made a bid to acquire certain pork production and processing assets of Farmland Foods, a division of Farmland Industries. Farmland and its Official Committee of Unsecured Creditors and Official Committee of Bondholders chose Smithfield as the "stalking horse" bidder after conducting an extensive marketing process with other potential acquirers, and after considering reorganizing the company around Farmland Foods. The Official Committee apparently concluded that the Smithfield transaction provides the greatest opportunity to generate the highest available value to creditors, in addition to offering security and stability to the employees, independent hog producers, customers and communities of Farmland Foods

Over $1.4 billion in aggregate claims have been filed against Farmland Industries by more than 20,000 farmers and 141,000 small businesses, as shown on a chart we have submitted for the record.. In Iowa alone, more than 420 bondholders filed claims exceeding $91 million, and claims exceeding $37 million have been filed by more than 1400 creditors. They really have waited long enough. Every day that the creditors and bondholders (who are mostly farmers) of Farmland wait for this transaction to be approved is a day their likely return is diminished.

One typical reaction to the announcement among those who are concerned about the members of the Farmland coop and their creditors came from Ron Plain, Agricultural Economist at the University of Missouri who said,

"The important aspect of the deal for pork producers is that there will be no change in Farmland Foods operations. Smithfield has stated that all the contracts will be honored, that all the plants will be kept open, that the brand will be continued, that the management, the people, will be retained. Considering that Farmland Industries is broke and that there could have been a loss of capacity, contracts and marketing strength, this is about as perfect an outcome as possible."

Under the terms of the agreement Smithfield will honor all current Farmland Foods hog production contracts. Smithfield and Farmland Foods also will remain committed to purchasing significant numbers of hogs on the open market. In short, the acquisition should have no impact whatsoever on the farmers currently supplying hogs to Farmland, either on a contract or a negotiated basis.

All of the 6100 employees of Farmland Foods will keep their jobs, and all of the Farmland Foods facilities will remain open at current production levels. The United Food and Commercial Workers will continue to be recognized at all of the unionized plants, and Smithfield has offered to assume the Farmland Foods pension plan. Farmland Foods will remain a stand-alone business operated by its current management, with the same entrepreneurial independence that Smithfield encourages in all of its businesses. The current Farmland Foods management team and headquarters employees will remain based in Kansas City. Smithfield will preserve and invest in the Farmland brand.

This acquisition involves pork production and processing assets, primarily Farmland's three hog slaughtering plants in the Midwest. Smithfield operates two hog slaughtering plants in the Midwest, where both companies process pork into products such as bacon, ham and case-ready pork that is sold to wholesalers, retailers and food service companies. The processing and sale of pork products is a national, if not international business, and approximately 200 companies in the United States sell such products.

You may hear today the argument that the acquisition will somehow restrict small farmer's ability to sell their hogs at fair prices in the areas surrounding the Midwest plants of Smithfield and Farmland. That is speculation and is not supported by the facts. Smithfield and Farmland today do not compete for the same hogs, as an examination of the location of the two companies' hog slaughter facilities and buying stations will make clear. This acquisition must pass muster with the Department of Justice and we firmly believe that it will, because the hog slaughtering industry in the Midwest is not concentrated. Neither Smithfield nor Farmland (alone or combined) is remotely in a position to exert control in the Midwest for the purchase or slaughter of hogs. Smithfield and Farmland are the fourth and sixth largest competitors, respectively. Tyson will remain the largest competitor, while the second and third competitors, Swift and Excel, together will continue to be larger than Smithfield/Farmland in the Midwest.

Moreover, this acquisition should be viewed in the broader perspective of competition for animal protein to consumers. Pork competes with beef and poultry where the dominant players, such as Tyson and Cargill (which are much larger and more diverse than Smithfield) have continued to grow through acquisitions in the poultry and meat industries, where higher levels of concentration are found than in the more fragmented pork industry. The level of vertical coordination is higher in those industries as well - put simply, chicken is cheap because of vertical coordination. These circumstances, combined with the fact that food retailers and wholesalers are consolidating, puts intense pressure on Smithfield to become more efficient in pork and to expand its offerings of other meats. The driving motivation behind this acquisition is to become even more responsive to our customers' demands, and to further our aim of providing the best and healthiest products at the most reasonable price to the consumer. Smithfield's efforts actually contribute to growing the demand for pork products and, in turn, demand for the hogs of large and small farmers alike.

Smithfield tried to make this transaction into as much of a status quo proposal as possible, because Farmland Foods remained a sound business within the financially troubled Farmland Industries and a proposal that preserved the strengths of Farmland was therefore a sound investment for Smithfield, and more likely to gain favor with the creditors, the bondholders and the bankruptcy court. Furthermore, John Morrell has no intention to close its existing facilities in Sioux Falls or Sioux City. As a result, there will be no decrease in slaughter capacity (sometimes referred to as "shackle space") as a result of this acquisition. What's more, the Farmland facilities we seek to acquire are generally newer than Smithfield facilities, but not as well-maintained as Smithfield's, and haven't seen the levels of capital expenditures that Smithfield has made in its plants. We intend to bring those facilities up to Smithfield standards in short order.

The Demand for Quality and Stability

Our business practices are driven by the demands of the increasingly global marketplace and the demands of our customers. Our customers want consistent meat quality, ready and predictable supplies, lean, safe and healthy meat products and a fair price. That demand for quality now comes from the largest corporate customers like McDonalds and from ordinary shoppers buying food for their families. They want their meat not just to be fresh and wholesome, but also to taste and look the same every time, and to be consistently lean every time they buy our products. Fast food retailers have responded to this demand by imposing strict requirements on packers. Grocers have also begun to demand not just high quality, but consistent and predictable meats for their customers. To meet these demands from our customers, consistent feed, feeding practices, animal husbandry and genetics are the hallmarks of the Smithfield system. A business model with some level of vertical coordination is the best way to assure that these requirements are met, and therefore, the best way for us to succeed as a business. It would be fair to say that the level of coordination in our business model is determined to a great degree by the retail grocery stores and restaurants that are the largest customers for us and our competitors as well as by consumers. It is a "pull-through" model rather than a push-through model - we are pulled along by the demands of our customers and have met those demands by maintaining some level of vertical coordination.

The exacting requirements our customers place on us also are relevant to supply issues.

The slightest interruption in supply is unacceptable to our customers because they typically are retailers and restaurants that rely for their success upon consistent sales. So our meat supplies must be predictable. That means that forward contracting with hog producers must be balanced by company owned animals in order to assure consistent supplies in the volatile commodities market. A degree of vertical coordination in our business model provides the certainty of supply that customers expect, but it doesn't mean that we use only hogs that we have raised. During the last two years, my company, John Morrell has bought 33% to 45% of the hogs available on the open market and Smithfield itself sells 25%-30% of the hogs sold on the open market, so we actually have a stake in keeping hog prices up.

American consumers and our customers abroad have demanded leaner pork. Smithfield and other companies have given it to them. We have developed our Lean Generation line of pork because of that demand from the marketplace. This pork product offers dramatically reduced fat content. It has been certified by the American Heart Association as "heart healthy." It also has boosted demand for pork. We all agree that those are good things for Americans' health and for everyone who raises hogs. We are able consistently to provide this new leaner pork because we have been able to control carefully the way that hogs are raised. Without some level of coordination among hog producers and meat packers, we will be out of the business of producing the consistently lean pork that has proved so popular both here and abroad.

Traceability, Food Safety and Security

There are other benefits to a coordinated system of production that allows us to trace the origin of any pork product. Special animal identification techniques are introduced at the farm and stay with the animal until final processing. Even at the early stages of a hog's life, our on-farm biosecurity procedures, and the data they produce, are completely within our control under the Smithfield system. Again, it is a reasonable level of vertical coordination that allows us to ensure delivery of safe meat products, as well as to comply with EPA standards and other regulations.

If we break up that chain of control in an artificial way, it will become more difficult to prevent contamination and to trace it to its source. Contamination is a serious risk. As you make decisions about the structure of our industry, please remember that rules about the economics of our industry can have consequences that reach far beyond economics. We at Smithfield and others in our industry have always had a responsibility to protect American consumers and ensure food safety. We have done that by ensuring that the product is fresh, that the process is hygienic and our facilities clean. But there is another threat that has been made more real to us since September 11, 2001. We must guard against the possibility that our products will become the weapons of terrorists who could seek to taint the food supply and kill or harm a great number of people, while crippling our industry as well as the restaurant and retail grocery industry. The current level of coordination in our system enables us to keep our products traceable and limits the number of people who have access to the products all along the chain of supply from the farm to the kitchen table. I want to ask you very seriously to consider this reality when you make decisions about the structure of our industry. It is not just a matter of economics; it is also a matter of food safety, of homeland security. We have always been happy to bear the responsibility to ensure the safety of the people who buy our products; in recent times that responsibility weighs a bit more heavily.

Managing Economic Risk

Just as our business model relates to security, it relates to risk management. It greatly reduces economic risk for producers, packers and ultimately the consumer. Forward contracting allows farmers to plan for the future. Farmers who choose contracts or marketing agreements with Smithfield or other companies also may find that their credit options are much more varied and attractive.

Bankers and other lenders now routinely demand that farmers produce contracts before providing them with financing to operate their farms. In our system both company-owned farms and contract growers have the benefit of a predictable place to sell their animals regardless of any spikes or downturns in current market prices. Those farmers operating outside an integrated system cannot so reliably predict their future. They face a high level of economic risk that is bound to bring disaster during aberrant periods in the market. Those who operate within a coordinated structure are protected from that unpredictability, and are better equipped to weather the challenges of a global market. There are many contract farmers who believe that they could not survive as a hog farmer without the stability provided under contracts with companies like Smithfield.

Family Farms

Of course, not everyone will choose the contracting route - people will decide whether to take advantage of that opportunity on the basis of their own practical judgments and values, as they should always be free to do. We understand that those decisions are made in the context of family tradition, by American farmers who value their independence and take so much pride in the land and in the work of feeding the world. They have had to make tough choices and to adapt to a changing marketplace as has every business that means to succeed in the global economy. Some of the family farmers this hearing is concerned with are our fellow hog producers, and they are also our suppliers. You may be interested to know, for example, that John Morrell purchased slightly more than half of its hogs (50.8%) from non-contract farmers in the fiscal year ended April 2003, which amounted to almost 4 million hogs. We respect the family farmers and value their work and their right to compete in the marketplace, but we don't agree that barring our company and others from raising hogs will improve the lot of independent hog producers in the marketplace. It plainly will harm the independent producers who do contract with Smithfield and other companies as well as the farmers who sell millions of hogs to Smithfield and Farmland on a negotiated basis today

Conclusion

John Morrell and all of the Smithfield Foods companies are part of a highly competitive business. We have built our business model in response to the non-negotiable demands of the consumer and the marketplace. We have met those demands by adapting, with a flexibility that we have achieved through a reasonable level of vertical coordination. That model has allowed us to succeed in business that relies on commodities yet maintain low and stable prices for consumers by owning and contracting for hogs. Our competitors in the poultry industry and in the hog industry in Canada and other countries long ago implemented far greater levels of vertical coordination, often with subsidies and with specific relief from prevailing regulations. We ask for no such relief. We ask only that our company and our industry not be barred from owning or contracting for some of our hogs as we strive to keep our company and our nation's meat industry competitive. We honor the family farm, as we enjoy mutually beneficial relationships with so many family farmers who raise hogs for Smithfield. We ask you to keep in mind that the coordination of our system serves the food security effort against contamination, both accidental and intentional. Finally we ask you to look at the economic data and consider what a ban on packer ownership would do to our industry and others. You are right to try to protect the interests of your constituents; we submit that you can do that best by resisting the call to impose a ban on packer ownership of livestock.

Some may say that Smithfield's proposed acquisition of Farmland assets has the potential to harm small hog farmers, but there is absolutely no basis for this concern. Smithfield believes that the proposed acquisition will save a failing company from bankruptcy, keep Farmland's slaughter plants running without interruption, and maintain small farmers access to existing purchase points for their hogs.

I have attached several documents which I request to be made a part of the record of this hearing.

Thank you very much.