Testimony of

Michael Stumo

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Consolidation in Agriculture and an Examination of the JBS/Swift Acquisitions

1. Introduction

Thank you Chairman Kohl, and members of the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, 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.

Horizontal concentration and vertical integration in the food and agriculture sector has harmed food producers and consumers, while the gross margins for retailers and processors increase each year. Farm gate prices for meat have trended lower during the last 20 years as consolidation increases. This is due to oligopsony market power on the buy side of the processors.

2. JBS/Swift acquisition

On May 4, 2008, JBS Swift announced plans to buy National Beef and Smithfield Beef. Dozens of organizations oppose it, and few support it. (See attached signatory letter on this topic). This is an unprecedented five-to-three merger that will harm price, choice, innovation and competition in the beef industry. The acquisition will substantially lessen competition in this already marginally competitive sector. Oligopsony power in the beef industry has already reduced cattle production in this country, even as our population, and overall beef demand, increases.

The core supply and demand should be identified clearly, to keep the focus appropriate.

a. Supply is the number of cattle available in a given week, that are for market.

b. Demand is the number of spaces available in the packing plants for those cattle to fill during that same period.

c. Consumer demand, cattle available next month, feed costs, and other factors are important - but secondary and derivative - to price.

The top five firms are the "market makers" in the slaughter steer and heifer market. Second tier plants are scattered across the country, but are not market makers. In other words, OCM does not consider second tier plants as able to move markets with their procurement decisions.

A large percentage of slaughter-ready cattle are now committed -via captive supplies - for sale prior to delivery at the market. These oral and written contract commitments are always calculated from market prices determined from the crucial negotiated cattle. Thus, the market price, derived from negotiated cattle, directly impacts the contract cattle. The live cattle market price is largely set in the Great Plains feeding region (Kansas, Oklahoma, Colorado, Nebraska and Texas) (See map attached). The price set in the feeding region directly impacts prices for slaughter-ready cattle, and these prices are almost immediately transferred to feeder cattle in all states.

The five biggest packers are currently Tyson, Cargill, JBS Swift, National Beef, and Smithfield Beef. All have some version of captive supplies, i.e., cattle committed to the packer without a negotiated price. Smithfield owns the largest feeding company in the nation, Five Rivers Ranch Cattle Feeding, LLC, with a 2 million head estimated annual capacity. If the merger is allowed, only three people - the head buyers employed by JBS, Tyson and Cargill - will make price decisions on over 80% of the slaughter steers and heifers each day.

The current cattle market is already suffering from reduced competition. This merger will substantially lessen competition. Cattle feeders have trouble now gaining bids for their cattle from the packers within transportation distance. If the merger is allowed, they will have even fewer potential buyers and fewer actual buyers.

3. Plant Locations

These are the locations of the five biggest beef packers.

JBS Swift has four U.S. plants:
* Greeley, CO
* Grand Island, NE
* Cactus, TX
* Hyrum, UT

National Beef has three plants:
* Liberal, KS
* Dodge City, KS
* Brawley, CA

Smithfield Beef has four plants:
* Moyer in PA
* Packerland in Green Bay, WI
* Plainview, MI
* Tolleson, AR

Tyson has seven plants:
* Holcomb, KS
* Dakota City, NE
* Lexington, NE
* Amarillo, TX
* Denison, IA
* Geneseo, IL
* Pasco, WA

Cargill has five major plants:
* Schuyler, NE
* Friona, TX
* Plainview, TX
* Fort Morgan, CO
* Taylor Pack, PA
* Dodge City, KS

4. Anti-Competitive Effects

This acquisition is likely to decrease competition for four reasons:

a. Buyer Number Reduction: The number of top-tier national buyers will be reduced from five to three. In the Great Plains region, the number of buyers will be reduced from four to three. A modified auction-style market is the model of bidding.

b. Captive Supplies: Partial vertical integration harms current competition and will drive a substantial lessening of competition post-merger. Also, Smithfield's Five Rivers Cattle Feeding company will assist the post-merger firm in depressing price because it will take more than one JBS plant equivalent out of the cash market.

c. Perishability: Slaughter cattle must be sold during a two week window. They cannot be stored in a warehouse. Thus, sellers must more often sell at the price packers offer, and have lessened negotiating leverage.

d. Disparity in power and information: The few head packer buyers have large market power individually and sophisticated information. The thousands of producers individually have no market power and comparatively little information.

Auction theory, and our members' experience, is clear that fewer buyers reduce cattle prices. Our feedlot members have trouble getting competitive bids for their slaughter-ready cattle each week because actual competition between buyers is less than vigorous. Cattle are perishable and must be sold within approximately two weeks or they degrade in quality and value, which magnifies the market power of the remaining packers. Additionally, partial vertical integration is another major market power magnification tool. Allowing this merger will substantially lessen the competition that exists and will increase the market power held by the remaining firms.

"Negotiated cattle" are those that set the price for slaughter-ready cattle, even for cattle that are contracted. Negotiated cattle are those in which there are competing bids when the animals are slaughter ready and offered for sale. Partial vertical integration - or captive supplies - have largely diminished the number of negotiated cattle and, at the same time, greatly enhanced packer market power. The partial vertical integration includes cattle committed to a packer, without price-relevant negotiation, because the packer either owns the animals or is certain to receive delivery through a contract. Our members report that packers are increasingly "out of the market" because the packers have sufficient captive supplies to fill their plants. Prices drop substantially in those weeks, and often do not recover.

With the current packers, there is likely to be at least one that needs to buy cattle that week. If we reduce competition by one or more packers, there will be more weeks each year that no packer needs to buy cattle, and price is depressed.

If JBS acquires Smithfield's Five Rivers Cattle Feeding Company, those company-owned cattle will take at least one post-merger JBS plant out of the market. One plant slaughtering 5,000 animals per day for 250 days per year, has a 1.25 million head per year capacity. Five Rivers production will fill more than 1.5 such plants.

Thus, consumer demand will not change, plant capacity will not change. No new efficiencies will be created, but cattle prices will fall.

Farmers and Ranchers in most continental U.S. states will directly feel the effects. Feeder cattle from the West, the South, the Midwest, and the Central U.S. are shipped to the Great Plains to be fed out in feedlots. Even if those lighter-weight cattle are sold and shipped elsewhere, the price impacts are the same. Specifically, calves and yearlings are priced in direct relationship to the fed cattle price expected when they are fed out to slaughter weight. If slaughter-ready cattle prices decline, feeder cattle prices decline also.

5. How Cattle Are Sold

Each week cattle are sold. Major feedlots develop a show list of cattle available for sale at the end of each week and give that show list to one to four interested cattle buyers. Small feedlots do not have show lists each week, but only sporadically.

JBS/Swift, Tyson, Cargill and National have many field buyers, each assigned to a region. Each day, those field buyers hold several conference calls with their head buyer. The field buyers relay the inventory of cattle in the field and information on competing bids. Head buyers relate the plant needs, other market factors, and decide upon price. The result is highly sophisticated realtime information held by the plants, in comparison to the very low information quality held by feeders.

The vast majority of feedlots are not able to attract all four buyers in the Great Plains states. Cattle can only be transported 250 miles economically, and most producers do not have four different plants within that distance.

Cattle buyers assigned to an area are not active buyers for each feedyard. They may not visit most feedyards to bid. Or they are mere "lookers", i.e. they visit a feedlot to gain the show list for the week. The "lookers" merely take inventory and report to the head buyer in one of the several conference calls per day that each company has between field buyers and the head buyer.

Packers have a large percentage of their plant capacity tied up in captive cattle. Those cattle have preferred access to the plant because (1) the packer owns them; (2) the cattle are committed via a forward contract or marketing agreement; or (3) there is an oral contract between the packer and the feeder committing the cattle to delivery without negotiation. The captive cattle numbers have eroded the volume of negotiated catte which set the price. Negotiated cattle volume is thus thin, enabling price manipulation by market makers (first tier packers) and rationing of market access.

The negotiated cattle set the price for all other cattle. The number of negotiated cattle is dwindling because the ability to access the market is very risky. Packers have aggressively offered contracts over the years because more contracts produce lower prices. Feeders have often accepted those contracts because the open market risk increases as contract use increases. Feeders understand the long term risks, but must stay in business today. That means market access is paramount to keeping feedlot customers despite the long term harm to the markets.

When packers have a large number of captive supplies, they need few negotiated cattle. They can force the price lower. The feeders have to either accept the price, or wait one more week. The cattle must be sold within two weeks because they are perishable. If the cattle are kept more than two weeks, they will draw substantial discounts for being overweight or overfat. When the price is forced lower, the marketing agreement cattle also receive less money. That is because marketing agreements are mathematically tied to the reported price derived from negotiated cattle.

Captive supplies affect price in this way. When four major packers in the Great Plains region, there is some chance that one will need cattle in a particular week. If there is a great need for negotiated cattle, then most feedlots will be able to sell at a competitive price. If there is a moderate need for negotiated cattle, then the small feedlots are frozen out of the market, and the larger feedlots still can sell cattle relatively competitively. If there is little need for negotiated cattle, then even the big feedlots must sell on a take-it-or-leave-it basis. Price suffers, and will not recover for at least two weeks. Consumer demand may stay the same or increase, but price still suffers.

If the JBS-Swift acquisition occurs, then there will be one less packer that may need cattle in a particular week. Stated another way, 25% of the packer buyers will be taken out of the market in the Great Plains feeding region. The number of weeks per year that there are few negotiated bids will go down, and the length of time to recover from that price shock will increase. Three head buyers will make all pricing decisions, utilizing sophisticated information systems and advanced market power tools. Rural America will lose money.

5. Feeder Cattle

Feeder cattle (about 500 pounds) and yearlings (about 750-800 pounds) are grown across the country and then sold to be fed out in feedlots. Certainly some ranchers feed out their own cattle, or retain ownership while paying a feedlot to fatten them, but the feeder/yearling market is the relevant inquiry here. I refer to feeder and yearling cattle collectively as "feeder cattle" here for purposes of this testimony.

Feeder cattle are shipped one thousand miles or more, contrary to the more limited economical shipping distance of slaughter weight steers and heifers. The purchase price for feeder cattle is directly tied to the market for fed cattle. Those who buy feeder cattle calculate the expected price for fed cattle, and have a very specific estimate of the cost of getting those 500 pound animals to market (cost of feed, feedlot yardage fees, interest, etc.), for the purpose of determining their breakeven price, and the price they can afford to pay for feeder cattle.

When the price of slaughter cattle lessens, the price for feeder cattle directly goes down. This decrease in feeder cattle price will be felt from coast-to-coast because of diminished competition in the feedlot region. Thus, the merger should not be allowed.

6. Five Rivers Cattle Feeding Company

Smithfield Foods owns Five Rivers Cattle Feeding Company, the biggest feedlot company in the country. JBS stands to acquire it. The company claims to market two million cattle per year. That is over 7.5% of the fed steer and heifer slaughter (excluding Holsteins and cows) in the country.

Post-merger, JBS Swift will slaughter 43,500 per day according to industry sources. Assuming 250 plant days per year, the annual slaughter will be 10.8 million per year. The Five Rivers yard will provide nearly 20% of that capacity, taking more than one of the post-merger firm's plant off the table for open market purposes. This result will depress fed cattle prices with no increase in consumer benefit or beef quality.

7. Holstein and Cull Cow Markets

Holstein and cull cow sales are the second most important source of revenue for dairy producers (the most important source is fluid milk sales). The prices for Holsteins and cull cows are based off a mathematical spread from the slaughter cattle market. That spread can increase or decrease, but the fed cattle market is the base.

If slaughter cattle prices decrease, so will Holstein and cull cow prices.

We believe there is "draw area" overlap between National's Brawley Beef (Brawley, CA) and Smithfield's Sunland Plant (Tolleson, AZ). Combining those two plants within one company will substantially reduce competition for Holsteins and cows in that region. More inquiry is needed on that issue of direct impacts of the acquisition on those markets.

8. No Efficiency Benefits or Consumer Benefit

The industry has alleged that consolidation has helped efficiency. It has not. This merger will achieve no efficiencies that cannot be achieved in other ways - i.e through marketing, management or readily available technology.

Plant size efficiencies are achieved at a very low level. The top five firms have exceeded that level of efficiency. Because this merger is among top firms, no plant level efficiency claims are credible. The plant sizes will remain unchanged.

Quality: There is no inherent difference in quality between contract cattle and negotiated/open market cattle. Certified Angus Beef, "natural" beef, and other types of beef are sold in all manners. Beef breeders sell their genetics to producers of all types, regardless of how they sell cattle. There are no patents or other agreements restricting the manner of selling genetics at the slaughter animal stage.

Our members produce for all markets, and sell in many different ways. The only data-driven information on the question came from the Pickett vs. Tyson litigation. Tyson's internal data revealed that the open market cattle were of superior quality to the cattle sold through marketing agreements and packer owned cattle. Some published articles claim that quality increases with some types of marketing, but those claims are mere repetition from meat packer sources, not based upon data.

Additionally, to the extent beef is leaner for consumers, industry structure is irrelevant. Any small plant has access to this technology. Indeed, much trimming of fat is still done by hand among the large plants.

Consumer Harm: Consumers beef prices increase with concentration, and are likely to increase further. The farm to retail price spread in the beef industry continues to increase. Assuming any efficiencies are gained, they are not passed on to consumers at the retail supermarket meat case.

Other means of achieving efficiencies: Most efficiencies can be achieved without merger and the resulting anti-competitive results. Better management is not determined by size. Technology is available to most firms. OCM has heard none of these claimed benefits, but has seen them in other cases. The JBS acquisition should not be allowed.

9. Other Recent Mergers and DOJ Underperformance

OCM is concerned that the unique aspects of agriculture are not appropriately accounted for at the Department of Justice. Last year, the Department approved two anticompetitive mergers.

First, DOJ approved Smithfield Foods acquisition of Premium Standard Farms in the hog packing industry. This was the most recent in a series of hog packing mergers, and the performance result in the country has been the loss of 90% of our hog farmers in 20 years. Very poor metrics. Devastating metrics to those forced out of business because of lack of competition.

Second, DOJ approved the continued monopolization of the seed industry by Monsanto.
Monsanto has a history of quashing competition using litigation against its customers, patent rights, unfair contract, monopoly pricing, tying arrangements, and mergers to eliminate competitors, gain market share and choke of competing research.

The Organization for Competitive Markets (OCM) recently submitted a letter to the Department of Justice (DOJ) urging it to review the JBS Swift acquisitions and to strongly consider blocking those acquisitions. However, in the past, the DOJ has not demonstrated a rich understanding of the effects of acquisitions in the agricultural sector on competition. The DOJ does not appear to have heeded the warnings from farmers' organizations, agricultural businesses, and consumer groups about the concentration of agricultural markets. Last year, the DOJ approved the acquisition of Delta and Pine Land (DPL) by Monsanto over the objections of OCM and a number of other organizations. Furthermore, the DOJ delayed responding to the Tunney Act comments submitted by OCM and many other organizations, as well as 13 states, for more than six months, shielding the transaction and the consent decree from a meaningful court review. (See OCM Tunney Act comments attached). The DOJ's examination of the acquisition and the remedies it proposed were so lacking that it prompted State Attorneys General to launch an investigation into Monsanto's anticompetitive practices.

The DOJ's handling of the Monsanto-DPL transaction serves as a good case study into the DOJ's failure to prevent significant concentration across the agricultural sector. Monsanto's acquisition of DPL gave the combined firm a 50% market share nationally in cottonseed and up to 75% of that market in certain key regions and also cut off substantial joint development efforts between DPL and Monsanto competitors, specifically DuPont and Syngenta. This was only the immediate effect, however. The longer term competitive effect is that the enormous new firm has concentrated the cottonseed and cotton trait markets to the point where it has a chokehold on both, competitors essentially are foreclosed from these markets. This will harm innovation and farmer choice in cotton traits and seed for a long time to come.

Monsanto' acquisition of DPL is only one in a string of Monsanto acquisitions of independently-owned regional seed companies. Like other markets within the agricultural sector, the entire seed market has experienced significant concentration in the past decade, due in no small part to Monsanto's actions. Whereas there were 600 independently-owned regional seed companies in 1996, by 2006 there were only 250. Monsanto itself has acquired nearly twenty-five of these companies in the past 5 years. Farmers are extremely concerned about the concentration in the seed market. Moreover, the DOJ did not review any of Monsanto's acquisitions of these companies and it admitted that it did not take into account the seed market concentration, or Monsanto's potentially anticompetitive licenses and sales practices with independent seed companies, in crafting the consent decree in the Monsanto-DPL transaction.

10. Conclusion

The United States pioneered antitrust law. Consumers, producers and competitors have benefited tremendously from avoiding much market power in the economy over past decades. But antitrust has been severely weakened. The balance in weighting the harm to competition and the efficiency benefits has shifted vigorously toward believing unproven efficiency claims and disbelieving likely or proven harm.

This shift is not fact based. It is harmful and wrong. Claimed efficiencies are accepted without factual proof, merely on the basis of theoretical argument. At the same time, the efficiencies are assumed to benefit consumers or the economy at large when there is no proof of such benefits flowing beyond the merging firm. The so-called efficiencies are, in reality, a means to increase the merging parties' profits only.

Conversely, the tools of market power and proof of likely price harm is ignored. Statutory change, requiring judges to rebalance these issues, is appropriate. The Agricultural Competition Enhancement Act, co-sponsored by Senators Grassley and Kohl, is a good start to rebalancing antitrust.