

# THE 2002 SENATE FARM BILL: THE BAN ON PACKER OWNERSHIP OF LIVESTOCK

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## I. OVERVIEW OF THE ISSUE

On December 13, 2001, the United States Senate approved an amendment to the Senate Farm Bill making it unlawful for a packer to own, feed, or control livestock intended for slaughter more than fourteen days prior to slaughter.<sup>1</sup> The amendment includes exemptions for packing houses owned by farmer cooperatives, and packers with less than two percent of national slaughter. The amendment was approved 51-46, and became part of the Senate Farm Bill.<sup>2</sup> In early 2002, the amendment language was clarified to prohibit arrangements that give packers “operational, managerial, or supervisory control over the livestock, or over the farming operation that produces the livestock, to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of the livestock.”<sup>3</sup> The new language was approved 53-46 on February 12, 2002, but did not survive the House/Senate Conference Committee on the Farm Bill.<sup>4</sup> More recently, two bills were introduced in the House containing language comparable to the Senate version.<sup>5</sup>

## II. REASONS FOR THE LEGISLATION

Why has the United States Senate, on two separate occasions, voted to add a packer ownership prohibition to its version of the Farm Bill? There are at least three major reasons that have spurred the legislation: (1) consolidation amongst firms in the meatpacking industry;<sup>6</sup> (2) the implications of the dimi-

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1. See 147 CONG. REC. S13,093 (daily ed. Dec. 13, 2001) (text of amendment); see also The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2001).

2. See 147 CONG. REC. S13,099 (daily ed. Dec. 13, 2001) (ratification of amendment).

3. 148 CONG. REC. S558 (daily ed. Feb. 8, 2002) (text of amendment); see also The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2002).

4. See Epilogue *infra*.

5. H.R. 3803, 107th Cong. (2002); H.R. 3810, 107th Cong. (2002).

6. Concentration in the meatpacking industry has been a significant concern for over one hundred years. At the beginning of the twentieth century, five firms controlled fifty-five percent of the market. See U.S. GEN. ACCOUNTING OFFICE, PACKERS AND STOCKYARDS PROGRAMS: USDA’S RESPONSE TO STUDIES ON CONCENTRATION IN THE LIVESTOCK INDUSTRY (Apr. 1997)

nished cash market for hogs and cattle in recent years due to packer-owned and contracted livestock;<sup>7</sup> and (3) the inability or unwillingness of government enforcement agencies to address the problems.

#### A. Consolidation in the Meatpacking Industry

The meatpacking industry has consolidated rapidly over the last twenty years. Table 1 illustrates the increase in the four firm concentration ratios in livestock slaughter from 1980 through 1999.

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(GAO/RCED-97-100), available at <http://www.gao.gov> (last visited Sept. 16, 2002). This situation led to the 1921 passage of the Packer and Stockyards Act (7 U.S.C. §§181-229) which created a division within the United States Department of Agriculture (“USDA”) to ensure fair business practices and to detect and prevent anticompetitive behavior. See generally, ROGER A. MCEOWEN & NEIL E. HARL, PRINCIPLES OF AGRICULTURAL LAW §15.02[2] (1998). An October 1991 GAO report found that the industry had become even more concentrated than it was in 1921 with four firms controlling 70% of the meatpacking industry. See U.S. GEN. ACCOUNTING OFFICE, PACKERS AND STOCKYARDS PROGRAMS: OVERSIGHT OF LIVESTOCK MARKETING COMPETITIVENESS NEEDS TO BE ENHANCED (Oct. 1991) (GAO/RCED-92-36), available at <http://www.gao.gov> (last visited Sept., 16, 2002). Since then, industry concentration has intensified further. See Table 1 *infra*.

7. See NEIL E. HARL, THE STRUCTURAL TRANSFORMATION OF AGRICULTURE, at <http://www.econ.iastate.edu/faculty/harl/> (last visited Aug. 20, 2002) (available under “Papers of Interest” link) (discussing the economic consequences of regionally dominant meat packers); JOHN D. LAWRENCE & GLEN GRIMES, PRODUCTION AND MARKETING CHARACTERISTICS OF U.S. PORK PRODUCERS, 11 (Iowa State Univ., Staff Paper No. 343, 2001), available at <http://www.econ.iastate.edu/research/webpapers/staffppr343FNL.pdf> (last visited June 3, 2002) (stating that a January 2001 survey suggested that 17% of hogs were bought on the cash market; remainder procured by some type of marketing agreement); See USDA-GIPSA, CAPTIVE SUPPLY OF CATTLE AND GIPSA’S REPORTING OF CAPTIVE SUPPLY, viii (Jan. 21, 2002), available at [http://www.usda.gov/gipsa/pubs/captive\\_supply/captivesupplyreport.pdf](http://www.usda.gov/gipsa/pubs/captive_supply/captivesupplyreport.pdf) (last visited June 3, 2002) [hereinafter USDA-GIPSA, CAPTIVE SUPPLY OF CATTLE]. “Based on its review of the underlying transaction date, GIPSA has estimated that 32.3% of the total 1999 slaughter of the top four packers was procured through captive supply arrangements.” *Id.*

**Table 1. Four Firm Concentration Ratio in Livestock Slaughter (%)**

<i>Year</i>	<i>Cattle</i>	<i>Steer &amp; Heifers</i>	<i>Cows/Bulls</i>	<i>Hogs</i>
1980	28	36	10	34
1985	39	50	17	32
1990	42	55	18	33
1995	69	81	28	46
1996	66	79	29	55
1997	68	80	31	54
1998	70	81	33	56
1999	70	81	32	56
2000	69	82	32	56

Source: International Agricultural Trade and Development Center, University of Florida.

In the 1980s and early 1990s, the consolidation in the meatpacking industry was primarily horizontal.<sup>8</sup> In the mid-to-late 1990s, vertical integration progressed rapidly.<sup>9</sup> Packers engaged in livestock production, entered long-term contracts to secure livestock production, and purchased downstream firms for

8. See James M. MacDonald & Mark Denbaly, Concentration in Agribusiness, Paper Presented at the Agricultural Outlook Forum 2000, Table 1 (Feb. 24, 2000) (on file with authors).

9. See generally C. Robert Taylor, *Where's the Beef? Monopoly and Monopsony Power in the Beef Industry*, Agriculture and Resource Policy Forum (Auburn University) Mar. 2002, available at <http://www.auburn.edu/~tayloct/> (available under "Recent Reports" link) (discussing the impact of rapid consolidation in the meatpacking industry since 1980).

further processing.<sup>10</sup> Additionally, major meatpacking firms have entered into a web of interlocking agreements through joint ventures and alliances.<sup>11</sup> This consolidation has led to serious concerns of an imbalance of power between meatpackers and independent producers.<sup>12</sup>

Similar concerns in the late 1800s and early 1900s led to the passage of the Sherman Act<sup>13</sup> in 1890, the Clayton Act<sup>14</sup> in 1914 and the Packers and Stockyards Act (PSA)<sup>15</sup> in 1921. Congress finds itself in an analogous position today because of the structure and conduct of the contemporary meat industry.

Some past consolidations have certainly resulted in efficiency gains that have been passed on to consumers.<sup>16</sup> However, as industry structure consolidates vertically and horizontally, efficiency gains are less likely to be passed on to either farmers or consumers.<sup>17</sup> Indeed, recent data indicate that the portion of the retail meat dollar attributable to packers (referred to as the farm-wholesale spread) has trended higher since the mid-1990s, as shown in Figure 1.<sup>18</sup>

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10. See Neil E. Harl & John Lawrence, *Long-Term Marketing Contracts with Packers . . . A Journey Through the Downside*, 35 IOWA PORK PRODUCER 1, 5-7 (1998).

11. See generally Taylor, *supra* note 9, available at <http://www.auburn.edu/~taylocr/> (available under "Recent Reports" link); see also MARY HENDRICKSON & WILLIAM HEFFERNAN, CONCENTRATION OF AGRICULTURAL MARKETS (2002), available at [http://www.nfu.org/documents/01\\_02\\_Concentration\\_report.pdf](http://www.nfu.org/documents/01_02_Concentration_report.pdf) (last visited June 19, 2002).

12. See generally Jon Lauck, *Toward an Agrarian Antitrust: A New Direction for Agricultural Law*, 75 N.D. L. REV. 449 (1999); HARL, *supra* note 7, at <http://www.econ.iastate.edu/faculty/harl/>.

13. 26 Stat. 209 (1890) (current version at 15 U.S.C. §§ 1-7 (2000)).

14. 38 Stat. 730 (1914) (current version at 15 U.S.C. §§ 12-27, 29 U.S.C. §§ 52-53 (2000)).

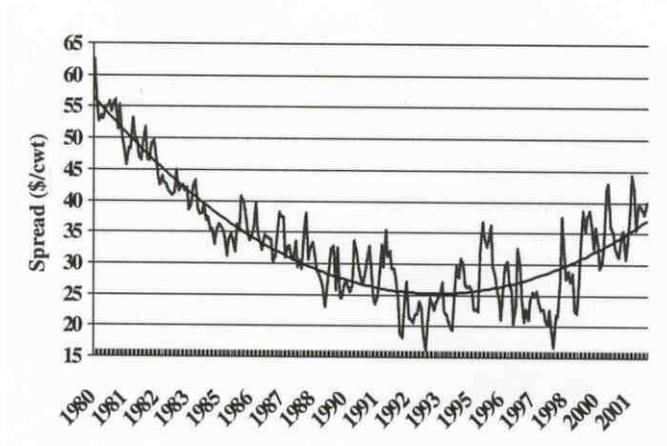
15. 42 Stat. 159 (1921) (current version at 7 U.S.C. §§ 181-231 (2000)).

16. See Taylor, *supra* note 9, available at <http://www.auburn.edu/~taylocr/> (available under "Recent Reports" link).

17. It is important to note that vertical and horizontal integration benefits consumers only if any economies derived from the integration are passed on to consumers. That outcome is likely only if competition is present and competitive markets are functioning well. Instead, any efficiency gains could be passed on to shareholders or used to pad costs within the firm. In any event, the higher the level of concentration and vertical integration, the greater the risk of unacceptable market conduct.

18. Taylor, *supra* note 9, available at <http://www.auburn.edu/~taylocr/> (available under "Recent Reports" link).

**Figure 1. The Farm to Wholesale Spread in Beef  
(USDA Data Adjusted for Inflation)**



In the last few years, the efficiency gains have been arguably negligible because economies of scale and scope can be achieved at much lower volume levels than are evidenced today.<sup>19</sup> Concerns of market power, thus, rise in importance.

In a competitive market, the farm-wholesale price spread should decrease as per-unit slaughter costs decrease. In other words, as slaughter costs decrease due to efficiency gains, a competitive market would force firms to pass those savings on to consumers. Figure 1 shows that this was indeed the case throughout the 1980s and the early 1990s.

Since the mid 1990s, however, the farm-wholesale price spread has trended strongly upward. This trend is inconsistent with what economists would expect in a competitive market, and should result in higher gross income for the

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19. As of 1997, the four largest firms controlled about 80% of cattle slaughter, but there were twenty-two plants with the highest level of production accounting for 80% of all production. Assuming these plants reflected scale economies, achieving such economies would require less than 3.7% of the market by each plant. For pork, the thirty-one largest plants yielded 88% of production. Again assuming that these plants reflected scale economies, achieving such economies could be reached with each plant having slightly less than 3% of the market. Consequently, a highly dispersed ownership and unconcentrated market would be consistent with the largest size of plants in both pork and beef packing. See Peter C. Carstensen, *Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy*, 2000 WIS. L. REV. 531, 537 (2000).

dominant packers — a fact which is confirmed by high profits being reported by the dominant firms in meat packing the past several years.<sup>20</sup>

The meatpacking industry explains the increased farm-wholesale price spread in a manner that does not implicate market power by asserting that they are adding value and/or realizing efficiency gains by moving to larger and larger slaughter operations and that slaughter costs are less for the leaner animals that are now produced.<sup>21</sup> As for the value-added claim, the USDA Economic Research Service (“ERS”) calculates the spread for a standard animal so that the spread will reflect only price changes.<sup>22</sup> Likewise, even if meat quality improves over time, there should be no long-run trend in the farm-wholesale price spread for given slaughter costs.<sup>23</sup> On the efficiency claim, economic theory predicts that efficiency gains that are realized in a competitive market would result in the farm-wholesale spread trending downward, not upward as it has since the mid-to-late 1990s.<sup>24</sup> The implication is that the meatpacking industry is less competitive today than it has been in the past.<sup>25</sup>

#### B. *The Impact of Contract-Supplied Livestock.*

A truly competitive market is characterized by many buyers and sellers.<sup>26</sup> The economic research is clear that when the number of buyers is reduced,

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20. See Taylor, *supra* note 9, available at <http://www.auburn.edu/~taylocr/> (available under “Recent Reports” link).

21. See *id.* at 2, available at <http://www.auburn.edu/~taylocr/> (available under “Recent Reports” link).

22. See *id.*

23. See *id.*

24. See *id.*

25. The upward trend for much of the 1990s and into 2001 is too strong and too persistent to be explained by short-term spikes in prices, spreads, production or competition with other meats. See James M. MacDonald & Michael E. Ollinger, *Consolidation in Meatpacking: Causes and Concerns*, AGRIC. OUTLOOK, June-July 2000, at 23. Also, the article states, “[A] long-term increase would be troubling. Increasing concentration in other sectors of the economy has often reflected intense competition and frequently led to falling costs and prices for the concentrating firms. But after an industry consolidates, when few firms face each other in a stable environment, competition may often become less intense.”

The USDA report concluded by asking the question, “[a]s consolidation is completed, will packers successfully limit price competition among themselves and maintain 1999’s high spreads?” *Id.*

26. See, e.g., DOUGLAS F. GREER, *INDUSTRIAL ORGANIZATION AND PUBLIC POLICY* 22-31 (2d ed. 1984); RICHARD LIPSEY ET AL., *ECONOMICS* 296-317 (7th ed. 1984); USDA-GIPSA, *PRICE*

downward pressure on price paid to sellers results.<sup>27</sup> Further, as marketplace volume decreases, the market is far more susceptible to intentional or unintentional actions taken by the dominant buyers.<sup>28</sup>

This is the case for the cash market in hogs and cattle. Both sectors have three buyers at best, and one at worst, in any given geographic procurement area.<sup>29</sup> If a plant shuts down or a packer pulls out of the market for other reasons, prices suffer. Glenn Grimes, an agricultural economist with the University of Missouri, reported in August 2001 that 83% of hogs were committed to packers due to ownership or contract arrangements.<sup>30</sup> This scenario leaves a very thin open market volume in which 17% of the hogs were traded in the open market. The beef industry is also trending towards thinner open market volume. A report released by USDA's Grain Inspection, Packers & Stockyards Administration on January 11, 2002, revealed that 32.3% of the annual cattle slaughter was commit-

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DETERMINATION IN SLAUGHTER CATTLE PROCUREMENT (1996), available at <http://www.usda.gov/gipsa/pubs/packers/conc-rpt.htm> (last visited June 4, 2002) [hereinafter USDA-GIPSA, PRICE DETERMINATION].

27. See, e.g., James M. MacDonald et al., *Competition and Prices in USDA Commodity Procurement*, 69 S. ECON. J. (forthcoming 2002); RICHARD J. SEXTON, FED CATTLE PROCUREMENT INVESTIGATION IN THE TEXAS PANHANDLE (1999), at <http://www.usda.gov/gipsa/programssp/txpeer/RichardSexton.pdf> (last visited June 6, 2002) (peer review of the GIPSA investigation of cattle procurement in the Texas Panhandle).

28. Concerning the impact of concentration in the hog industry, a group of Purdue University economists have stated,

We see evidence of increased concentration . . . to the point where public vigilance is warranted. Concentration indices are high and may be reaching the point where markdown pricing on hogs will be significant and place producers at a clear disadvantage . . . . Two major policy options are anti-trust activity on the one hand and increasing the market power of hog producers on the other.

PHILIP PAARLBERG ET AL., STRUCTURAL CHANGE AND MARKET PERFORMANCE IN AGRICULTURE: CRITICAL ISSUES AND CONCERNS ABOUT CONCENTRATION IN THE PORK INDUSTRY 11 (Purdue Univ., Staff Paper No. 99-14, 1999) (submitted as testimony to the United States House of Representatives, Committee on the Judiciary, Oct. 20, 1999) (transcript available with author).

29. See HARL, *supra* note 7, at <http://www.econ.iastate.edu/faculty/harl> (discussing the economic consequences of regionally dominant meat packers).

30. See LAWRENCE & GRIMES, *supra* note 7, available at <http://www.econ.iastate.edu/research/webpapers/staffpapr343FNL.pdf> (stating that a January 2001 survey suggested that 17% of hogs were bought on the cash market; remainder procured by some type of marketing agreement).

ted to packers through ownership or contract arrangements.<sup>31</sup> Twenty-five percent of that captive supply number (8% of annual slaughter) was packer owned.<sup>32</sup>

Thus, the opportunity exists for buyers to manipulate the open market due to their position as dominant buyers combined with the decreasing volume of those markets.<sup>33</sup> The motive is undeniable because any exercise of market power likely results in decreased procurement prices for packers in both hogs and cattle.<sup>34</sup>

Another key aspect of both the motive and opportunity to strategically affect the market through packer owned and contracted livestock supplies arises from the ability of packers to bid conservatively for livestock or strategically to pull out of the market altogether. When packers have guaranteed supplies for which they need not bid, they have far less incentive to bid aggressively for open market cattle and hogs due to the comfort margin.<sup>35</sup> More significantly, packers have an incentive to schedule the processing of packer owned and contracted livestock in order to affect price trends negatively. Essentially, they have a significantly enhanced ability to pull out of the market while keeping plant capacity at one hundred percent.<sup>36</sup>

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31. See USDA-GIPSA, CAPTIVE SUPPLY OF CATTLE, *supra* note 7, at viii, available at [http://www.usda.gov/gipsa/pubs/captive\\_supply/captivesupplyreport.pdf](http://www.usda.gov/gipsa/pubs/captive_supply/captivesupplyreport.pdf). “Based on its review of the underlying transaction date, GIPSA has estimated that 32.3% of the total 1999 slaughter of the top four packers was procured through captive supply arrangements.” *Id.*

32. See *id.*

33. A packer practice of negotiating for larger numbers of livestock several days in advance of shipment gives packers opportunities to use such livestock in affecting prices paid for such livestock.

34. In mid-April 2001, it was reported that a deliberate packer strategy to decrease slaughter so as to decrease beef supplies and increase packing plant cutouts and margins contributed to lower cash cattle prices. See Rod Smith, *Cattle to Rally, Then Retreat; Hogs, Eggs Down; Butter, Cheese Up*, FEEDSTUFFS, Apr. 16, 2001, at 22.

35. A significant question is whether such a practice violates the Packers and Stockyards Act (“PSA”). Indeed, on December 26, 2001, the Federal District Court for the Middle District of Alabama certified a nationwide class action against IBP on the legal question of whether IBP’s use of captive supply violates §§ 192(a), (d) and (e) of the PSA. See *Pickett v. IBP, Inc.*, No. 96-A-1103-N, 2001 U.S. Dist. LEXIS 22453 (M.D. Ala. Dec. 21, 2001). The claim is that IBP’s privately held store of livestock (via captive supply) allows IBP to avoid reliance on auction-price purchases in the open market for most of their supply. IBP then uses this leverage, the claim is, to depress the market prices for independent producers on the cash and forward markets in violation of the PSA. The court specifically noted that the plaintiffs had demonstrated that they possessed a “workable economic analysis” to determine the effect of captive supply on cash market prices. *Id.* At \*30.

36. A 1996 USDA-GIPSA funded report predicted this result by stating,

The motive for strategic behavior by dominant firms in the hog and cattle sectors is further increased by the fact that the cash market is the primary price discovery point for formula contracts and marketing agreements. Formula contracts and marketing agreements are generally tied to the cash market through some sort of formula. Thus if the cash market declines, packers pay less for livestock whether procured through the cash market or contract.<sup>37</sup>

A significant number of economic studies of the issue have found that increases in supplies of livestock that are committed to the dominant packing firms through ownership or contract are correlated with lower prices in the cash

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What are the implications (of increased ownership and contracting) for spot markets? Terminal and auction markets for market hogs, dealers, and order buyers would decline rapidly in volume, following current trends. Spot markets for the residual supply and demand would become more thinly traded, and probably more volatile as the "shock absorber" for unanticipated changes in supply and demand. Price reporting would become more difficult, and concern about price manipulation would escalate as relatively small changes in the behavior of large market participants more likely could have an impact on reported market prices. If long-term arrangements become dominant, the probable impacts would include: . . . less spot market volume, with associated problems of more limited market access for small producers and increased short-term price volatility for their hogs . . .

Marvin Hayenga et al., *Vertical Coordination in Hog Production*, in CONCENTRATION IN THE RED MEAT PACKING INDUSTRY (1996), available at

<http://www.usda.gov/gipsa/pubs/packers/conc-rpt.htm> (last visited June 5, 2002).

37. On the incentive for packers to manipulate the market to which their contracts are tied, Virginia Tech University agricultural economist Wayne Purcell stated the following:

Contracts with a formula arrangement where the base price is either a cash market in which the packer/processor is an active buyer or a plant average price paid for the week prior to delivery offer the wrong incentives. Whether 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.

Wayne D. Purcell, *Contracts and Captive Supplies in Livestock: Why We Are Here, Implications, and Policy Issues*, Report Presented at the Denver Captive Supply Forum (Sept. 2000), at <http://www.usda.gov/gipsa/forum/purcell.htm> (last visited Apr. 20, 2002).

On March 15, 2002, Senator Enzi (R-WY) introduced S. 2021 into the Senate in an attempt to address the price manipulation problem. S. 2021 would amend the Packers and Stockyards Act by prohibiting certain kinds of forward contracts. The legislation focuses on formula pricing in forward contracts and prohibits contracts that do not have a firm base price equated to a fixed dollar amount at the time a contract is signed. The bill permits prices based on a futures market price and allows for premiums paid for factors outside the packers' control such as grade and product quality. The bill establishes criteria to ensure that formula-pricing and forward marketing contracts are traded in open markets and, to accomplish that end, requires that any buyer and seller be given the chance to participate. In the event of blind bids, more than one bid must be solicited. In addition, buyers and sellers are permitted to witness bids that are offered and accepted. *See* S. 2021, 107th Cong. (2002).

market.<sup>38</sup> Though some have claimed that correlation is not causation, those arguments are not credible. Further, it is important to note that the economic studies are not able to detect collusion or intent to manipulate a market because economists do not have the tools or the data for such inquiries. The strongest result is a consistent correlation between the problematic or strategic conduct and a negative result.

Lastly, evidence of how market power can be used by meat packers can be found in bidding practices. The few dominant buyers, if they buy in the same area, can develop practices that ultimately minimize competition. For example, in the Texas Panhandle region, the following particularly troubling aspects of bidding practices have been demonstrated:

- **The convention of bidding only whole dollar amounts per hundred pounds of live cattle weight.** University of California-Davis agricultural economist Richard Sexton estimated that this practice cost producers approximately \$25 million in lost revenues during the roughly 15-month period of data collection for the Panhandle study.<sup>39</sup>

- **Use of a queuing mechanism to distribute cattle to buyers, wherein the first bidder has priority in the case of tie bids.** A related problem is that the first bidder in line is given an opportunity to revise his bid in the event that someone bids higher. Thus, the key feature in securing the cattle is not to make a high bid but, rather, to secure the first bid. It need not be the buyer's "best" bid because the buyer will be able to revise the bid in the event that a higher bid is received. It is probably easy for buyers to agree to queuing conventions among

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38. For example, a report of the USDA Grain Inspection, Packers & Stockyards Administration has found that through contractual arrangements (forward contracting, marketing agreements and packer-fed cattle), packers can obtain livestock two or more weeks before slaughter. The report estimated that a 1% increase in a packer's inventory of forward contracted cattle on any given day is associated with lower prices (three to five cents per hundredweight) paid for cattle in the cash market. With captive supplies running as high as 70% in some weeks, the economic impact could be as high as \$25 to \$50 per head of cattle sold. Clement E. Ward et al., *Role of Captive Supplies in Beef Packing*, in CONCENTRATION IN THE RED MEAT PACKING INDUSTRY (1996), available at <http://www.usda.gov/gipsa/pubs/packers/conc-rpt.htm#chap3> (last visited June 5, 2002).

39. SEXTON, *supra* note 27, at <http://www.usda.gov/gipsa/programsp/txpeer/RichardSexton.pdf> (last visited June 6, 2002) (peer review of the GIPSA investigation of cattle procurement in the Texas Panhandle). A similar convention by the stockbrokers who were market makers on the NASDAQ stock exchange resulted in civil antitrust damages of more than \$1 billion as to those stock brokers. In re NASDAQ Market-Makers Antitrust Litigation, 176 F.R.D. 99 (S.D. N.Y. Oct. 14, 1997). For additional discussion of the case, see *Price Fixing: \$1 Billion Settlement is Approved in Suit Against NASDAQ Market-Makers*, Antitrust & Trade Reg. Rep. (BNA) No. 1885 (Nov. 12, 1998).

themselves. These mechanisms, which would be difficult to maintain in a competitive environment, serve effectively to allocate the cattle among the packers.

Additionally, packer-to-packer trades can be a method of collusion. When packers own and raise livestock, they can sell that livestock to other packers thereby both affecting the market price and communicating that price to each other. Smithfield Foods, for example, purchased Murphy Farms and Carroll Foods. Many of the former Murphy hogs were, and continue to be, sold to IBP. This constitutes ongoing price communication between Smithfield and IBP via sales transactions that appear relatively innocent upon first observation.<sup>40</sup>

### C. *The Effectiveness of Government Enforcement Agencies*

The current enforcement regime has proved unequal to the task of promoting competition and reducing the anticompetitive effects of both industry structure and industry conduct.<sup>41</sup> Case law and past USDA administrative decisions have narrowed the scope of the PSA dramatically.<sup>42</sup> Further, USDA's

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40. The proposed legislation would remove the ability of packers to manipulate the market in this manner. Other legislative remedies would be appropriate for other practices.

41. U.S. GEN. ACCOUNTING OFFICE, PACKERS AND STOCKYARDS PROGRAMS: ACTIONS NEEDED TO IMPROVE INVESTIGATIONS OF COMPETITIVE PRACTICES 4-5 (Sept. 2000)(GAO/RCED-00-242), available at <http://www.gao.gov> (last visited Sept. 6, 2002) (summarizing a 1997 report of USDA's Office of Inspector General concerning the Packers and Stockyards Act that found serious problems in the enforcement of the law with respect to anticompetitive practices). The GAO report concluded that despite substantial reorganization, serious problems remained. *Id.* at 21-22. See also Lawrence J. Dyckman, Director of Food and Agricultural Issues of the U.S. General Accounting Office, Testimony before the Subcommittee on Administrative Oversight and the Courts, Senate Judiciary Committee, available at [http://www.senate.gov/~judiciary/oldsite/9252000\\_ld.htm](http://www.senate.gov/~judiciary/oldsite/9252000_ld.htm) (last visited Sept. 9, 2002).

42. See, e.g., *Corona Livestock Auction v. USDA*, 607 F.2d 811 (9th Cir. 1979) (reversing order of Secretary on basis that findings of fact made without the factually based evaluation necessary to show required injury); *Cent. Coast Meats, Inc. v. USDA*, 541 F.2d 1325 (9th Cir. 1976) (stating Secretary must show that conduct in question is likely to produce the sort of injury the Act is designed to prevent); *Armour & Co. v. United States*, 402 F.2d 712 (7th Cir. 1968) (setting aside judicial officer's finding that a regional discount coupon promotion violated the Act; court held the Secretary did not have authority to regulate various sales methods); *Swift & Co. v. Wallace*, 105 F.2d 848 (7th Cir. 1939) (setting aside Secretary's order requiring packer to cease and desist from giving "unreasonable preferences" in price and credit terms; court held Secretary failed to take into account relevant factors of competition and that packer had not acted in bad faith); *Griffin v. Smithfield Foods, Inc.*, 183 F. Supp. 2d 824 (E.D. Va. 2002) (upholding defendant's practice of acquiring hogs through contractual arrangements and direct ownership on basis that defendant engaged in such transactions with purpose of competing more effectively and because plaintiff's offered only speculative damages); *In re Palmer*, 50 Agric. Dec. 1753 (1991) (Judicial Officer abandoned severe sanctions policy in favor of case by case analysis). The court in *Griffin*

Grain Inspection, Packers & Stockyards Administration has lacked the resources and talent effectively to litigate major competition cases, or minor ones, against highly paid and experienced lawyers for the industry. In fact, the USDA has not won a major competition case for at least two decades—despite the fact that USDA believed certain practices were illegal. For example, while the USDA believes that the bid queuing practice (right of first refusal) discussed above minimizes price competition, and has held that such a practice does violate the PSA, that position has not been sustained on appeal.<sup>43</sup> In addition, the USDA determined that Cargill/Excel changed its premium structure for hogs in 1997 and 1998 without telling hog producers. The result was a loss to those producers of approximately \$2.9 million. The administrative law judge for the USDA agreed, but refused to assess a penalty.<sup>44</sup> While the USDA is appealing that refusal, it is clear that the deterrent factor is severely lacking.

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made no effort to analyze anti-competitive effects of defendant's conduct, failed to note that PSA proscribes packer conduct having "the purpose *or . . . effect* of manipulating or controlling prices, or . . . creating a monopoly" as stated in 7 U.S.C. §192(e) (2000), and failed to note that other courts have held that PSA does not require proof of any particular injury (emphasis added). *See Bowman v. USDA*, 363 F.2d 81, 85 (5th Cir. 1966) (quoting *Daniels v. United States*, 242 F.2d 39, 42 (7th Cir. 1957), *cert. denied*, 354 U.S. 939 (1957)).

43. *See IBP, Inc. v. Glickman*, 187 F.3d 974, 976 (8th Cir. 1999). While the Eighth Circuit reversed the USDA's decision, the court recognized that the right of first refusal did reduce the incentive for competitors to bid. The court reasoned that the PSA's language requires that a practice or device be *unfairly or unjustly* discriminatory and not merely discriminatory. The court's reasoning appears flawed inasmuch as the court, to arrive at its holding, relied on the fact that the packer paid more for the cattle at issue than it did for other cattle. Without significantly more information concerning the mechanics of the residual market, the comparison by the court appears meaningless. Thus, by having a right of first refusal and controlling the contract supply, the packer could also suppress price competition in the spot market precisely because it has a lock on the contract market. While the court claimed to recognize that the PSA prohibited the conduct at issue based on the conduct's potential to undermine competitive markets, the court actually required proof of actual harm which was not developed in the case record. Thus, the court concluded that the right of first refusal involved in the case did not potentially suppress or reduce competition sufficient to be proscribed by the Act.

44. *In re Excel*, 61 Agric. Dec. \_\_\_\_ (2002) (forthcoming).

## III. THE PACKER OWNERSHIP AMENDMENT

A. *The December 13, 2001 Version*

The version of the ban that passed the Senate on December 13, 2001, and became a part of the Senate Farm Bill<sup>45</sup> amended 7 U.S.C. § 192 (§ 202 of the Packers and Stockyards Act of 1921) by adding a new subsection (f) as follows:

It shall be unlawful for any packer with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or for any live poultry dealer with respect to live poultry, to:

(f) Own, feed, or control livestock intended for slaughter (for more than 14 days prior to slaughter and acting through the packer or a person that directly or indirectly controls, or is controlled by or under common control with, the packer), except that this subsection shall not apply to –

(1) a cooperative or entity owned by a cooperative, if a majority of the ownership interest in the cooperative is held by active cooperative members that –

(A) own, feed, or control livestock; and (B) provide the livestock to the cooperative for slaughter; or

(2) a packer that is owned or controlled by producers of a type of livestock, if during a calendar year the packer slaughters less than 2 percent of the head of that type of livestock slaughtered in the United States . . .<sup>46</sup>

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45. See The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2001).

46. See *id.* (amendment No. 2534).

In a paper dated January 14, 2002, eight economists, none of whom are lawyers, interpreted the legislation as prohibiting pork and beef packers from making *any* arrangement with livestock producers to acquire their livestock more than two weeks prior to slaughter.<sup>47</sup> The economists opined that the prohibition would include forward contracts, marketing agreements, contracts containing any promise of delivery, and would result in producers having no legally assured market for their livestock before the last two weeks preceding slaughter.<sup>48</sup> The economists further assumed, based on their interpretation of the statutory language that alliances in which packers participate with producers would also be banned.<sup>49</sup> Based on their interpretations and assumptions concerning the statutory language, the economists predicted that the beef and pork sectors would become less efficient and less competitive due to the loss of contracting rights and alliances.<sup>50</sup>

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47. See Dillon Feuz et al., Comments on Economic Impacts of Proposed Legislation to Prohibit Beef and Pork Packer Ownership, Feeding, or Control of Livestock 1 (Jan. 14, 2002) (unpublished paper), *available at* <http://www.econ.iastate.edu/faculty/Lawrence/Acrobat/JohnsonAmendment.pdf> (last visited June 5, 2002).

48. *Id.*

49. *See id.*

50. *See id.* Interestingly, most of the authors of the report have significant ties to the livestock packing industry and several have received compensation from livestock packers for consulting work done on behalf of the packers. Indeed, at the time the paper was released, one of the authors was serving as an expert witness for IBP, Inc. in a federal class action lawsuit involving the legal issue of whether IBP's use of captive supply violates §§192(a), (d) and (e) of the Packers and Stockyards Act. *See* Pickett, 2001 U.S. Dist. LEXIS 22453. The authors did not disclose any of these facts. The non-disclosure concerns surrounding the economists' paper spurred, at least in part, the introduction of legislation into the Kansas Senate on February 12, 2002, requiring public disclosure of such matters. Senate Bill 570 would have prohibited, beginning January 1, 2003, any unclassified employee of a state university from acting as a consultant unless the employee files a disclosure statement with the local information officer of such university or at a location designated by the Kansas Board of Regents within ten business days after the contract had been signed. The statement would be an open record and retained for five years after the employee had left the university. S.B. 570, 2001-2002 Leg., 2002 Sess. (Kan. 2002), *available at* <http://www.kslegislature.org/bills/2002/570.pdf> (last visited Sept. 6, 2002). On February 15, 2002, the chair of the Senate Committee on Elections and Local Government cancelled the hearing on the bill.

House Bill 3013 was introduced on March 8, 2002, containing language nearly identical to S.B. 570, but adding language protecting information covered by the attorney-client and doctor-patient privilege. H.B. 3013, 2001-2002 Leg., 2002 Sess. (Kan. 2002), *available at* <http://www.kslegislature.org/bills/2002/3013.pdf> (last visited Sept. 6, 2002). A hearing on the bill was held on March 21, and the House Ethics and Elections Committee passed the bill the same day. *See* Full History of Bill 3013, *available at* <http://www.kslegislature.org/cgi-bin/billtrack/index.cgi>

### 1. *Construing the Statutory Language – The Meaning of “Control”*

In their paper, the economists base their entire analysis, without any supporting documentation, on the assumption that the statutory prohibition of “control” of livestock will prohibit all types of marketing contracts, including forward contracts.<sup>51</sup> They then focus their entire argument against the proposed legislation based on claims of harm to various kinds of contractual arrangements used in the livestock industry.<sup>52</sup> Interestingly, however, the economists never once even suggest that packers need to actually own or control livestock in order to accomplish any of the specific objectives that they identify as crucial to achiev-

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(last visited Sept. 6, 2002). However, H.B. 3013 was not allowed to be debated on the House floor by the speaker (who is from Manhattan, the home of Kansas State University) and remained on the calendar for the remainder of the legislative session, where it formally died on May 16, 2002. *See Full History of Bill 3013, available at* <http://www.kslegislature.org/cgi-bin/billtrack/index.cgi> (last visited Sept. 6, 2002).

House Bill 2959, a bill concerning the Kansas Open Records Act and disclosure of information, was in the Senate Utilities Committee when H.B. 3013 was heard in the House. The Senate Utilities Committee incorporated the consulting disclosure language of H.B. 3013 into H.B. 2959, but the consulting disclosure language was opposed strongly behind the scenes by the President’s Office at Kansas State University and the Kansas Board of Regents. The Senate majority leader (also from Manhattan) refused to allow H.B. 2959 to be debated in the Senate, and the bill died on May 15, 2002. *See Full History of Bill 2959, available at* <http://www.kslegislature.org/cgi-bin/billtrack/index.cgi> (last visited Sept. 6, 2002).

On May 7, 2002, the consulting disclosure language of H.B. 2959 was added to S.B. 647, a bill concerning higher education. On May 8, the House passed the bill in final action and sent it to the Education Conference Committee. *See Full History of Bill 647, available at* <http://www.kslegislature.org/cgi-bin/billtrack/index.cgi> (last visited Sept. 6, 2002). House and Senate rules require language to be passed in one camera before it can be a subject in any conference committee. House and Senate Utility Conference Committee members had agreed to insert both the consulting disclosure language and the utility security language into the conference committee report on Senate Bill 112. This was done on May 8, 2002, but the speaker (again from Manhattan) would not allow the conference committee report to be voted on. On May 14, the speaker of the House allowed the House to vote on S.B. 112. *See Full History of Bill 112, available at* <http://www.kslegislature.org/cgi-bin/billtrack/index.cgi> (last visited Sept. 6, 2002). The bill passed, but Senators were informed by the Senate majority leader (from Manhattan) that the bill would not run on the Senate floor unless the consulting disclosure language was removed. Meanwhile, the conference committee on S.B. 647 was working on compromise language that the Kansas Board of Regents and the Governor supported. The bill containing the compromise language eventually passed both the House and Senate and was signed by the Governor on May 30, 2002. *See Full History of Bill 647, available at* <http://www.kslegislature.org/cgi-bin/billtrack/index.cgi> (last visited Sept. 6, 2002). The compromise language requires disclosure only in very limited situations.

51. *See Feuz et al., supra* note 47, *available at* <http://www.econ.iastate.edu/faculty/Lawrence/Acrobat/JohnsonAmendment.pdf>.

52. *See generally id.* (discussing implications of prohibiting agreements).

ing economic efficiency and a competitive market. The clear implication of their argument is that the prohibition of actual packer ownership of livestock does not raise any significant efficiency or competition concerns.

Importantly, the amendment's primary sponsor, Senator Tim Johnson (D-SD), offered a formal clarification in the Senate that the word "control" contained in subsection (f) of the proposed amendment is to be interpreted in the context of ownership.<sup>53</sup> Thus, the congressional intent is that the amendment is not to prohibit contracts for future delivery of livestock, but instead prevent packers from owning cattle outright, through a subsidiary, or through arrangements (contractual or otherwise) that give them operational control over livestock except within the last two weeks before slaughter.<sup>54</sup>

From a legal standpoint, "control" issues arise frequently in an agency context in situations involving the need to distinguish between an "independent contractor" and an "employee" for reasons including, but not limited to, liability and taxation.<sup>55</sup> Typically, the existence of an agency relationship is a question of fact for a jury to decide.<sup>56</sup> At its very essence, whether a relationship is an independent contractor relationship or a master-servant relationship depends on whether the entity for whom the work is performed has reserved the right to control the means by which the work is to be conducted.<sup>57</sup> Under many production contract settings, the integrator controls both the mode and manner of the farming operation.<sup>58</sup> The producer no longer makes many of the day-to-day manage-

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53. See 147 CONG. REC. S13,660-61 (daily ed. Dec. 19, 2001) (statement of Sen. Johnson).

54. See *id.* at S13,661.

55. An employee is generally one who works subject to the control of the employer. This usually requires control both with respect to the manner and means of performing the particular job task. In these situations, the employer is responsible for the acts of the employee committed in the scope of the employee's employment. If an employer-employee relationship exists, the employer is responsible for withholding and employment taxes. See, e.g., *Déjà Vu Entm't Enters. v. United States*, 1 F. Supp. 2d 964 (D. Minn. 1998) (employers of an adult entertainment establishment need not pay employment taxes if a reasonable basis for not treating the performers as employees is established under Section 530 of the Internal Revenue Code).

56. See *Carlton v. Ala. Dairy Queen, Inc.*, 529 So. 2d 921, 923 (Ala. 1988).

57. See, e.g., *McEOWEN & HARL*, *supra* note 6, §11.09[1] (discussing the employer's liability to third persons for acts of employees and the master-servant or independent contractor relationship).

58. See generally *Tyson Foods, Inc. v. Stevens*, 783 So. 2d 804, 808-809 (Ala. 2000) (holding Tyson to be in agency relationship with farmer under hog production contract because Tyson specified where hog houses were to be located, the size of each house, mandated the implementation of a waste-management system, visited the farm weekly, provided the hogs, hog feed and veterinary supplies and care).

ment decisions while the integrator controls the production-to-marketing cycle. The integrator is also typically given twenty-four hour access to the producer's facilities.<sup>59</sup> Conversely, forward contracts, formula pricing agreements, and other types of marketing contracts typically do *not* give the integrator managerial or operational control of the farming operation or control of the production-to-marketing cycle. Instead, such contracts commonly provide the packer with only a contractual right to receive delivery of livestock in the future. While it is not uncommon that livestock marketing contracts contain quality specifications, most of those contract provisions relate exclusively to the amount of any premium or discount in the final contract payment for livestock delivered under the contract. Importantly, the manner in which quality requirements tied to price premiums are to be satisfied remains within the *producer's* control.<sup>60</sup> Accordingly, such marketing contracts would likely be held to be beyond the scope of the legislation's ban on packer ownership or *control* of livestock more than two weeks before slaughter. Thus, a packer would still have the ability to coordinate supply chains and assure markets for livestock producers through contractual arrangements provided the contracts do not give the packer operational and managerial control over the livestock producer's production activities.

## 2. *Application to Cooperatives*

Whether the statutory language applies to packer "alliances" with producers would also be judged under the same standard. If a packer merely provides marketing expertise and advantages to producer-members of the alliance, but does not exercise control over the manner in which the livestock are to be produced, insufficient control would be present to subject the activity to the ownership ban under either an agency or partnership theory. This interpretation comports with congressional intent. For example, Senator Grassley (R-IA) stated in debate over the amendment that "[I]t has never been our intent to prevent co-operatives from engaging in relationships with packers, and the amendment does not do that . . . . Co-op members . . . can freely commit all or a portion of their

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59. See generally *id.* (discussing Tyson's agency relationship with farmer).

60. For example, under a formula pricing cattle contract, cattle feeders must adapt their feeder cattle procurement and cattle feeding management practices to produce slaughter cattle that can earn premiums in accordance with the price grid specified in the contract. Under these types of marketing contracts, the cattle feeder remains responsible for making the managerial decisions necessary to receive any price premiums specified in the contract. The packer does not gain substantial operational control over the cattle feeder's production activities.

cattle for slaughter without violating this amendment. *The reason is that the packer . . . exercises no operational control over livestock production.*<sup>61</sup>

### 3. Comparable State Legislation

The packer ownership amendment is also comparable to existing state legislation in several significant livestock producing states.<sup>62</sup> For example, an Iowa statute prohibits any processor of beef or pork from owning, controlling or operating a feedlot in Iowa in which hogs or cattle are fed for slaughter.<sup>63</sup> The legislation, however, does not prevent a processor from contracting for the purchase of hogs or cattle.<sup>64</sup> The provision has never been held to prohibit packers from entering into forward contracts, formula pricing agreements or other types of marketing arrangements with livestock producers so long as control of the farming or ranching operation remains vested in the producer.<sup>65</sup>

The Minnesota provision takes the position that livestock feeding is engaging in farming and, thus, is covered by the corporate farming statute.<sup>66</sup>

Nebraska law prohibits direct or indirect packer ownership of livestock more than five days before slaughter, and has not been held applicable to any type of livestock marketing agreement.<sup>67</sup> *Again, the key to understanding the scope of the statutory provision lies in determining whether the producer remains in decision making control of the farming operation.*

The South Dakota provision is contained in the state constitution as a 1998 amendment prohibiting non-family farm corporate ownership of land or livestock.<sup>68</sup>

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61. 147 CONG. REC. S13,661 (daily ed. Dec. 19, 2001) (statement of Sen. Grassley) (emphasis added).

62. *See, e.g.*, IOWA CODE § 9H.2 (2001); MINN. STAT. § 500.24(3) (Supp. 2001); NEB. REV. STAT. § 54-2604 (Supp. 2001); S.D. CONST. art. XVII, §§ 21-24 (Supp. 2000). On May 16, 2002, the Federal District Court for the District of South Dakota, in a highly suspect opinion, ruled the 1998 amendment an unconstitutional violation of the Supremacy Clause and the Dormant Commerce Clause of the United States Constitution. *See S.D. Farm Bureau v. Hazeltine*, 202 F. Supp. 2d 1020 (D.S.D. 2002).

63. *See* IOWA CODE § 9H.2 (2001).

64. *See id.*

65. Indeed, many various types of marketing contracts are presently in use in Iowa.

66. *See* MINN. STAT. § 500.24(3) (1990 and Supp. 2001).

67. *See* NEB. REV. STAT. ANN. § 54-2604 (Supp. 2001).

68. *See* S.D. CONST. art. XVII, §§ 21-24 (Supp. 2000). On May 16, 2002, the Federal District Court for the District of South Dakota, in a highly suspect opinion, ruled the 1998 amendment an unconstitutional violation of the Supremacy Clause and the Dormant Commerce Clause of the United States Constitution. *South Dakota Farm Bureau, et. al. v. Hazeltine*, 202 F.Supp. 2d

Importantly, the dire consequences the economists predict will occur if the packer ownership amendment ultimately becomes law have not arisen in the livestock sectors of Iowa, Minnesota, Nebraska, or South Dakota since enactment of the comparable legislation in those states.<sup>69</sup>

#### 4. *Contractual Arrangements, Livestock Markets and the Proposed Legislation*

Contractual arrangements and various kinds of alliances can contribute significantly to the development of efficient and competitive livestock production. Importantly, the amendment exempts small firms slaughtering less than two percent of any type of livestock.<sup>70</sup> This is apparently designed to allow small firms and new entrants to experiment and develop their products without having to be concerned about the legal details of the relationship.<sup>71</sup> The legislation also exempts farmer cooperatives where the members are themselves feeders.<sup>72</sup> This expands the range of opportunity for developing new and creative solutions to the challenge of developing improved meat products. In addition, large packers still would have available a full range of contractual opportunities to obtain specific types of livestock designed to meet specific needs. Moreover, such contracts could be drafted to include future delivery times and other elements that facilitate the coordination of the packer and the producer. Thus, contracts that do not impose control over the producer can still provide all the benefits of coordination and end product specification that the economists identify as desirable elements of current arrangements. Indeed, it is likely that most contracts and marketing agreements would not necessarily have to be changed at all.

The central challenge for the very competent lawyers for those buyers that currently use agreements to manage the actual day-to-day operation of producers will be to develop contracts that define the characteristics that are to be delivered without unlawfully limiting the freedom of the producer to select the methods and means of producing those results. The packers, if they are not engaged in strategic conduct or manipulative behavior, should not have any problem in defining the objectives they seek and leaving it to the producer to achieve the desired result. Indeed, a result-oriented system of contracting will free pro-

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1020 (D. S.D. 2002).

69. See 147 CONG. REC. S13,661 (daily ed. Dec. 13, 2001) (remarks by Sen. Johnson).

70. See The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2002) (amendment S.A. 2837 § (a)) (explaining exceptions to the packer ownership ban in the original proposed language).

71. See 147 CONG. REC. S13,661 (daily ed. Dec. 13, 2001).

72. See S. 1731 (amendment S.A. 2837 § (a)) (exempting farms owned by cooperatives to feed livestock).

ducers to substitute livestock from third parties when that is more efficient and practical within the context of the contractually required results. This could have the effect of enhancing competition and fairness in the production of livestock because the packers would not be as able to play one seller against another by refusing to buy directly.

B. *The February 12, 2002 Version*

After passage of the original language on December 13, 2001, concerns were raised about the meaning of the term “control.”<sup>73</sup> In response to these concerns, Senator Grassley (R-IA) introduced amended language into the Senate on February 8, 2002. The Senate approved the amended language on February 12, 2002.<sup>74</sup> The new language would amend § 202 of the Packers and Stockyards Act of 1921<sup>75</sup> by adding a new subsection (f) as follows:

It shall be unlawful for any packer with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or for any live poultry dealer with respect to live poultry, to:

(f) Own, feed, or control 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 that the producer is no longer materially participating in the management of the operation with respect to the production of livestock, except that this subsection shall not apply to—

(1) an arrangement entered into within 14 days before slaughter of the livestock by a packer, or a person that directly or indirectly controls, or is controlled by or under common control with, the packer;

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73. See Feuz et al., *supra* note 47, at 1, available at <http://www.econ.iastate.edu/faculty/Lawrence/Acrobat/JohnsonAmendment.pdf> (last visited June 5, 2002).

74. The final vote was 53-46.

75. See Packers and Stockyards Act of 1921, § 202, 42 Stat. 159 (1921) (current version at 7 U.S.C. § 192 (2001)).

(2) a cooperative or entity owned by a cooperative, if a majority of the ownership interest in the cooperative is held by active cooperative members that –

(A) own, feed, or control livestock; and

(B) provide the livestock to the cooperative for slaughter; or

(3) a packer that is owned or controlled by producers of a type of livestock, if during a calendar year the packer slaughters less than 2 percent of the head of that type of livestock slaughtered in the United States . . . .<sup>76</sup>

This legislation, by its terms, is targeted to: (a) formal ownership by the dominant packing firms and (b) arrangements through which packers exert management authority over the production of livestock, though nominal title remains with the producer, to the extent that the producer no longer materially participates in the management of the operation with respect to the production of livestock.<sup>77</sup> Excluded are all forward contracts, marketing agreements and other non-cash sales arrangements whereby producers maintain material participation over the management of the operation.<sup>78</sup> Also excluded are joint ventures and alliances, except those giving a dominant packing firm ownership or primary management control over the production of livestock.<sup>79</sup> Further, farmer-owned cooperatives and small packers continue to be excluded from coverage under the amended language.<sup>80</sup>

### 1. *The Meaning of “Material Participation”*

In a report commissioned by the National Cattlemen’s Beef Association and the National Pork Producer’s Council and released on March 25, 2002 by the Sparks Company,<sup>81</sup> the authors criticized the “material participation” language in

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76. See S. 1731 (amended) (amendment S.A. 2837).

77. See *id.*

78. See *id.*

79. See *id.*

80. See *id.*

81. See Carole T. DuBois & Kim Essex, *Impacts of the Proposed National Ban on Packer Ownership and Feeding*, National Cattlemen’s Beef Association, at <http://policy.dnsalias.net/sparks> (last visited June 6, 2002).

the amended proposed legislation for not providing a “bright-line” test for “control,” and raised numerous questions about the meaning of the passage in the amended proposed legislation defining “control” in terms of packer involvement in the production process “to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock . . . .”<sup>82</sup>

a. *The Role of Legislation and its Relationship to Administrative Law*

The criticism demonstrates a fundamental lack of understanding of the role of legislation and the relationship of legislation to administrative law. Congress has generally resisted such efforts to provide highly detailed and specific “bright line” tests, particularly when it has legislated with respect to issues relating to the structure of the economy or a specific sector or subsector. As examples—

- Undoubtedly the most venerated statute impinging upon economic activity in the United States, the Sherman Act of 1890, often referred to as the “charter of economic freedom,” which led to major structural changes in the economy, contains not one phrase that could be construed as a bright-line test.<sup>83</sup> That act refers to “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . .”<sup>84</sup> Moreover, the act refers to “attempt to monopolize” and to “conspire with any other person or persons, to monopolize.”<sup>85</sup>

That legislation has stood the test of time and has provided the necessary statutory framework for numerous price fixing cases,<sup>86</sup> cases alleging attempts to monopolize<sup>87</sup> and intent to monopolize,<sup>88</sup> all without highly specific language in

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82. *Id.*

83. *See* Sherman Act of 1890, ch. 647, 26 Stat. 209 (1890) (current version at 15 U.S.C. §§ 1-7 (2000)).

84. 15 U.S.C. § 1 (2000).

85. *Id.* § 2.

86. *See, e.g.,* N. Pac. Ry. Co. v. United States, 356 U.S. 1 (1958); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); United States v. Joint-Traffic Ass’n, 171 U.S. 505 (1898); United States v. Trans-Missouri Freight Ass’n, 166 U.S. 290 (1897); *In re* High Fructose Corn Syrup Antitrust Lit., 295 F.3d 651 (7th Cir. 2002).

87. *See, e.g.,* United States v. Empire Gas Corp., 537 F.2d 296 (8th Cir. 1976), *cert. denied*, 429 U.S. 1122 (1977); Lorain Journal Co. v. United States, 342 U.S. 143 (1951); Am. Tobacco Co. v. United States, 328 U.S. 781 (1946); Swift & Co. v. United States, 196 U.S. 375 (1905).

88. *See, e.g.,* William Inglis & Sons Baking Co. v. ITT Cont’l Baking Co., 668 F.2d

the statute. Indeed, the vitality of the Sherman Act has been its careful construction of a legal framework for evaluating economic questions of structure.

- The Clayton Act of 1914<sup>89</sup> provided the first statutory framework for challenging mergers without mention of the four-firm concentration ratio, the Herfindahl Index<sup>90</sup> or other “bright-line” test. The statute simply specified that mergers were proscribed that might “substantially lessen competition or tend to create a monopoly.” That language, with only minor amendments, continues to serve as the basic framework for evaluating proposed mergers.

- The Federal Trade Commission Act of 1914<sup>91</sup> refers to “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce.”<sup>92</sup> That language hardly qualifies as a “bright-line” test.

- The Packers and Stockyards Act of 1921,<sup>93</sup> a very broad regulatory statute, makes it unlawful for any packer, live poultry dealer or handler, market agency, or livestock dealer “to engage in or use any unfair, unjustly discriminatory, or deceptive practice...”<sup>94</sup> Again, that hardly measures up to a “bright-line” test.

- The Capper-Volstead Act of 1922,<sup>95</sup> another statute designed to alter the economic playing field, authorized producers to act collectively except where “the price of any agricultural product is unduly enhanced . . . .”<sup>96</sup> It is likely that some critics probably raised an objection and argued for a bright-line test then. Wisely, the Congress did not follow what would certainly have been viewed as unwise advice.

1014 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982); *Knutson v. Daily Review*, 548 F.2d 795 (9th Cir. 1976), *cert. denied*, 433 U.S. 910 (1977).

89. See Clayton Act, ch. 323, 38 Stat. 730 (1914) (current version at 15 U.S.C. §§ 12-27 (2000) and 29 U.S.C. §§ 52-53 (2000)).

90. This is the so-called “H index”, so named for its inventors Orris Herfindahl and Albert Hirschman. The index is the sum of the squares of the sizes of firms in a market, in which sizes are expressed as a proportion of total market sales (or assets, or employment). See generally A.O. Hirschman, *The Paternity of an Index*, 54 AM. ECON. REV. 761 (1964).

91. Federal Trade Commission Act, ch. 310, 38 Stat. 716 (1914) (current version at 15 U.S.C. §§ 41-51 (2000)).

92. 15 U.S.C. § 45(a)(1) (2000).

93. See Packers and Stockyards Act of 1921, ch. 64, 42 Stat. 159 (1921) (current version at 7 U.S.C. §§ 181-231 (2000)).

94. 7 U.S.C. §§ 192(a), 213(a) (2000).

95. Capper-Volstead Act, ch. 57, 42 Stat. 388 (1922) (current version at 7 U.S.C. §§ 291-92 (2000)).

96. 7 U.S.C. § 292 (2000).

The Congress in respecting the constitutional separation of powers, grants to the Executive Branch of Government the rule making power as well as the general enforcement power of such statutes, with authority to publish and to make final detailed implementing regulations. Indeed, it is widely understood that Congress is not well-advised to enact highly detailed (and necessarily rigid) “bright-line” tests in this or any other area of the law.

b. *The Use of “Material Participation” Language*

The important question is how accurately the statutory language reflects congressional intent as to packer “control” over livestock.<sup>97</sup> The language prohibits packer involvement in the production process to “such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock.”<sup>98</sup> The proposed amendment states forthrightly that packers would be precluded from dominating the production process to such an extent that a producer is no longer participating materially in management.<sup>99</sup> Stated in a slightly different fashion, the Senate bill would, if enacted in the revised form, be properly interpreted as precluding contracts or other arrangements that reduce the producer to a mere laborer with no involvement in management or a level of involvement in management that is not material.<sup>100</sup>

The term “material participation” has a long history in agriculture as well as in other sectors of the economy. Each time Congress has visited or revisited this area, the legislation enacted has used language sparingly. For example, in 1956, Congress enacted an amendment to Section 1402 of the Internal Revenue Code to enable farm landowners to participate in the social security program.<sup>101</sup> The amendment simply referred to “material participation” by the landowner in the production of agricultural or horticultural commodities. Regulations subse-

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97. 147 CONG. REC. S13,660-61 (daily ed. Dec. 13, 2001) (statements of Sen. Grassley and Sen. Johnson).

98. 148 CONG. REC. S601 (daily ed. Feb. 8, 2002) (statement of Sen. Grassley).

99. See generally *id.* at S601-02.

100. See *id.*; see generally Neil D. Hamilton, Why Own the Farm If You Can Own the Farmer (and the Crop)?: Contract Production and Intellectual Property Production of Grain Crops, 73 NEB. L. REV. 48 (1994) (discussing the perils of contract production in the context of grain production).

101. 70 Stat. 840 (codified as amended at 26 U.S.C. § 1402).

quently adopted by the United States Treasury have provided detailed guidance for that particular application of the term.<sup>102</sup>

In 1986, Congress, in enacting the passive loss rule, made it clear that the guideline should be more demanding than merely “materially participating” and so defined “materially participating” on a basis which is “(A) regular, (B) continuous, and (C) substantial.”<sup>103</sup> Again, Congress signaled that the test should be more demanding in the setting of passive losses and the regulations and cases have reflected that Congressional enactment.<sup>104</sup>

The revised language of the amendment communicates clearly that the administrative agency with the rule-making power is expected to develop implementing regulations but the message is that producers’ involvement in management must not be diminished below a “material” level.<sup>105</sup>

The language employed communicates, as has been done before, how the rule is to differ from the “material participation” rule used in other settings and for other purposes.<sup>106</sup> The proposed provision would be in the tradition of legislation leveling the economic playing field dating back to the Sherman Act of 1890.<sup>107</sup>

Just as the language in the Sherman Act, the Clayton Act,<sup>108</sup> and other enactments since has demonstrated, divestitures have been ordered, mergers have been challenged and halted and those convicted of price fixing have been sentenced to incarceration and substantial fines and civil penalties on the basis of something less than a “bright-line” test in the basic legislation.

Greater specificity is neither desirable nor recommended at the legislative level.

It is noted that Iowa,<sup>109</sup> as well as Minnesota,<sup>110</sup> Nebraska,<sup>111</sup> and South Dakota,<sup>112</sup> have state-level bans on packer ownership of livestock. The Iowa pro-

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102. See Treas. Reg. § 1.1402 (as amended in 1974).

103. 26 U.S.C. § 469(h)(1) (2000).

104. See generally *id.* § 469; Mona L. Hymel, *Tax Policy and the Passive Loss Rules: Is Anybody Listening?*, 40 ARIZ. L. REV. 615 (1998).

105. See 26 U.S.C. § 469(l) (2000). History has shown that greater specificity by Congress would be unwise, imprudent, and would diminish the life of the provision. Moreover, it is the role and responsibility of the Executive Branch, not the Legislative Branch, to provide detailed, implementing guidance for such provisions.

106. See 26 U.S.C. § 469(h)(1) (2000).

107. See Sherman Act, ch. 647, 26 Stat. 209 (1890) (current version at 15 U.S.C. §§ 1-7 (2000)).

108. Clayton Act, ch. 323, 38 Stat. 730 (1914) (current version at 15 U.S.C. §§ 12-27 (2000) and 29 U.S.C. §§ 52-53 (2000)).

109. See IOWA CODE § 9H.2 (2001).

vision for example imposed a ban several years ago making it “unlawful for any processor of beef or pork to own, control or operate a feedlot in Iowa in which hogs or cattle are fed for slaughter.”<sup>113</sup> That language, while providing even less of a “bright-line” test, has not caused problems in Iowa, a leading livestock feeding state, particularly in hogs.

#### IV. CLAIMS AGAINST THE LEGISLATION

The meat packing industry and numerous land-grant university livestock economists have argued strenuously against the legislation,<sup>114</sup> with their arguments based largely on the supposition that the legislation would eliminate all livestock marketing contracts.<sup>115</sup>

The major claims that have been made against the legislation are addressed in this section.

**Claim #1:** The legislation would make it illegal for livestock producers and packers to establish shared risk arrangements.

**Response:** Most captive supplies are not shared risk arrangements. Rather, they are contracts tying the delivery price to either the cash or futures market. Price risk remains with the producer and is not borne by the packer. To the

110. See MINN. STAT. ANN. § 500.24(3) (West 2001). Minnesota takes the position that livestock feeding is engaging in farming and thus is covered by the corporate farming statute. See *id.* at § 500.24(2) &(3).

111. See NEB. REV. STAT. § 54-2604 (2001).

112. See S.D. CONST. art. XVII, §§ 21-24. On May 16, 2002, the Federal District Court for the District of South Dakota, in a highly suspect opinion, ruled the 1998 amendment an unconstitutional violation of the Supremacy Clause and the Dormant Commerce Clause of the United States Constitution. See *S.D. Farm Bureau v. Hazeltine*, 202 F. Supp. 2d 1020 (D. S.D. 2002).

113. IOWA CODE § 9H.2 (2001).

114. See, e.g., *New Report Concludes Packer Ownership Proposal Could Cost Cattle Industry \$3.5 Billion*, NCBA NEWS, Mar. 18, 2002, at <http://www.beef.org/> (under Industry News Archives link) (last visited June 10, 2002) (quoting Terry Stokes, CEO of the NCBA, stating that the “[National Cattlemen’s Beef Association] is opposed to the Johnson Amendment because of the economic devastation it could cause cattle and ranching operations”); see generally Feuz et al., *supra* note 47, available at <http://www.econ.iastate.edu/research/abstracts/NDN0124.pdf> (arguing that prohibiting packer ownership would have a negative impact on beef and pork sectors); Steve Meyer et al., *Prohibition on Beef Packer Ownership, Feeding and Control of Cattle: Comments and Discussion*, Texas Cattle Feeders Association, at <http://www.tcfa.org/LMIC%20Packer%20ban%201-02.pdf> (last visited Sept. 12, 2002) (discussing the negative impacts of a proposed ban on packer ownership).

115. See Feuz et al., *supra* note 47, available at <http://www.econ.iastate.edu/faculty/Lawrence/Acrobat/JohnsonAmendment.pdf> (assuming the legislation would ban any arrangement with livestock producers two weeks prior to slaughter); see also Meyer et al., *supra* note 114.

minimal extent that “shared risk” arrangements exist, they do not violate the amendment if the packer does not own the livestock or exercise management control over the production operation to the extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock.<sup>116</sup> In addition, interested parties could control risk by use of hedging on the Chicago Mercantile Exchange.

**Claim #2:** The legislation is unwarranted.

**Response:** Packers utilize multiple mechanisms to strategically affect the market in their favor. The motive and opportunity exists for them to do so.<sup>117</sup> Packer ownership of livestock is one of the tools that enables strategic scheduling to affect the cash price, and derivatively, the price of livestock procured through contracts tied to the cash market.<sup>118</sup> The recent USDA/GIPSA captive supply report released January 11, 2002 found that 25% of captive supplies in beef are packer owned.<sup>119</sup> In the hog industry, the packer owned portion in some geographic markets is extremely high while the national market share is estimated at nearly one-fourth of the total slaughter.<sup>120</sup>

**Claim #3:** There have been no hearings and no studies of the issue.

**Response:** The red meat industry has been one of the most studied industries over the past century. In the 1990s, several studies from USDA have emerged on many aspects of the concentration, contracting and ownership issues. There have been several hearings in the Congress in recent years concerning concentration and competition in the livestock sector.<sup>121</sup> These hearings have in-

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116. See The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2002) (amended); see also 148 CONG. REC. S558 (daily ed. Feb. 8, 2002) (discussing the amendment to Senate Bill 1731 which added the prohibition on packer ownership).

117. See *supra* notes 26-40 and accompanying text.

118. A report of the USDA Grain Inspection, Packers & Stockyards Administration has found that through contractual arrangements (forward contracting, marketing agreements and packer-fed cattle), packers can obtain livestock two or more weeks before slaughter. The report estimated that a 1% increase in a packer's inventory of forward contracted cattle on any given day is associated with lower prices (three to five cents per hundredweight) paid for cattle in the cash market. With captive supplies running as high as 70% some weeks, the economic impact could be as high as \$25 to \$50 per head of cattle sold. Ward et al., *supra* note 38, available at <http://www.usda.gov/gipsa/pubs/packers/conc-rpt.htm#3> (last visited June 5, 2002).

119. See USDA-GIPSA, CAPTIVE SUPPLY OF CATTLE, *supra* note 7, available at [http://www.usda.gov/gipsa/pubs/captive\\_supply/captivesupplyreport.pdf](http://www.usda.gov/gipsa/pubs/captive_supply/captivesupplyreport.pdf). “Based on its review of the underlying transaction date, GIPSA has estimated that 32.3 percent of the total 1999 slaughter of the top four packers was procured through captive supply arrangements.” *Id.*,

120. See, e.g., MacDonald et. al., *supra* note 27.

121. See H.R. CONF. REP. NO. 106-948 (accompanying the 2001 Agricultural Appropriations Bill, Pub. L. No. 106-387); see also Hearings before the Senate Agriculture Committee (Apr.

cluded packer ownership as a significant issue. In addition, a USDA field hearing was held in Denver on September 21, 2000, focusing on captive supplies and packer ownership with regard to proposed rulemaking. Further, there have been many studies of concentration, contracts and packer ownership through USDA and university sources.<sup>122</sup> Packer ownership is one of the several aspects of market power that has been discussed in those studies.<sup>123</sup>

**Claim #4:** The legislation will harm packer/producer alliances and the high-value branded programs they are working together to create, and will harm competition.

**Response:** Contractual arrangements and various kinds of alliances can contribute significantly to the development of efficient and competitive livestock production. For that reason, the amendment leaves unaffected almost all market conduct except for arrangements whereby packers own livestock or exercise management control over the production operation to the extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock.<sup>124</sup> All “alliances” are thus permitted if these two caveats are not violated. For example, a farm cooperative and a dominant firm can jointly operate a packing plant as long as the livestock is procured through a contract. The amendment also specifically permits non-dominant packing firms (that slaughter under two percent of the national slaughter) to enter into arrangements or “alliances” with producers and own livestock.<sup>125</sup> Further, branded programs are unaffected if merely a supply contract is involved.<sup>126</sup>

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27, 2000); Senate Antitrust Subcommittee (Sept. 28, 2000); Senate Appropriations Subcommittee on Agriculture, Rural Development and Related Agencies (May 17, 2001) (on file with author).

122. See, e.g., USDA-GIPSA, PRTCE DETERMINATION, *supra* note 26; USDA-GIPSA, CONCENTRATION IN THE RED MEAT PACKING INDUSTRY (1996), available at <http://www.usda.gov/gipsa/pubs/packers/conc-rpt.htm> (last visited Apr. 11, 2002); see also SEXTON, *supra* note 27, at <http://www.usda.gov/gipsa/programsp/txpeer/RichardSexton.pdf>

123. Most all of the studies have correlated increases in captive supplies, including packer owned livestock, with lower and more volatile producer prices. Economists do not have the proper tools to go beyond correlation to find collusion or intentional strategic behavior. The evidence is as strong as economists can produce. Non-agricultural literature on industry structure and conduct informs us as to the conclusion that a prohibition of packer ownership is likely to improve the competitive environment. See, e.g., F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 522-23 (3d ed. 1990).

124. See The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2002) (amended).

125. See *id.*

126. There is no credible evidence that “alliances” or branded programs will be deterred in any way. In addition, large packers still would have available a full range of contractual opportunities to obtain specific types of livestock designed to meet specific needs. Moreover, such contracts could be drafted to include future delivery times and other elements that facilitate the coordi-

**Claim #5:** The legislation would have a large detrimental economic impact.

**Response:** On one hand the dominant firms and industry apologists claim that the percentage of supplies packers own is insignificant.<sup>127</sup> On the other hand, they argue that a huge negative economic impact will result. The argument that the amendment threatens investment in quality control and market development has little basis in fact. Investment in quality control as to live animals has occurred consistently for years through education by universities, checkoff programs, third party agri-advisory services and packers. Investment in market development has also occurred uninterrupted for years through the same sources.<sup>128</sup> There is no evidence that packer ownership of livestock is either the best or even an appropriate method to achieve any such gains that may or may not be proved.<sup>129</sup>

**Claim #6:** The legislation would force the divestiture of some of the largest cattle feeding businesses and would cause a precipitous drop in feeder cattle prices.

**Response:** The amendment is written to provide a divestiture period that is as generous, or more generous, than large divestitures arising under antitrust law in other sectors.<sup>130</sup> Packers have 180 days to divest cattle and sheep and eighteen months to divest swine.<sup>131</sup> Most antitrust divestitures provide for six months.<sup>132</sup> For example, the divestiture resulting from the 1998 Cargill-Continental Grain settlement with the Department of Justice provided for six

nation of the packer and the producer. Contracts that do not strip the producer of material participation in the management of the operation with respect to livestock production can still provide all the benefits of coordination and end-product specification that are commonly identified as desirable elements of current arrangements.

127. See, e.g., Meyer et al., *supra* note 114, available at <http://www.tcfa.org/LMIC%20Packer%20ban%201-02.pdf> (stating that “packers own a very small percentage of cattle”).

128. All parties—universities, checkoff programs, third party agri-advisory services and packers—claim credit for any gains therefrom.

129. Indeed, the prohibition of actual packer ownership of livestock does not raise any significant efficiency or competition concerns.

130. The Antitrust Division of the Department of Justice typically gives the parties six months to divest assets in a merger case. The six month period begins when the court order of divestiture becomes final, which normally takes three to four months. See ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 380 (5th ed. 2002).

131. See The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2002) (amended); see also 148 CONG. REC. S558 (daily ed. Feb. 8, 2002) (stating the effective date in subsection (b) of the amendment).

132. See ABA SECTION OF ANTITRUST LAW, *supra* note 130, at 380.

months to divest several large river, rail and port facilities for grain handling and storage.<sup>133</sup>

The claim that feeder cattle prices will diminish fail to take into account: (1) new entrants to the feeder cattle market who would likely bid to fill slaughter demand; and (2) the fact that feeder prices are tied to breakevens resulting from the cash slaughter market. Consequently, packer slaughter capacity should not be anticipated to change as a result of the amendment. If packers do not own the cattle to be slaughtered, they will bid for the feeder cattle to fill the void. Because feeder prices are determined from predicted breakeven analyses derived from the steer and heifer market, it is unreasonable to assume that a drop in the feeder cattle market would arise or persist.

**Claim #7:** The legislation would harm cattle feeders in regions served by fewer packing plants.

**Response:** Because the amendment does not ban contractual arrangements if the packer does not own the livestock or exercise management control over the production operation to the extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock, packing plants could, via contract, still ensure a supply of livestock.<sup>134</sup> Ownership interests are simply not the only (or even the best) way to obtain longer-run supplies and develop the upstream supply market. In addition, if the plant is small (less than two percent of the national slaughter), the amendment does not apply, so a new entrant could use ownership as part of its entry strategy if such a strategy is deemed essential.<sup>135</sup> As to existing plants, a significant question is why they would seek to tie up supply. One effect of such behavior is to make competing entry more difficult. Such plants may actually be engaged in exclusionary behavior by exploiting a low-volume market where there is little or no competition, but if entry by other firms occurred, they would have to pay market prices. Moreover, if a plant is badly managed and does not make proper provision for supplies, it may fail, but its assets will be available for another owner who can make better use of the assets.

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133. See 65 Fed. Reg. 15,982 (Mar. 24, 2000). The divestiture period in the amendment should allow for an orderly exit from the feeding business. Because cattle require a maximum of six months to feed from feeder cattle weight to slaughter weight, packers can be expected to merely consume their own product during the divestiture period while refraining from restocking. The same is true for hogs which require five to six months from birth to slaughter. There is a tremendous economic disincentive for packers to sell cattle or hogs that are not at slaughter weight because the value of those animals prior to slaughter weight is very low.

134. See The Agricultural, Conservation, and Rural Enhancement Act of 2001, S. 1731, 107th Cong. (2002) (amended); see also 147 CONG. REC. S558 (daily ed. Feb. 8, 2002).

135. See S. 1731; see also 147 CONG. REC. S558 (daily ed. Feb. 8, 2002).

**Claim #8:** The required divestiture in the pork industry would have an even more severe economic impact.

**Response:** Again, the industry claims that the volume of packer owned livestock is insignificant at the same time assertions of drastic harm arise.<sup>136</sup> Hog slaughtering companies have been extremely profitable over the past few years.<sup>137</sup> Producers have not been so fortunate.<sup>138</sup> Additionally, the eighteen-month divestiture period for hogs is quite generous inasmuch as it is three times as long as the six-month period of time traditionally allowed in antitrust divestiture cases.<sup>139</sup> Dominant hog packing firms will have both the incentive and the time to maximize the return in the open market on their facilities. Again, the important point is that once the ban is in place, firms subjected to the ban will have sufficient time to adjust business strategy.

**Claim #9:** The export impact would be severe.

**Response:** There is no credible evidence linking packer ownership to export successes. The dominant economic factors in exports of products of given quality are monetary policy (strong or weak dollar), subsidies, tariffs, and the quality of private company marketing staff.

**Claim # 10:** The legislation will accelerate the move of the U.S. industry to our Canadian and Mexican neighbors.

**Response:** Nebraska,<sup>140</sup> Iowa,<sup>141</sup> Minnesota,<sup>142</sup> and South Dakota<sup>143</sup> have some form of packer feeding prohibition. Yet these states have maintained their

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136. See *supra* notes 127-129.

137. For example, Smithfield Foods reports in its 2001 Annual Report that it has averaged 28% profit over the last two decades. The report is available at <http://www.smithfieldfoods.com> (last visited June 19, 2002).

138. See John D. Lawrence, *Summary of Estimated Livestock Returns: 1991-2000*, Iowa State University Department of Economics, available at <http://www.econ.iastate.edu/faculty/Lawrence/EstRet/ESTRET91-00.htm> (last visited June 19, 2002). From 1991 through 2000, average net profit per head was twenty-one cents; 50.9% of the months were profitable and 49.1% of the months were not profitable.

139. See *supra* notes 130 - 132.

140. NEB. REV. STAT. Section 54-2604 prohibits direct or indirect packer ownership of livestock more than five days before slaughter, and has not been held applicable to any type of marketing agreement. NEB. REV. STAT. § 54-2604 (Supp. 2001).

141. IOWA CODE section 9H.2 prohibits any processor of beef or pork from owning, controlling or operating a feedlot in Iowa in which hogs or cattle are fed for slaughter. The legislation, however, does not prevent a processor from contracting for the purchase of hogs or cattle. IOWA CODE § 9H.2 (2001).

142. See MINN. STAT. § 500.24(3)(2001).

143. The South Dakota provision is contained in the state constitution as a 1998 amendment prohibiting non-family farm corporate ownership of land or livestock. See S.D. CONST. art. XVII §§ 21-24 (Supp. 2000). On May 16, 2002, the Federal District Court for the District of South

packing capacity. Stated another way, those state packer feeding prohibitions have not negatively affected the livestock sector in a manner that differs from states without such prohibitions.<sup>144</sup>

Also, the Tariff Rate Quotas (“TRQ”) currently in effect for imports are prohibitive. The current TRQ for beef is 700,000 tons, most of which is filled by Argentina and New Zealand. The “fill rate” on this TRQ is 630,000 tons. That means that any new beef imports coming into the United States will have a very high tariff applied, once the TRQ limit is reached.

Additionally, Mexico is a grain deficit country lacking the feed sources to ramp up production. Also, the traditional breeds of cattle that American consumers prefer to eat would have difficulty surviving and thriving in the hot climate of Mexico. Quality would be significantly affected by a shift to other countries. Lastly, the USDA Food Safety Inspection Service is coming under increasing political and citizen pressure for allowing imports of meat from foreign slaughter plants due to recent reports of unsanitary conditions.<sup>145</sup>

Clearly, the competitive advantage for cattle remains in the U.S. due to basic and fundamental economic factors. The risks and uncertainties arising from shifting plant production to other countries are immense. If the shift occurred, more opportunities for new entrants to the domestic slaughter industry, or growing small firms, would be undeniable.

**Claim #11:** The legislation increases the competitive advantage of poultry.

**Response:** There is little or no evidence of prospective harm to the red meat industry in relation to poultry. However, it is important to note that neutrality is often not the goal of legislation of any type when responding to public interest concerns. In any event, many of the dominant meat packing firms also have significant poultry interests.<sup>146</sup> Thus, any competitive advantage for poultry among the firms in the industry will be significantly minimized or negated.

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Dakota, in a highly suspect opinion, ruled the 1998 amendment an unconstitutional violation of the Supremacy Clause and the Dormant Commerce Clause of the United States Constitution. *S.D. Farm Bureau v. Hazeltine*, 202 F. Supp. 2d 1020 (D.S.D. 2002).

144. That is because the dominant factors in plant location are the availability and price of feed grains, and the availability of livestock.

145. Relatedly, the 2002 Farm Bill contains a country-of-origin labeling provision primarily in response to such concerns. *See* The Farm Security and Rural Investment Act of 2002, H.R. 2646, 107th Cong. § 10816 (2002).

146. For instance, in terms of share of the market, Tyson is number one in beef, number two in pork and number one in broilers. ConAgra is number two in beef, number three in pork and number four in broilers. Cargill is presently ranked third in beef, fourth in pork and third in turkeys. Also, Hormel owns Jennie-O Turkeys, the number one firm in turkeys. *See* HENDRICKSON & HEFFERNAN, *supra* note 11, *available at*

Concerning the argument that the legislation will cause harm to beef and pork producers if beef and pork lose ground to poultry, econometric studies have documented only limited substitution between beef/pork and poultry.<sup>147</sup> Thus, any adverse efficiency effects caused by the legislation will be either nonexistent or not of sufficient degree to cause wholesale consumer substitution from beef/pork to poultry.

**Claim #12:** A loss of animal feeding operations will yield a corresponding loss of markets for grain production.

**Response:** There is no evidence that a net loss in animal feeding operations will occur. There is every reason to believe that production by non-packers will fill any void left by the “insignificant” volume of livestock that the packing industry divests over either a six-month (for cattle) or eighteen-month (for hogs) period.

## V. CONCLUSION

The packer ownership amendment is a congressional attempt to address existing problems in the competitive environment of the livestock industry. Because the amendment permits contractual arrangements between packers and producers unless the producer no longer materially participates in the management of the operation with respect to the production of livestock, the claimed harms arising from the amendment are likely to be less significant than claimed offsets by the potential benefit to the marketplace. If any negative market effects occur, such effects will likely be the result of packers exercising power over the marketplace. The economic fundamentals, apart from strategic behavior, do not warrant such dire claims. In addition, irrespective of the merits of the economic argument that contracting and alliances in livestock production are essential to efficiency and competition, the amendment’s ban on packer ownership will not bar producers and packers from entering into such agreements.

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[http://www.nfu.org/documents/01\\_02\\_concentration\\_report.pdf](http://www.nfu.org/documents/01_02_concentration_report.pdf).

147. See, e.g., KUO S. HUANG & WILLIAM F. HAHN, USDA-ERS, U.S. QUARTERLY DEMAND FOR MEATS, Tech. Bull. No. 1841, Table 2 at 13 (Feb. 1995) (cross elasticity of demand for pork and broilers at the retail level of 0.0765, meaning that a 1% change in the price of pork results in a seven one-hundredths percent change in quantity for broiler meat).

VI. EPILOGUE<sup>148</sup>

The U.S. House of Representatives did not include a packer ownership prohibition in its version of the Farm Bill, never having voted on the matter. The Farm Bill conference committee convened to reconcile differences between the Senate and House versions, and observers recognized that support for the ban on packer ownership differed sharply between the two chambers. Five of the seven Senate conferees had voted for the latest version of the ban on the Senate floor, while not one of the fourteen members of the House had vocally supported the provision, and a number of House members vehemently opposed the ban.

On April 11, 2002, the conference committee held a public joint conference and debated the merits of the packer ban for nearly three hours. Senator Harkin of Iowa, one of the measure's co-sponsors, and Senator Conrad of North Dakota, defended the ban on packer ownership arguing that when packers are allowed to own livestock, they have greater ability to manipulate the market by pushing and pulling supply. Senators Harkin and Conrad relied on USDA studies and academic white papers to make the point that they believed that the Congress should act, and not wait for more studies or investigations. Not a single House conferee spoke in favor of the measure.

The House conferees repeated many of the same arguments raised previously by the opponents of the ban, such as that the USDA has not found any causal relationship between captive supplies and price,<sup>149</sup> the ban would flood the market with livestock currently owned by packers,<sup>150</sup> without packer ownership farmers would have a harder time finding financing,<sup>151</sup> the ban would cause capital to move out of the United States,<sup>152</sup> the ban would have a negative effect on

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148. The text and footnotes contained in the Epilogue are drawn from both testimony transcripts of House and Senate Committee hearings related to the debate of the ban on packer ownership of livestock, and interviews the author conducted with Legislative staff members. The transcripts and interview notes are available with the author. Additionally, the transcripts are published by the Federal Document Clearing House.

149. Rep. Boehner (R-OH) and Rep. Goodlatte (R-VA) argued that they still sought proof on the causal relationship between packer ownership and price.

150. Rep. Pombo (R-CA), Rep. Lucas (R-OK) and Rep. Dooley (D-CA) raised fears that prices for fat cattle, hogs and feeder cattle would decrease as a result of the ban. Rep. Dooley also raised concerns that the value of packing plants would also diminish with the packer ban.

151. Rep. Pombo (R-CA) and Rep. Clayton (D-NC) raised concerns that the ban would make it harder for producers to find financing because the risk involved in production contracts, where the grower raises hogs that a packer owns, is less than the risk involved with independently owned livestock operations.

152. Rep. Goodlatte (R-VA) argued that the packer ban may cause significant capital flight from the United States.

marketing agreements and forward contracts,<sup>153</sup> and the ban would force livestock production out of the United States.<sup>154</sup> Most of the members of House conference committee members suggested that more study was needed before they would support a ban on packer ownership.<sup>155</sup> Making his only appearance at any time of the public conference meetings, Senator Helms (R-NC) appeared to make a statement on how the ban would have a devastating impact on the state of North Carolina.

At the end of the debate, the Senate conferees voted four to three to support the Senate provision and sent the issue to the House side.<sup>156</sup> Conference rules allow only House members to request a vote on the House position on a particular issue. None of the House conferees requested such a vote. Thus, the individual House conferees never took a vote on the record.

Days after this debate, as part of a global offer on the entire farm bill, the Senate offered to extend the time that packers had to divest livestock to four years. The House offered to strike the packer ban and replace it with a presidential commission established to study the issue of packer ownership. When the final conference report was agreed to, it did not include either the ban on packer ownership of livestock or any type of study or commission.

On July 16, 2002, the United States Senate Committee on Agriculture, Nutrition, and Forestry held hearings on the proposed ban on packer ownership of livestock and the USDA's enforcement of the Packers and Stockyards Act. Senator Johnson (D-SD) promoted the packer-ban legislation and re-clarified that it would not affect contracted livestock. Senator Craig (R-ID), who opposed the legislation in the spring of 2002, made very strong statements of his belief that packers manipulate prices, and suggested more study of the issue. Bill Hawks,

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153. Rep. Holden (D-PA), Rep. Lucas (R-OK) and Rep. Pombo (R-CA) argued that the provision might make illegal some forward contracts that producers currently use.

154. Rep. Combest (R-TX) argued that the packer ban in states like Iowa have caused the industry to leave the state. Senator Harkin (D-IA) countered that Iowa hog numbers have remained steady during the more than twenty years that Iowa has had a ban on packer ownership of livestock, and that some states (such as Nebraska) have seen an increase in livestock numbers while a statutory ban on livestock numbers was in place.

155. Those who supported the idea of more studies or continued investigation included Rep. Boehner (R-OH), Rep. Lucas (R-OK), Rep. Peterson (R-MN) and Rep. Moran (R-KS). Rep. Stenholm (D-TX) suggested that the House and Senate Agricultural Committees hold in-depth hearings on whether the Packers and Stockyards Act needs to be updated.

156. Voting to support the ban on packer ownership were Senators Harkin (D-IA), Leahy (D-VT), Conrad (D-ND) and Daschle (D-SD). Voting to oppose the Senate provision were Senators Lugar (R-IN), Helms (R-NC) and Cochran (R-MS). Although Senator Cochran supported the packer ban on the Senate floor, he changed his vote in conference.

the USDA Undersecretary of Agriculture for Marketing and Regulatory Programs, argued for additional study of the issue, and suggested the study be conducted by experts other than livestock marketing agricultural economists at land-grant universities. The American Farm Bureau Federation testified in favor of the legislation, and the American Meat Institute and the National Cattleman's Beef Association testified against the legislation.

On August 1, 2002, Senator Grassley (R-IA) introduced into the Senate The Transparency for Independent Livestock Producers Act.<sup>157</sup> The legislation is designed to complement the packer ban proposal. The legislation requires that, by January 1, 2008, twenty-five percent of a packer's daily kill must come as a result of spot market purchases. The legislation applies to those packers large enough to be required to report daily live animal prices to the USDA through the mandatory price reporting act, and requires that covered packers purchase at least 5% of livestock on the daily open market or on a cash basis by January 1, 2004, 15% by January 1, 2006, and 25% by January 1, 2008.<sup>158</sup> However, the legislation specifies that any packer that is purchasing at least 25% of the livestock on a daily spot market basis as of the effective date of the act is prohibited from reducing such purchases below the 25% threshold (12.5% for packer-cooperatives). The legislation specifies that it does not pre-empt state law regarding packer feeding of livestock.

Undoubtedly, competition issues in the livestock industry will remain in the legislative forefront in coming months.

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157. A Bill to Amend the Agricultural Marketing Act of 1946 to Increase Competition and Transparency Among Packers that Purchase Livestock from Producers, S. 2867, 107th Cong. (2002).

158. The schedule is reduced for purchases of livestock by a covered packer that is a cooperative association of producers by setting the applicable spot market purchase percentage at 5% for the years 2004 and 2005, 7.5% for year 2006, and 12.5% for years 2008 and later).