
**ANTITRUST AND AGRICULTURE:
The Need for Regulatory Implementation and Enforcement
of the Packers and Stockyards Act**

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I. INTRODUCTION

Over the last few decades, many of the agricultural markets on which independent family farm producers rely have experienced dramatic increases in both horizontal consolidation and vertical integration. As a result, these producers have experienced significant loss in the number of potential buyers for their farm products and a reduction in prices they receive as the competition for purchase of their goods has decreased.

This article discusses the level and impact of such consolidation and integration in the meatpacking sector. It also discusses some of the key efforts of livestock producers to address the adverse impact of this consolidation and vertical integration on the availability of competitive markets and livestock prices through enforcement of the Packers and Stockyards Act, a federal law designed to prevent monopolization, price manipulation, and other anti-competitive practices in the packing industry.

A. Report on Horizontal Consolidation and Vertical Integration

A recent report prepared for the U.S. Senate Committee on Agriculture, Nutrition, and Forestry provides a good explanation and summary of research studies on horizontal consolidation and vertical integration in the agricultural sector.¹ The following are highlights from that report.

Horizontal consolidation results when two or more firms in the same stage of production in an industry merge or combine. An example of horizontal consolidation is the 1999 acquisition of Pioneer Hi-Bred International, Inc., by DuPont; both companies engage in seed production and genetic modification.²

Vertical integration occurs when one firm acquires or allies with another firm in the same industry but at another stage of the production cycle. An example of a firm that has rapidly moved to vertically integrate is the packing company, Smithfield Foods, which has acquired many hog production operations over the last decade. As of 2004, Smithfield was the world's largest producer of pork products—owning 808,000 sows—accounting for almost 14 percent of the U.S. total.³

Businesses may pursue horizontal consolidation and vertical integration to reduce uncertainty and generate savings in their transaction costs between stages of the production cycle. However, research suggests the diseconomies of scale can overwhelm the economies of scale for large-sized firms.⁴ Once horizontal consolidation reaches a given level, the remaining firms will attain market power—the power of a firm to

¹ See Democratic Staff of the Committee on Agriculture, Nutrition, and Forestry of the United States Senate, *Economic Concentration and Structural Change in the Food and Agriculture Sector: Trends, Consequences and Policy Options* (October 29, 2004).

² *Id.* at 3.

³ *Id.* at 3 citing Freese, B. (2004 October); Pork Powerhouses 2004. *Successful Farmer*.

⁴ *Id.* at 3 citing Canback, S. (2003). “Diseconomies of Firm Size,” Working paper, Henley Management College.

significantly affect price through its actions.⁵ A firm's ability to exercise market power increases when there is both consolidation and vertical integration.⁶ In addition, though firms participating in consolidation and vertical integration may experience some technical efficiencies, economic gains by one player usually represent redistribution of income from other players in the sector.

Horizontal consolidation and vertical integration in the meat packing industry have increased dramatically over the last 25 years. "In 2003, it was estimated the four-firm concentration ratio in the packing industry was 84 percent for steer and heifer slaughter and 64 percent for hog slaughter."⁷ "These ratios represent increases in the level of concentration since 1980 of 68 percent and 88 percent, respectively."⁸ In addition, the Herfindahl-Hirschmann Index (HHI) for firms processing boxed-beef was 2,208 in 1995, significantly above the measure of 1,800 on this scale that the Department of Justice considers to be highly concentrated.⁹

How consolidation and vertical integration redistribute income within an industry is demonstrated by what happened with the hog market in the fourth quarter of 1998. During that quarter, market hog prices dropped below Depression level prices in real terms, but processors and retailers were able to maintain the average retail value of the hog which dropped by less than two percent from the previous quarter.¹⁰ During this time, hog prices dropped by 60 percent, but the retail meat prices remained essentially stable.¹¹ This "farm to retail price differential allowed IBP, the nation's largest meatpacker at the time, to generate fourth-quarter profits that were four times higher than for the same quarter in 1997."¹²

One of the practices often used by consolidated and vertically integrated meatpacking firms is to secure part of their packing capacity through what are known as "captive supplies"—livestock that is either directly owned by the company and in some cases raised through production contracts or is committed to it through a forward contract or marketing agreement. Independent livestock producers are concerned about how these

⁵ *Id.* at 3.

⁶ *Id.* at 3 citing Sarris, A. and A. Schmitz (1981); Price Formation in International Agricultural Trade, *Imperfect Markets in Agricultural Trade*, edited by A.F. McCalla and T. Josling, Totowa, NJ: Allenheld, Osmun and Co. Publ.

⁷ *Id.* at 5 citing Henderickson, M., and Heffernan, W. (2004), Concentration of Agricultural Markets Table. Available online at <http://www.foodcircles.missouri.edu/consol.htm>.

⁸ *Id.* at 5.

⁹ *Id.* at 5 citing Mathews, K.H. Jr., W.F. Hahn, K.E. Nelson, L.A. Duewer, and R.A. Gustafson (1999). U.S. Beef Industry Cattle Cycle, Price Spreads, and Packer Concentration. Economic Research Service, U.S. Department of Agriculture, TB-1874.

¹⁰ *Id.* at 8 citing Economic Research Service, U.S. Dept. of Agriculture (March 2002), *Red Meat Yearbook*.

¹¹ *Id.* at 9.

¹² *Id.* at 8.

captive supplies may impact prices they receive for livestock and the lack of information or transparency in prices paid under these arrangements.

“Empirical studies indicate that captive supplies increase price instability for producers that sell outside the integrated channels, increasing their costs of doing business by forcing them to spend more time and money to find buyers, as well as decreasing their prices.”¹³ A January 2003 study concluded that more than 86 percent of our nation’s hog supply was sold under some sort of pre-arranged contract.¹⁴ Research suggests that it is the large farms that the vertically integrated companies rely on for their supplies, and that they are much less willing to work with small- or medium-size farms.¹⁵ This means that farmers with smaller operations must rely on spot markets for price discovery. But these markets do not reflect the prices paid for captive supplies. Though livestock producers may be able to obtain additional information on livestock prices pursuant to the Livestock Mandatory Price Reporting Act of 1999, recent studies on this law’s impact differ as to whether individual producers actually benefit.¹⁶

Livestock producers’ belief that the use of captive supplies causes declines in spot market prices has been born out in empirical analyses, “which found a price reduction of between \$1-2 a hundredweight for live cattle compared to a situation without captive supply practices.”¹⁷ Even small (three percent or less) reductions in price from the use of captive supply practices can have a significant impact on livestock producers as it represents between 12 and 25 percent of long-run cattle feeding profits.¹⁸

¹³ *Id.* at 11 citing Connor, J.M. (2003); *The changing Structure of Global Food Markets: Dimensions, Effects, and Policy Implications*, Department of Agricultural Economics, Purdue University, Staff Paper 03-02.

¹⁴ *Id.* at 11 citing Grimes, G., and R. Plain (2003); *2003 Hog Marketing Contract Study*. University of Missouri and National Pork Producers Council.

¹⁵ *Id.* at 11 citing Gebremedin, T. and R.D. Christy (1996, July); *Structural Changes in U.S. Agriculture: Implications for Small Farms*, *Journal of Agricultural and Applied Economics*, 28, 57-66, General Accounting Office (1998). *Changes in Nebraska’s and Iowa’s Counties with Large Meatpacking Plant Workforces*. GAO/RCED-98-62.

¹⁶ *Id.* at 11 citing Azzam, A. M. (2003, May); *Market Transparency and Market Structure: The Livestock Mandatory Reporting Act of 1999*, *American Journal of Agricultural Economics*, 85, 387-395; and Njorge, K. (2003); *Information Pooling and Collusion: Implications for the Livestock Mandatory Reporting Act*, *Journal of Agriculture and Food industrial Organization*, 1.

¹⁷ *Id.* at 11 citing Durham, C. (1998), *Formula Pricing (Marketing Agreements) v. Fixed Pricing (Forward Contracts)*; Unpublished analysis commissioned by Western Organization of Resource Councils.

¹⁸ *Id.* at 11 citing Lawrence, John (2004); *Packer Concentration, Captive Supplies, and Fed Cattle Prices*. Available online at <http://www.econ.edu/classes/econ135/lawrence/captive%20Supplies%20and%20price.ppt>

II. PACKERS AND STOCKYARDS ACT

A. History of Enactment

The Packers and Stockyards Act was enacted in 1921 in response to an earlier report by the Federal Trade Commission that found “the five great packing concerns of the country—Swift, Armour, Morris, Cudahy, and Wilson—have attained such dominant position that they control at will the market in which they buy their supplies, the market in which they sell their products, and hold the fortunes of their competitors in their hands”¹⁹ At the time of enactment, “the Big Five” meatpacking firms owned or controlled public stockyards and transportation and distribution networks, held financial interests in retail stores, and slaughtered the vast majority of all livestock.

For further discussion of the legislative history of the P&SA see Appendix A, Petition for Rule-making on Captive Supply Procurement Practices under the Packers and Stockyards Act, at 19-27.

B. Section 202 of the Packers and Stockyards Act

Section 202 of the P&SA (7 U.S.C. § 192) provides in pertinent part to this discussion:

It shall be unlawful with respect to livestock . . . for any packer . . . to:

(a) Engage in or use any unfair, unjustly discriminatory, or deceptive practice or device; or

(b) Make or give any undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever; or

. . .

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

III. PETITION FOR RULEMAKING ON CAPTIVE SUPPLY PROCUREMENT

A. Western Organization of Resource Council Petition

This year will be the tenth anniversary of the Petition for Rulemaking on Captive Supply Procurement methods that FLAG submitted to USDA on behalf of the Western Organization of Resource Councils (WORC). The proposed rules are still relevant today and are needed more now than ever to protect producers from the manipulation of prices and undue discrimination.

¹⁹ *Report of the Federal Trade Commission on the Meat Packing Industry* 392 (1919).

The petition asked the Secretary of Agriculture to exercise his authority under the Packers and Stockyards Act to issue rules restricting packers' use of certain procurement practices to acquire captive supplies of slaughter cattle. The petition requests that the Secretary issue a rule that:

1. Prohibits packers from procuring cattle for slaughter through the use of a forward contract, unless the contract contains a firm base price that can be equated to a fixed dollar amount on the day the contract is signed and the forward contract is offered or bid in an open, public manner.
2. Prohibits packers from owning and feeding cattle, unless the cattle are sold for slaughter in an open, public market.

Packers' direct ownership and feeding of cattle for slaughter and their procurement of slaughter supplies through forward contracts have decreased prices paid to cattle producers. In addition, because forward contracts are not traded publicly and packer-fed cattle are not sold publicly, these practices unjustly discriminate against some producers and provide unreasonable preferences to others. Thus, these practices are in violation of § 202 of the Packers and Stockyards Act (7 U.S.C. § 192) and should be restricted through rules.

For the specific language of the proposed rule, a thorough analysis of the economic evidence supporting the rule, and a detailed analysis of the Secretary's legal authority to issue such a substantive rule, see the Petition for Rulemaking at Appendix A.

B. Post-Petition Actions

The petition as drafted, rather than the rule in proposed form, was published in the *Federal Register* for public comment. The comments were reviewed by GIPSA and a report published. FLAG on behalf of its clients commented on this report and participated in numerous meetings with the Secretary and high-level officials at USDA to discuss the petition and the supporting economic evidence. USDA also commissioned additional economic studies of the red meat industry. An economist working with WORC submitted comments and analysis based on the evidence and findings in one of these studies. She found that the evidence in USDA's own commissioned studies indicated that packers were strategically utilizing cattle it held under formula-priced marketing agreements differently than those held under fixed-priced forward contracts; packers tended to call-in more fixed-priced forward contract cattle when cash market prices were higher and tended to use more formula-priced marketing agreement cattle when cash market prices were rising less, possibly to keep the base price under those agreements lower.

IV. CAPTIVE SUPPLY REFORM ACTS

The proposed rule in the WORC petition for rulemaking has in essential part been introduced as bills in both the U.S. Senate and House amending the § 202 of the Packers

and Stockyards Act to prohibit the procurement of livestock through the use of a forward contract unless that contract has a fixed base price and is publicly bid.²⁰

V. COMMENTS ON RECENT LITIGATION AND NEED FOR REGULATORY ENFORCEMENT

Recent federal appellate court decisions also suggest that, to obtain restrictions on captive supply procurement of livestock under the Packers and Stockyards Act, it most likely will need to come through USDA regulation.

A. WORC Rule Addresses Issues Raised by *Pickett v. Tyson Fresh Meats, Inc.*

In *Pickett v. Tyson Fresh Meats, Inc.*, the Eleventh Circuit Court of Appeals held that Tyson's use of marketing agreements to procure slaughter cattle did not violate § 202 of the Packers and Stockyards Act because the evidence failed to demonstrate an adverse effect on competition.²¹ Finding that there was no evidence from which a reasonable jury could conclude that Tyson's stated reasons for the use of the marketing agreements were not legitimate competitive justifications, the Court affirmed the lower court's Rule 50(b) judgment as a matter of law for Tyson, after the jury had ruled in the cattle producers' favor. For further discussion of this case, see Doug O'Brien's *Competition and Trade Practice in Agriculture: Litigation and Legislation*.

In *Pickett*, the district court found that the plaintiffs had presented evidence demonstrating that "Tyson's marketing agreements have decreased the price of cattle on the cash market and on the market as a whole"²² The Court accepted as legitimate competitive justifications Tyson's explanations for the use of marketing agreements. Tyson explained that the marketing agreements assist in the company's coordination of a reliable and stable supply of cattle to keep its plants running efficiently, reduce the company's transactions costs by eliminating the need to negotiate for each individual pen of cattle, and allow it to pay for each head of cattle in a pen individually based on quality of the meat rather than paying for the entire pen "on the average," providing incentive to producers to produce more of the high-yield medium-quality cattle Tyson sought.²³ The Court does not make any attempt to distinguish aspects of the marketing agreements that may be a cause of the decline in cash market prices from those aspects of the marketing agreement that provide Tyson the ability to coordinate supply and pay on each head of cattle for the meat yield and qualities it seeks.

As discussed above, USDA's own economic studies indicate that it is the use of formula-prices (non-fixed base prices) in marketing agreements that may provide the incentive for and allow the packers to manipulate prices by calling in cattle on marketing agreements

²⁰ See, Captive Supply Reform Act, S 960 and H.R. 4257.

²¹ *Pickett v. Tyson Fresh Meats, Inc.*, 420 F.3d 1272 (11th Cir. 2005), cert. denied 126 S.Ct. 1619 (Mar. 27, 2006).

²² *Pickett*, 420 F.3d at 1286.

²³ *Pickett*, 420 F.3d at 1282-1286.

strategically based on what is happening with the cash market or futures prices on which the base price in the contracts is set. The WORC proposed rule would allow packers to acquire as much of their slaughter capacity as they wanted through marketing agreements that offered the opportunity to choose the day within a two-week window for delivery, thus allowing them to coordinate their supply to keep their plants working at peak efficiency. It would also allow them to use marketing agreements make adjustments from the base price to provide incentive for the yield and quality factors it seeks. By requiring that marketing agreements or other forward contracts include a fixed base price and be bid through a open and public market, the WORC rule simply restricts the aspects of the marketing agreement that make it possible for packers to use them to manipulate price. As part of its discussions and negotiations on its petition for rulemaking, WORC also gave USDA information about private sector development of electronic markets that could make bidding on marketing agreements much more efficient than bidding in the cash market. Such electronic markets would also address the need for the packers to reduce transaction costs raised by Tyson as a justification for use of marketing agreements. Thus, the WORC rule would restrict the use only of the aspects of marketing agreements that make it possible for packers to use them strategically to manipulate price but retain the competitive benefit justifications for them raised by Tyson in *Pickett*.

B. *Excel Corp. v. USDA*

The Tenth Circuit Court of Appeals in *Excel Corp. v. USDA* affirmed USDA’s Judicial Officer’s decision ordering Excel to cease and desist from failing to notify hog producers of its changed formula for estimating lean percentage because by failing to notify producers that Excel was violating a USDA regulation implementing § 202 of the Packers and Stockyards Act.²⁴ For further discussion of this case, see Doug O’Brien’s *Competition and Trade Practice in Agriculture: Litigation and Legislation*.

The Court recognized that, although USDA does not have “carte blanche authority” to prohibit just any practice it chooses, Congress did grant it this authority to implement and enforce the P&SA.²⁵ It also found “that Congress and the USDA are the arbiters of what practices will impede competition.” Accordingly, the Court deferred to the agency’s decision stating:

In determining whether the USDA (through the JO) committed any errors of law in interpreting § 201.99, we owe “substantial deference” to USDA’s interpretation of that regulation. *Thomas Jefferson Univ. V. Shalala*, 512 U.S. 504, 512, 129 L.Ed. 2d 405, 114 S.Ct. 2381 (1994). That is because the USDA has been charged by Congress with administering the P&S Act, see 7 U.S.C. § 228 (outlining the authority of the Secretary and the USDA with regard to the P&S Act), and § 201.99 is one of the regulations intended by the USDA to implement the P&S Act. *Mainstream Marketing Serv., Inc. v. FTC*, 358 F.3d 1228, 1236 (10th Cir. 2004) (noting “that the courts owe deference to a federal agency’s interpretation of the statute it administers”).

²⁴ *Excel Corp. v. USDA*, 397 F.3d 1285 (10th Cir. 2005).

²⁵ *Excel Corp.*, 397 F.3d at 1293.

Our “task is not to decide which among several competing interpretations best serves the regulatory purpose.” *Thomas Jefferson*, 512 U.S. at 512. “Rather, the agency’s interpretation must be given controlling weight unless it is plainly erroneous or inconsistent with the regulation. *Id.* (internal quotations omitted).²⁶

The Court’s deference to the agency’s interpretation of what practices will impede competition and violate the Packers and Stockyards Act made through its rulemaking and administrative adjudication enforcement authority demonstrates just how important it is for USDA to address captive supply procurement and other anti-competitive practices in the meatpacking industry through rulemaking and administrative enforcement actions.

²⁶ *Excel Corp.*, 397 F.3d at 1295.