S. HRG. 110–569

CONCENTRATION IN AGRICULTURE AND AN EXAMINATION OF THE JBS/SWIFT ACQUISITIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MAY 7, 2008

Serial No. J–110–91

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

45–064 PDF WASHINGTON : 2008

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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CONCENTRATION IN AGRICULTURE AND AN EXAMINATION OF THE JBS/SWIFT ACQUISITIONS

WEDNESDAY, MAY 7, 2008

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 2:32 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Herb Kohl, Chairman of the Subcommittee, presiding.

Present: Senators Kohl, Feingold, Hatch, and Grassley.

OPENING STATEMENT OF HON. HERB KOHL, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Chairman KOHL. Good afternoon. We will call this hearing to order at this time. Today we meet to examine the rising tide of consolidation in agriculture. Recent years have witnessed an enormous transformation in the agriculture industry. Disparity in market power between family farmers and large agribusiness firms all too often leaves the individual farmer and rancher with little choice regarding who will buy their products and under what terms. In this hearing, we will focus on just the latest example of that trend: JBS/Swift's plans to acquire two other meatpacking firms, a transaction that would reduce the number of major competitors in this industry from five down to just three.

In 1890, our Nation's fundamental antitrust law, the Sherman Act, was passed in large part as a response to the consolidation in the meatpacking industry. We now appear to have gone full circle as the JBS/Swift acquisitions will leave the meatpacking industry even more concentrated than it was a century ago. If approved, the JBS/Swift acquisitions will increase the market share of the top four firms to 91 percent. JBS/Swift will also acquire Five Rivers, the Nation's largest feedlot, marketing 2 million cattle annually. This threatens to give JBS/Swift a very strong lever over the Nation's cattle supply while leaving independent ranchers with little bargaining power. By reducing the number of major buyers for ranchers' cattle from five down to three, and in some regions even two, this deal will give the remaining beef processors enormous buying power. With little choice to whom to sell their cattle, ranchers will increasingly be left in a "take it or leave it" position.

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We should be equally concerned with effects on millions of beef consumers across the country in this era of rising food prices. Will only three major national sellers of beef be enough to ensure a competitive market for supermarkets, small grocery stores, and restaurants? Or will consumers need to go on a diet while the giant meatpacking firms grow ever fatter?

And so I urge the Justice Department to undertake a close and serious examination of the effects of the JBS/Swift acquisitions on both ranchers and consumers. Unfortunately, it appears that the Justice Department's antitrust enforcement efforts, both in the ag sector and generally, have been much too weak and passive in recent years. In the opinion of many experts, the Justice Department has often failed to take effective action as merger after merger in the pork, milk, and seed markets have sharply increased concentration as well as reducing competition. Antitrust investigations in the dairy industry have languished, with no resolution. While the Justice Department sits largely on the sidelines, agriculture concentration rises, and food prices rise.

Weak antitrust enforcement, of course, has not been limited to agriculture. Previously unthinkable mergers among direct competitors in many other highly concentrated industries affecting millions of consumers have been approved by the Justice Department, often over the reported objections of career staff. The most recent example was the Department's approval of the XM/Sirius merger, a merger to monopoly in the satellite radio industry. This is not the time for the Government to take a cramped or limited view of antitrust enforcement. In this era of rising prices and ever increasing consolidation, the need for vigorous enforcement of our antitrust laws has never been greater, in agriculture and in all other key sectors of our economy.

Millions of consumers are depending on aggressive antitrust enforcement, and now is not the time for our antitrust enforcers to be asleep at the switch.

[The prepared statement of Senator Kohl appears as a submission for the record.]

I would like to call upon my colleague Senator Grassley now for his comments.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Thank you very much, Chairman Kohl, for calling this hearing. I requested that you do this hearing and you responded within 24 hours, a very positive response, and this is the result of your response. I appreciate it very much. I also appreciate the opportunity to give my opening statement. At this very hour, 2:30, the Conference Committee on Agriculture is reconvening farm bill negotiations, and so I am going to have to go to that. It is my intent to come back, but if I do not get back, I will submit questions for an answer in writing. Unfortunately, you never know whether those meetings are going to take 5 minutes or 5 hours. So that is why I will have to go.

I requested this hearing because of widespread concerns about increased competition in agriculture as well as concerns raised about the proposed acquisition of National Beef Packing, Smithfield

Beef, and Five Rivers Ranch Cattle Feeding by JBS acquisitions. It is important that the Judiciary Committee review positive and constructive solutions to the agriculture competition concerns as well as potentially problematic mergers, such as this JBS transaction.

For well over a decade, I have had serious concerns about increased consolidation in agriculture, and, of course, not just as it affects farmers, but the impact upon all of rural America. I share the concerns of many family farmers and independent producers that the agriculture industry has consolidated to the point where many of these smaller market participants do not have equal access to fair and competitive markets. I share the concern of many in the agriculture industry that large agribusinesses are in a better position to engage in anticompetitive and predatory business practices.

Senator Kohl and I introduced S. 1759, the Agriculture Competition Enhancement Act, in response to concerns about excessive concentration in agriculture. I was disappointed that we were not able to include some version of this bill as part of the agriculture farm bill, but I hope that we will be able to discuss the legislation today and hear witnesses' views on it. I would like to see this bill move through this Committee, the Judiciary Committee, because I truly believe that it will address concerns about agriculture mergers.

The JBS merger is a part of this growing "bigger is better" trend in agriculture. I wrote to the Justice Department Antitrust Division to urge a careful review of this transaction and to consider thoroughly the projected impacts on the beef industry. JBS is the world's largest beef packer and the third largest processor in the United States. National Beef Packing and Smithfield Beef Group are the fourth and fifth largest beef processors here. If this transaction were to be approved, JBS would control approximately 32 percent of the beef-processing market share, killing far more animals than Cargill Meats or Tyson Foods.

I am concerned that the proposed JBS merger could severely reduce the already limited number of buyers for the commodities of small and independent beef producers. The transaction could leave producers minimal selling options throughout large geographic areas. It would allow JBS to control the largest share of the beef market and potentially decrease product choice and increase product prices for the consumers of America.

I spent a lot of time focused on the independent producer, but with the rising costs of food worldwide, we all ought to be particularly interested in hearing the potential effects on our customers in the grocery aisle.

I am not the only one that has this issue with this proposed merger. Small independent producers, family farmers, and other agriculture groups share my concerns about the proposed JBS transaction and increasing agribusiness consolidation. Expanded packer ownership, exclusive contracting, and captive supply are adversely impacting their ability to compete in the marketplace. They share my concerns about reduced market opportunities, anticompetitive and predatory business practices, and a result, fewer choices and higher costs for American consumers.

So, Mr. Chairman, I am pleased that we will be able to have representatives from JBS and National Beef tell us what they believe will be the benefits to this transaction. I am also pleased that we have industry folks and agricultural antitrust experts here to give us their view, both on the transaction as well as what they see coming on in the future in the agriculture industry and how we will be impacted by less competition.

I very much appreciate once again Chairman Kohl agreeing to hold this hearing. Thank you.

[The prepared statement of Senator Grassley appears as a submission for the record.]

Chairman KOHL. Thank you for being here, Senator Grassley.

We now turn to the Committee's Ranking Member, Senator Orrin Hatch.

STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

Senator HATCH. Well, thank you, Mr. Chairman. It is always a pleasure to be with you here today, and I appreciate that you have called this hearing on agriculture consolidation in JBS/Swift's proposed acquisitions.

Agriculture consolidation has long been one of the most important questions that we face in antitrust law. In fact, one could say that our Nation's antitrust laws were born from the concerns of farmers and ranchers that improper market power was being employed by large agricultural processors and the railroads.

The antitrust ramifications of agriculture consolidation are still a very important topic today. The meatpacking industry has had some very tough times over the past several years. Perhaps most dramatic was the 2003 BSE incident which led to an overreaction by many of our trading partners and the almost overnight collapse of our most important beef export markets.

In addition, there has been enormous consolidation in the agriculture industry over the past 30 years, especially in livestock markets. For example, according to the Congressional Research Service, in 1985, the four largest meatpackers accounted for only 39 percent of the cattle- packing industry. By 2007, that number had grown to 71 percent. Similarly, in 1985, the four largest swine packers represented 32 percent of the market. In 2005, that share had risen to 63 percent.

The effects of this consolidation are not only being felt in the packing business. The number of American farms producing swine has fallen dramatically from 667,000 in 1980 to 67,000 in 2005.

Now, this consolidation has also had a major impact on theories of the proper enforcement of antitrust law. Currently, there is a disagreement between two groups of legal thought. The first group believes market consolidation and vertical integration undermine the smaller livestock producers by reducing their potential to use the cash or the spot market. The second group argues antitrust law is designed to maintain or create competitive markets for consumers. They believe it is improper to regulate an industry through antitrust law because one of the market's competitors is suffering due to otherwise legitimate competition and business practices. Ar-

ticulating these different views will be one of the subjects of today's first panel.

Our second panel will explore the specifics of consolidation with a discussion of JBS/Swift and Company's proposed acquisition of National Beef and Smithfield Beef. If the transaction is approved, only three major meatpackers will remain from the current five. Specifically, JBS/Swift will control 32 percent of the market, Tyson 24.8 percent, and Cargill 21.6 percent. It should also be noted that JBS/Swift is making these acquisitions when most experts agree that there is overcapacity in the packer market.

So how does JBS/Swift intend to profit from its investment? I have been informed that JBS/Swift intends to promote the export of American beef vigorously. If so, the acquisition is well timed to exploit the Korean Government's recent decision to lift many of its remaining importation barriers imposed on American beef, something that I have been very concerned about for a long time. It remains to be seen if this business model will succeed. However, JBS/Swift has recently acquired meatpackers in Argentina, Australia, and Italy.

After the company's acquisition of Swift, to its credit it did follow through on its promise to expand operations and to hire additional workers. However, many have antitrust concerns about this transaction. So I look forward to exploring these issues in greater detail during the hearing.

Again, I want to thank you, Mr. Chairman, for calling this important hearing, and I look forward to paying attention to everything I can with regard to it. Thank you.

Chairman KOHL. Thank you very much, Senator Hatch.

We would now like to introduce the members of our first panel. Our first witness will be Douglas Ross. Mr. Ross is a Special Counsel for Agriculture in the Antitrust Division of the U.S. Department of Justice. Mr. Ross has also served in the Office of Policy Development at the Department of Justice.

The next witness on this panel will be Peter Carstensen. Professor Carstensen teaches at the University of Wisconsin Law School, where he focuses on antitrust law and competition policy. Prior to his position at the University of Wisconsin, Professor Carstensen was an attorney at the Antitrust Division of the Department of Justice.

We thank you both for appearing at our Subcommittee hearing today, and if you will rise and raise your right hand and repeat after me. Do you affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. ROSS. I do.

Mr. CARSTENSEN. I do.

Chairman KOHL. We thank you both for being here. At this time, Mr. Ross, we will take your testimony.

STATEMENT OF DOUGLAS ROSS, SPECIAL COUNSEL FOR AGRICULTURE, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE, WASHINGTON, D.C.

Mr. ROSS. Thank you, Mr. Chairman. Thank you for the opportunity to discuss the Antitrust Division's antitrust enforcement

record in the important agriculture sector of our economy. I have a longer written statement that I request be made a part of the record.

Chairman KOHL. That will be done.

Mr. ROSS. But I would like to begin with a brief statement now.

The Department of Justice is committed to maintaining an active involvement in the agricultural sector and to protecting competition there through aggressive antitrust enforcement, as warranted. The Department takes very seriously the concerns expressed by agricultural producers about competitive problems.

In antitrust analysis and enforcement, the Department carefully considers market power issues, both on the sell side, which is often seen as monopoly, and on the buy side, described as monopsony. The Department hears and takes into account monopsony or buyside market power as a particular concern in merger enforcement for agricultural producers who often sell their products to large agribusinesses. The Department has brought a number of enforcement actions in the agricultural sector in recent years and has undertaken special outreach to the agricultural community. We have for many years regularly consulted the Department of Agriculture to obtain the benefit of their expertise in our agriculture work.

The Department's legal authority in this area is the antitrust law. Other agencies have other legal authority, and agriculture policy is far bigger than antitrust. In our area of authority, we are constantly on the lookout for possible antitrust violations and will not hesitate to take appropriate enforcement action when warranted.

My statement demonstrates that we have been active in enforcing the antitrust laws in the agriculture sector, having filed several important cases to remedy anticompetitive effects that were likely to result from proposed mergers and acquisitions and to stop collusive, anticompetitive practices that adversely affected farmers and competition in this key sector of the economy.

I look forward to your questions about our work. Thank you.

[The prepared statement of Mr. Ross appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Ross.

Mr. Carstensen?

STATEMENT OF PETER C. CARSTENSEN, PROFESSOR OF LAW, UNIVERSITY OF WISCONSIN LAW SCHOOL, MADISON, WISCONSIN

Mr. CARSTENSEN. He was able to get through that in only 2½ minutes. No professor is going to be able to top that performance.

I am truly honored to be offered this opportunity to express my views on the state of antitrust enforcement in markets related to agriculture. I have a longer statement, which I hope will be included in the record.

Chairman KOHL. We will do it.

Mr. CARSTENSEN. Thank you.

In a nutshell, the Government agencies charged with enforcing antitrust law have repeatedly failed to challenge or to remedy competitive problems that confront American agriculture. The most conspicuous failure has come in merger enforcement where a series

of decisions either not to challenge mergers or settle for weak, even anticompetitive, remedies has resulted in increased concentration on both the input and the output side of agriculture.

The American farmer is being caught in an economic vise. When they seek to buy various inputs they need—seed, fertilizer, equipment, herbicides—they face an increasingly concentrated markets and exploitive strategies by producers. When they attempt to sell their products, especially, I think, in the dairy, meat, and grain areas, they have only a very limited number of buyers who use their buyer power to drive down the prices paid for these products.

What I would like to do is to give you the highlights of several of the lessons that I think and examples that I think highlight this point. I want to start with the concerns that Senator Grassley expressed in particular about the pork industry. Doug Ross says on page 5 of his written statement that mergers that increase market power violate Section 7, and so I want to use the pork industry as an example where there has been a failure to do this.

Smithfield bought Farmland in about 2002 or 2003, and has recently been allowed to buy Premium Standard Brands. First lesson: Buyer power already exists. The RTI's study of livestock markets done for GIPSA found that there was statistically significant buyer power in hogs in that period 2002 to 2005, that is, during the period when the acquisition of Farmland occurred. But what is important is that the PSB merger, the acquisition of PSB necessarily increased buyer power to the detriment of farmers, yet the Department of Justice raised no objection, ignored the empirical analysis, and in its statement justifying its failure to sue, it made inaccurate factual statements.

The second lesson—and it is a very important one—is that buyer power—and this comes from the RTI study. Buyer power arises from much lower levels of concentration when measured by the HHI index number than one would expect to predict seller power on the seller side of markets. That is, the concentration was in the 1,000 to 1,300 level in this period when the RTI study found the existence of buyer power. It is an important lesson that has been totally ignored by our law enforcers.

As to milk, Mr. Ross's statement describes the theory of the Dean settlement, done without litigation, no—there is no consent decree. There is no opportunity to comment on this. The theory was when Suiza bought Dean that there would be a divestiture and no exclusive dealings. Since then, DFA, Dairy Farmers of America, has become associated with both the successor to the Dean-Suiza facilities, also has linked to Hood, and has managed to get exclusive dealing contracts. There is—and I think Senator Kohl referenced this in his comments—an ongoing Justice Department investigation of many years' standing of a number of these bad business practices. Apparently, nobody has informed Mr. Ross of all the problems that came out of this consent decree.

I have written some hostile comments about the Monsanto-Delta and Pine Land settlement, which, again, results, it seems to me, in some very unfortunate results. There are several other comments about that. I will not elaborate further on that.

We know that the next panel is going to deal a lot more with the beef industry. What I want to emphasize—and it is clear in Mr.

Bullard's testimony—the Justice Department has known about a number of anticompetitive, apparently collusive or monopolistic practices in that industry for a number of years. They are well documented, and they have done nothing.

So the bottom line here is that we have a passive and inactive antitrust enforcement process that has resulted in increased concentration, harms to producers of agricultural products, and, of course, harms then to consumers.

What can Congress do? Because you, unfortunately, cannot bring the lawsuits, which I would love to have you do.

First, I think hearings like this do deliver a message to Mr. Ross, and I hope he is going to take it back to the Justice Department.

Second, I think your staff can do more to ask for confidential briefings on some of these decisions, and you yourselves can attend those briefings so that you are better able to understand why they are not doing the things that they ought to be doing.

You could also get a GAO study of some of these key decisions in terms of what happened afterwards, because I think if you look at pork, if you look at dairy, you look at some of these other industries, you are going to see the actual harms.

Finally, you know, Doug is my old sparring partner. We have done these kinds of shows across the country. He is a dedicated civil servant, and he comes down here and he tries his best to justify what his masters are doing. The problem is he was brought in to be a more focused person, really to engage the issues of agriculture, to make sure that the Department of Justice actually understood things. And, sadly, it is just clear that those who actually make the decisions have not gotten the message.

Therefore, I think it is really time to change the institutional and legal framework for evaluating mergers and anticompetitive conduct in agricultural markets. I think the Grassley-Kohl bill, the Agricultural Competition Enhancement Act, S. 1759, is a really necessary step in that direction. I congratulate you, Senator Kohl, for being a sponsor of that legislation. It is a great contribution.

Farmers need workably competitive markets. They need a kind of antitrust enforcement that will control both the structure of those markets and the conduct that is allowed to occur.

[The prepared statement of Mr. Carstensen appears as a submission for the record.]

Chairman KOHL. Thank you, Professor Carstensen.

Mr. Ross, we often hear from farmers and ranchers that they have little bargaining power in comparison to the largest agribusiness conglomerates. Many of them claim that the Justice Department has not fulfilled its responsibility to prevent anticompetitive mergers and practices in the agriculture sector of the economy.

Do you believe that the farmers' concerns about increasing levels of consolidation among agribusiness firms are warranted? And if so, why has the Justice Department permitted these consolidations to take place?

Mr. ROSS. Senator, we hear the same concerns about market power, and we take them very seriously. In fact, they have been important parts of each of the investigations that we have done, and I point, for example, to the Cargill-Continental matter in which the issue of market power was the key one.

We did an analysis and established that in nine regional markets, the buyer power of the merged firm would be anticompetitive. As a result, our relief required that ten divestitures of port and grain elevators be done in order to preserve competitive alternatives for farmers to sell their grain and soybeans.

Chairman KOHL. Well, Professor, what is your view of what you have just heard? Are farmers and ranchers' concerns warranted? And in your opinion, has the Justice Department done enough to stop these consolidations, especially among food processors?

Mr. CARSTENSEN. I think the concerns are very much warranted, and as I referenced that RTI study in the pork industry, which is the most recent confirmation that we have very serious problems of buyer power that are being increased. And if you go back and look at the Justice Department's explanation for why they did not object to the Smithfield-Premium Standard Brand merger, they announced that finished hogs could be hauled 400 miles from North Carolina to Kentucky for processing and, therefore, the farmers of North Carolina were at no risk of being exploited—this in the face of data that shows that they are at about a 10-percent discount in North Carolina whenever there is a full supply of hogs in the market because it is costly to haul your hogs anywhere.

And I think the Continental-Cargill merger is another example of minimalist enforcement. It was a clearly bad merger. They did the least that they possibly could do. We have not seen a good followup on what the consequences of that merger are. Anecdotally, when I talk to grain farmers, what I hear is we went from having two or possibly three buyers to, at most, two buyers, and in many more areas we are seeing only one buyer for our corn, for our soybeans, et cetera.

This is one of the things that has made ethanol really interesting because those plants do create a different kind of competition right now in corn markets. It does not do much for soybeans. It does not do much for wheat, but it does change the dynamic because there are competitive buyers in the marketplace.

So we really need more focus on this, and, again, something I said earlier, the analysis of buyer power is different. Buyers are different from sellers in terms of when they get leverage in the market, what kinds of market shares give you leverage. As a buyer, you are the decider. You are the decisionmaker with respect to whether or not you buy. That creates power at much lower levels of concentration. We simply have not seen from the Justice Department any recognition of that inherent economic fact.

Chairman KOHL. Professor Carstensen, at this time, as you know, millions of consumers all across the United States are suffering from rising food prices in many basic commodities. Do you believe that the increasing concentration we are witnessing in agriculture is a big cause of the higher food prices paid by consumers? And if that is true, do these higher prices find their way back into the farmers and ranchers' hands?

Mr. CARSTENSEN. The first part is, yes, the concentration has two levels. It has an effect downstream—or I should say upstream on the farmers, and it has an effect downstream on the consumers. That is, both ends of this process are subject to exploitation by lower prices to farmers, higher prices to consumers. The best docu-

mentation of that comes from Professor Cotterill, in a hearing I think before this Committee a few years ago, involving New England dairy products. And, again, Mr. Bullard's written statement for the Committee has a good deal of the documentation that shows that increasing spread between what is being paid at the farm gate, which is constant or declining, and what is being charged to consumers. So what we are seeing is, no, it is not coming back to the farm gate. It is not coming back to the farmer. But the price to the consumer is going up. It is getting caught in those two levels of concentration.

One of the things I emphasized in my written statement is concentration at retail grocery markets, which is really where you get the leverage over the consumer, and then concentration at the production level.

Chairman KOHL. Thank you.

Mr. Ross, what is your view? Does reduced competition among agribusiness companies inevitably lead to higher prices? And isn't strong antitrust enforcement very important to prevent such loss of competition?

Mr. ROSS. Senator, the antitrust laws could not be more important to protecting consumer prices, and effective competition leads to all kinds of benefits, like better quality of products, greater innovation, and the ability of farmers as consumers as well as producers to benefit from a competitive economy.

Chairman KOHL. Thank you.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman.

Professor Carstensen, you have written, "Strategic behavior by market-dominating firms has weakened or eliminated the open market process that in turn gave agricultural producers the freedom and flexibility to be genuinely independent entrepreneurs." Now, some think that may be nostalgia for a bygone era. Has not the Department of Justice merely been fulfilling its mandate by only taking action when it believes that a competitive market happens to be in jeopardy? Or, put another way, are you not advocating the Department become a regulator, ensuring survival of small producers, when the Department's responsibilities under the law will be to ensure competitive markets, not the competitors themselves?

Mr. CARSTENSEN. My father was a historian of agriculture, so maybe I have got some residual nostalgia genes.

Let's be clear about this. Markets are going to change. What is an efficient level of production is going to change. The benefit of workably competitive markets is those changes are driven by economic fundamentals, not by strategic behavior.

What I was concerned with in the passage you quoted was the kinds of strategic behavior that adversely affects the functioning of the market and favors some players in the market not based on their inherent efficiencies. The most recent USDA studies, for example, in pork show that small pork producers, hog producers, I guess I should say—have the same level of efficiency that very large ones do. The problem is going to be market access, finding fair rules. And if we are going to go to a contract world—I am not opposed to that, necessarily. If contracts are what we do, then we

need proper rules for the contract market so that, again, it is fair, open, and efficient. And efficient is key here because we do want to have those markets be dynamic, to change with the changing technology.

Senator HATCH. Well, on a related point, you wrote a Law Review article entitled "Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy." This article was described by the National Agricultural Law Center as arguing in favor of using antitrust law to protect independent farmers.

Now, there has been a tremendous amount of consolidation in the livestock markets. However, according to the Congressional Research Service, ranchers and farmers that hold fewer than 100 cows still control half of the market. Now, the top 30 feedlots only control 40 percent of the cattle on feed. In fact, the USDA believes that there are more than 88,000 lower-capacity feedlots in operation today.

Now, my question would be: Why should the Government interfere in a marketplace where half of the cow/calf businesses appear to be held by smaller farms and there is more than an ample number of smaller feedlots?

Mr. CARSTENSEN. Well, if we were talking about a merger among feedlots, I would agree with you. I do not see an antitrust issue there. But we are talking about mergers among the buyers from those feedlots that are going to reduce the numbers from five to three and are going to create, I think—and certainly this is consistent with all the other data that we have—going to create substantially more buyer power.

As the next panel is going to focus, I think, much more on the specifics of the beef industry, the problem is access to the slaughter facility. The problem is the terms and conditions under which those feedlots get to sell.

We have seen a cyclical long-term decline in the number of feedlots that exist and in the number of cattle that are being put on feed, and what that tells us generally is that we are looking at the kind of situation that looks a lot like there is exploitation of monopsony power or oligopsony power, that is, buyer power on these downstream—or, I am sorry, upstream suppliers.

One of the important points that your data makes fundamentally is that you can be a 100-head feeder or a 10,000-head feeder, and it looks like you can compete in the market as long as you have access to the meat processors, to the cattle slaughter facilities.

What we are focused on here today is a merger at that buying level. That is the place where the problem will exist for all of the different feeders that you are identifying.

Senator HATCH. OK. Mr. Ross, I will just ask a question of you. During the previous administration, Cargill acquired Continental in the already concentrated grain trader market. Specifically, the number of grain traders was reduced from four to three. However, the Department of Justice insisted that the combined Cargill- Continental sell 10 percent of its operations to a competitor. Why then in 2003 did the Department of Justice decline to take action on the Smithfield purchase of Farmland Food's pork-processing plants?

Was this also not a highly concentrated market? And why the difference in enforcement actions? Just so we understand better.

Mr. ROSS. Thank you, Senator. We welcome opportunities to be more transparent about the bases on which we decide to enforce or not, where appropriate.

In the Cargill matter, we did extensive analysis of the market, including talking to many experts in the area, including farmers, and our analysis showed that there would be the kind of anticompetitive consequences, that is, a substantial lessening of competition in a market, in nine regional markets. And, therefore, we required relief of the sort that we have described.

By contrast, in the pork matter involving Smithfield- Farmland, we did a similar kind of analysis, and the facts showed a different result. We looked at the procurement areas for each of Farmland's plants and how many packers would buy hogs in the same procurement areas and the slaughter capacity of each of the competing packers. Our conclusion was that neither Smithfield nor Cargill, which you will recall was one of the potential buyers there, would make as much as 30 percent of the live hog purchases if it had acquired Farmland's assets. And our conclusion was that there would still be at least six competing packers where the acquirer had competing plants. So we thought that was a basis on which not to take action because there was no anticompetitive result.

Senator HATCH. Thank you, Mr. Chairman. My time is up.

Chairman KOHL. Thank you, Senator Hatch.

I would like to say that we are going to, as a result of our concern about these mergers and their impact on higher food prices, we are asking the GAO to make a study to look at whether or not there really is a correlation between these two critical factors.

Professor Carstensen, Senator Grassley and I have written a bill that would shift the burden of proof so that merging parties in agriculture mergers have to justify that their mergers do not harm competition rather than the other way around, which is as it is now. Do you support this idea? And if you do, tell us why.

Mr. CARSTENSEN. I think it is a very good idea because it really requires not just the vague waving of hands in the Justice Department office saying that there are going to be no harms, but actual proof in a court of law where the defendant merging parties have to come in and genuinely justify the non-anticompetitive implication of the merger, and especially as the court decisions have accumulated of late, courts have really been putting an extraordinary burden on the Justice Department and the Federal Trade Commission to establish that any particular merger will tomorrow result in serious harm.

The statute actually only calls for evidence that the merger may substantially lessen competition or tend to create a monopoly. So that this restores in many respects the classic statement of what the standard should be, and I think it is a wonderful idea.

Chairman KOHL. Mr. Ross, I assume you agree.

Mr. ROSS. Senator, surprisingly enough, Professor Carstensen has also referred to me as his "punching bag," and here again we will disagree.

The Antitrust Division is satisfied that the burden of proof in all merger enforcement actions should be the same, whether for agri-

culture or any other part of the economy, that it works effectively. And I am aware of no case in which we would decline to take a case to court because of the burden of proof.

Chairman KOHL. Thank you.

Senator Feingold?

Senator FEINGOLD. Thank you, Mr. Chairman. Before I get to my statement and questions, let me specifically welcome Professor Carstensen. I have know him and been friends for many years with him and his wife, Carol, who is a distinguished and long-serving school board member in Madison.

Mr. CARSTENSEN. Just finished.

Senator FEINGOLD. I am aware of that.

Mr. CARSTENSEN. After 18 years.

Senator FEINGOLD. I read the paper that comes to my door there, and she did a wonderful job. It is good to see you, and I thank you and all the other witnesses for appearing this afternoon.

Mr. Chairman, thank you for holding the hearing to shed light on an important issue for farmers and consumers. Before I talk about agriculture specifically, I want to note the overall troubling state of concentration across multiple sectors of the economy. Over the past few years, consolidation and related competition concerns have increased in a variety of areas, including freight railroads, food retailers, and radio stations, just to mention a few.

Just 2 weeks ago, this same Subcommittee chaired by my distinguished colleague from Wisconsin considered proposed mega mergers among airlines, and now we are turning to a merger that would reduce the number of major beef meatpackers from five to three. This growing concentration raises serious questions about the Department of Justice's enforcement of existing laws, as well as the adequacy of those laws to ensure fair, open, and equitable markets.

Increased consolidation and market concentration are serious problems for agricultural producers throughout the Nation. As I travel around our home State of Wisconsin, and as the Chairman knows, these issues are consistently raised by farmers and growers.

With respect to the proposed JBS/Swift acquisitions, it is important to my constituents that the facilities in Wisconsin remain operational and that there is no loss of jobs. I also have serious concerns that the combination of the third, fourth, and fifth largest beef meatpackers will significantly reduce the number of potential cattle buyers and as a result depress prices. While Wisconsin is not the leader in beef cattle production, the prices for these animals form the basis for the prices paid for culled dairy cows and could, therefore, have a significant impact on the bottom line of thousands of Wisconsin's family dairy farmers.

Exacerbating this horizontal concern is the significant vertical integration that the post-merger company would enjoy from the major cattle-feeding operation of Five Rivers Ranch Cattle Feeding. Both the prepared testimony of Mr. Stumo and Mr. Bullard highlight how this captive supply will negatively impact competition and the prices paid to farmers and ranchers.

Earlier this year, I signed a letter with several of my colleagues expressing some of these concerns to the Attorney General. Mr. Chairman, I would ask unanimous consent that it be included in the record.

Chairman KOHL. It will be done.

Senator FEINGOLD. Mr. Chairman, I hope that the Justice Department will get serious about protecting consumers and agricultural producers from increased consolidation and market concentration.

Mr. Ross, in Professor Carstensen's written testimony, he says, "the Antitrust Division has an open investigation of the conduct of the milk industry, but the matter has been pending for years without any action." This statement goes on to describe the industry as "rife" with a "panoply of anticompetitive practices" that have resulted in "serious losses of income and coercion of farmers."

Now, I have heard similar frustration directly from dairy farmers and others in the dairy industry in Wisconsin. What do you have to say with regard to the status of the investigation and Professor Carstensen's observation?

Mr. ROSS. Senator, we take concerns about the dairy industry, as well as any other part of the important agriculture economy, very seriously. Without confirming or denying a particular investigation, which would be inappropriate, we continue to monitor any anticompetitive practices that are brought to our attention, and we do an extensive analysis to determine whether an antitrust enforcement action is appropriate.

As my statement indicates, we have been active in the dairy industry involving the Suiza-Dean merger and other dairy areas, so we continue to have active knowledge and monitoring of the important sector in agriculture that involves a key industry in your State.

Senator FEINGOLD. I look forward to following-up on that.

Mr. Ross, Professor Carstensen described the controls that DOJ placed on the Dean-Suiza merger as ineffective. Specifically has written testimony says, "in addition, the press release announcing approval implied that the new firm would not enter into a long-term exclusive dealing contract with Dairy Farmers of America, the largest dairy cooperative. However, Dean and DFA quickly found a way around that commitment."

Could you shed some light on the merger commitment? Did the Antitrust Division err in not making the provision broader to include partnerships and joint ventures in that prohibition?

Mr. ROSS. Senator, our analysis was a careful and thorough one, and the remedy we devised before allowing that merger to go forward was one that was based on extensive analysis of the market conditions on the ground. If there are concerns about what has happened subsequently, we welcome anybody bringing that to our attention, and we will examine it very seriously.

Senator FEINGOLD. Well, it does sound like a potentially troubling oversight to me.

Professor, do you have anything to add?

Mr. CARSTENSEN. The investigation was completed. The staff recommended that there be litigation. It has been sitting, at least according to the information I have, in the Assistant Attorney General's office for more than a year. The key original attorney, I believe, has now reached retirement and retired.

The Government—this alleged complaint—there was never a complaint in Dean-Suiza. It was what is called a "fix it first." They

bargained for about 9 months about the divestiture. More divestiture was made than originally proposed. It was settled with whatever confidential documents were exchanged between the parties, since there was no consent decree, there was no Tunny Act disclosure requirement, no opportunity for anybody to comment on this, and then all kinds of problems began to emerge for the dairy world because of this relationship not only with Dean, new Dean, but also NDH, National Dairy Holdings, that was owned in substantial part by DFA, and then it gets linked to Hood, so you have got one, two, and three all tied together.

One credit to the Justice Department: They did go after a small dairy acquisition—and it is in Mr. Ross's statement—in Kentucky that DFA attempted to pull off. And one of the good things about that particular piece of litigation, because they actually went to trial on that, was that it did bring to light a good deal of the dubious transactions, the discriminatory transactions within the DFA empire. But for the Justice Department to claim that they are monitoring the situation is to say that they are doing nothing.

Senator FEINGOLD. And although Mr. Ross indicated a willingness to be open to any sort of things that have happened since, it sounds to me like this could have been prevented in the first place by proper drafting. Is that a correct statement?

Mr. CARSTENSEN. If they had gone the consent decree route, yes, they could have drafted that. The State Attorneys General are involved in these investigations. The Justice Department is the party that has not been heard from.

Senator FEINGOLD. Mr. Chairman, could I ask one more question?

Chairman KOHL. Go right ahead.

Senator FEINGOLD. Thank you very much for the additional time.

As the Chairman knows—and I am grateful for his support—I have worked with Senator Grassley for a number of years on legislation called the Fair Contracts for Growers Act that would make mandatory arbitration clauses in agricultural contracts unenforceable.

The Judiciary Committee passed this bipartisan bill earlier this Congress by a wide margin, and the farm bill seems poised to at least take a step in the right direction by requiring that growers be given a specific option to opt in or out of any mandatory arbitration clause. But the Government needs to make sure that this provision has some teeth, and I will explain why by asking our witnesses to put themselves in the work boots of a poultry grower.

So, first off, you have taken out a loan for several hundred thousands dollars to build poultry houses. There is only one poultry company contracting with growers in your region, and they supply you with chicks and feed and determine your payment based on the weight gain and condition of the animals at the end of each approximately 7-week, flock-to-flock contract.

Your most recent contract has a new clause that commits you to mandatory binding arbitration with arbitration procedures dictated by the company. As required by the new farm bill language, you were told you have a choice whether to opt in or out of this provision. You have seen some information about large up-front fees required for arbitration and do not think you have enough cash to

cover them if a dispute arises. So you want to decline the arbitration clause, knowing that you may have a chance to go to arbitration if a dispute arises and the company still wants to arbitrate after the fact.

But what if one of your neighbors opted out earlier in the year and he has since been plummeting down the grower ranking for weight gain and is being threatened with termination as a "bad producer"? Does that make you think twice before opting out?

Does it seem like law school here?

Mr. CARSTENSEN. Yes, yes, and I am on the wrong side of the table, Senator.

[Laughter.]

Senator FEINGOLD. For once.

Mr. CARSTENSEN. Yes. That would be an enormous problem with an opt-in/opt-out legislation of this sort. You know, arbitration when agreed to by the parties at the time of the dispute is fine. It can be actually a very efficient dispute resolution mechanism when it is imposed on parties, and especially when there is unequal bargaining power as in the poultry example that you have, and that is a very real-world example.

Opt-in/opt-out, do you want to continue to be my poultry raiser? In which case you are going to opt for whatever I want you to opt for because I as the contractor am going to have the power. So it is such a theoretically interesting step if you imagined equal bargaining power, but in real-world terms, it really does not solve the problem.

Senator FEINGOLD. Mr. Ross, do you want to comment at all?

Mr. ROSS. Certainly, Senator. This sounds like a provision in which there may be disagreement among farmers over whether they like it or they do not like it. Some may and some may not.

In any event, contract provisions really fall outside the purview of antitrust enforcement action except when they are a part of a larger analysis in a merger context.

Senator FEINGOLD. Fair enough. And thank you for the additional time, Mr. Chairman.

Chairman KOHL. Thank you very much, Senator Feingold. And, gentlemen, we appreciate your being here today. You have brought to light many of the important issues that we are discussing and studying, and thanks for coming.

We will turn now to the second panel. Our first witness on the second panel will be Wesley Batista. Mr. Batista is the President and the CEO of JBS/Swift and Company. Prior to becoming CEO of JBS/Swift, Mr. Batista was the chief operating officer of JBS's beef operations in Brazil and in Argentina.

Our next witness will be Steve Hunt. Mr. Hunt is the CEO and co-founder of U.S. Premium Beef and Chairman of the Board of National Beef Packing Company. Prior to his involvement at U.S. Premium Beef, Mr. Hunt worked in various areas of commercial banking, including direct agricultural lending and credit training.

Our next witness will be Bill Bullard. Mr. Bullard is the CEO of the Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America, or R-CALF USA. Prior to joining R-CALF USA, Mr. Bullard served as the Executive Director of the South Dakota Public Utilities Commission. He is also a former cow and calf rancher.

Our next witness will be Dillon Feuz. Professor Feuz teaches agricultural economic at Utah State University. His primary research interests are livestock marketing as well as farm and ranch management.

Next we will have Michael Stumo. Mr. Stumo serves as the general counsel for the Organization for Competitive Markets, which is a nonprofit research and advocacy organization with a focus on competition issues in agriculture.

And, finally, we will have David Balto. Mr. Balto is a Senior Fellow at the Center for American Progress where he focuses on competition policy, intellectual property law, as well as health care. He has also worked as an antitrust attorney at the Antitrust Division of the Department of Justice, Federal Trade Commission, as well as in the private sector.

We appreciate all of you being here today. If you will rise and raise your right hand, repeat after me. Do you affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but, so help you God?

Mr. BATISTA. I do.

Mr. HUNT. I do.

Mr. BULLARD. I do.

Mr. FEUZ. I do.

Mr. STUMO. I do.

Mr. BALTO. I do.

Chairman KOHL. Mr. Batista, we will start with you.

STATEMENT OF WESLEY M. BATISTA, CHIEF EXECUTIVE OFFICER, NORTH AMERICA, JBS SWIFT AND COMPANY, GREELEY, COLORADO

Mr. BATISTA. Mr. Chairman and other members of the Committee, thank you for the opportunity to introduce JBS/Swift to the Committee and to discuss our commitment to invest in America's meatpacking industry. I am the CEO of JBS/Swift, and I want to share with you today JBS' vision.

Our goal through these transactions is to invest our skills, energy, expertise, and money to grow the U.S. meatpacking industry. We want to expand U.S. sales of beef and pork, domestically and around the world. In the process, we will keep and create U.S. jobs.

We are operators of beef, pork, and lamb processing plants, not financial investors. My father started our business in 1955 when he slaughtered just one or two animals per day to supply restaurants in the new capital city of Brazil—Brasilia. We are still a family business. JBS now has global operation that we plan to use as a platform to expand the sales of U.S. beef and pork around the world.

Our history is clear. When we acquired Swift last year, we expanded operations, we added additional shifts, we hired more employees, we improved operations, and we bought more cattle. With respect to the Smithfield and National facilities, we will do the same—buy more animals, expand operations, and hire more workers.

As we are doing right now, we will continue to compete aggressively for the purchase of cattle and the sales of beef by all avail-

able commercial means. And we will increase our demand and sales over time. This will benefit ranchers and feedlots.

We will keep plants open, make them more efficient, expand sales of U.S. beef. We also look forward to hire more workers consistent with changes in U.S. immigration law. We view the U.S. labor force as a great resource.

A couple of questions have been raised that we would like to address. The first is our relationship with producers. We will continue to work with producers as we always have. I have had meetings with employees, cattle producers, and community leaders in Kansas, Colorado, and Texas, and feel we are being embraced. I will continue to do this.

There is one major region in the Nation which contains the vast majority of all the major slaughtering plants for steer and heifers. That region is the beef belt. It includes northern Texas, Oklahoma, Iowa, Kansas, Nebraska, and eastern Colorado. None of the Smithfield plants are in the beef belt. Most of the Smithfield plants handle primarily Holstein steers and cows.

Regarding the crucial beef belt, after this merger, JBS, Cargill, Tyson, and regional and local plants will continue to compete intensely for the purchase of cattle. With cattle moving on trucks, there will be many competing plants wanting to buy animals in the beef belt.

In terms of consumer prices, beef products are sold throughout the Nation by numerous competitors of all sizes. JBS/Swift sells primarily commodity beef and some case-ready beef and pork. In contrast, National Beef sells very successful, branded beef products, and we plan to expand those operations. Swift and National will continue to sell into different, and competitive, national markets.

In fact, when selling to large national retailers there will be intense competition among national, regional, and local players.

I want to end with one final point. The JBS history in the U.S. is before you. Swift was floundering, had reduced its work force, shut down shifts, and sold plants before JBS purchased Swift. Then, after we bought Swift, we expanded operations, added additional shifts, and hired more workers. We kept local managers.

We are investing billions of our company's money in the United States, with a goal to grow the industry, to hire more U.S. workers, and increase demand for U.S. beef and pork around the world.

We are fully cooperating with the Department of Justice review and hope that review can conclude as swiftly as possible so that we can implement our growth strategy on beef and pork.

We appreciate this opportunity to tell our story before this Committee and look forward to the answering your questions.

On a personal note, my family and I greatly enjoy living in America in our home in Fort Collins. This is a great country.

Mr. Chairman, thank you very much.

[The prepared statement of Mr. Batista appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Batista.

Mr. Hunt?

STATEMENT OF STEVEN D. HUNT, CHIEF EXECUTIVE OFFICER, U.S. PREMIUM BEEF, LTD., KANSAS CITY, MISSOURI

Mr. HUNT. Chairman Kohl, I appreciate this opportunity to come before you today to talk about JBS' proposed transaction to acquire National Beef from U.S. Premium Beef. I am the CEO of U.S. Premium Beef and the Chairman of National Beef, but most importantly, I am a fifth-generation cattle producer. I speak to you today on behalf of U.S. Premium Beef owners and independent producers, which on March 14th overwhelmingly voted to favor proceeding with this transaction. They believe that the livelihood of all cattle producers is dependent upon the health and growth of the beef industry, and that is why we agree with JBS' vision.

U.S. Premium Beef is a one of a kind producer-owned beef processing company, formed to link producers with consumers through ownership in processing. As a result, we have been able to design a supply of cattle specifically bred and managed to meet consumer preferences, which results in premiums back to the producer and the processing company.

U.S. Premium Beef was formed in 1997. In addition to processing customer cattle throughout the United States, we have processed over 6 million cattle of U.S. Premium Beef members. In addition to that, we have paid out over $117 million in cash premiums to our members since we began. We have also paid an additional $87 million in cash dividends. That was the result of our ownership in processing. In other words, our producer owners have become beef processors through U.S. Premium Beef. We have been able to realize the financial rewards from the ranch to the consumer's plate.

Simply put, through value-based pricing, our company gives producers the economic incentive to deliver more valuable, consumer-preferred beef.

Since our formation, we have been working to diversify our business geographically through expansion, acquisition of other protein businesses, and pursuit of businesses in markets outside the United States. This has been essential in managing the risk our owners take in ownership of processing. This is a strategy that producers pursue on the farm and that other businesses pursue as well.

Since the discovery of BSE in the United States in 2003 and the subsequent loss of the export market, losses and prospects of the declining herd have left the beef industry in a position where few want to invest.

In 2006, Hicks Muse announced that they were selling Swift. Smithfield Foods has also made the decision to exit the beef processing industry. Whereas prior to 2003, our company was routinely approached by willing investors and partners, today we witness very few, if any, parties willing to invest in the U.S. beef processing industry, except one.

JBS, a family owned business based in Sao Paulo, Brazil—you have just heard from Wesley Batista—with U.S. headquarters in Greeley, Colorado, is willing to invest over $3 billion in our U.S. meat processing industry. They believe that by putting our companies together, we can create more value and increase efficiencies, not only necessary to sustain our industry, but to begin growing it again.

More importantly, JBS has the same vision for industry growth and success as we do. Since acquiring Swift last year, JBS has expanded production and purchased more cattle. They also have looked for ways to expand demand for U.S. beef by pushing into new international markets. They are able to use their unique perspective to introduce U.S. beef to foreign companies and new customers.

For U.S. Premium Beef, this partnership with JBS is a natural decision that enables our producer owners to broaden our investment into a well-diversified, multi-protein world leader in value-added products, while at the same time we are able to maintain our founding principles of value-based pricing and dissemination of valuable carcass data to every single producer on every single animal.

JBS respects what we have accomplished at U.S. Premium Beef/National Beef and wants to buildupon our value-added strategy to help bring more value to producers so we can expand production once again. After the completion of our proposed transaction with JBS, more producers will have the ability to market through our unique producer-owned company by delivering cattle to more plants, thus reducing freight costs and improving efficiencies for producers and the processing company. Our confidence in JBS' dedication to expanding demand for U.S. beef is a strategy that is exemplified by U.S. Premium Beef's agreement to become a substantial investor in JBS.

The farmer and rancher owners of U.S. Premium Beef have a right and an obligation to pursue sound business strategies employed by our competitors, recommended by our universities, and applauded by Congress. These include value-added strategies through vertical integration from the bottom up, product diversification to lay off risk, and foreign investment to participate in the growing consumer global market.

As you know, the Department of Justice is reviewing the proposed transaction. I am confident its review will be thorough and, when complete, will lead them to recognize the benefits of this transaction. The beef processing industry is highly competitive, with Cargill, Tyson, JBS, and a number of other processors remaining to compete fiercely for cattle and to sell beef to our sophisticated customer base. This transaction will enhance this competition by allowing the combined company to perform more efficiently and provide a platform for growth in the future.

Mr. Chairman, thank you for this opportunity, and I look forward to answering questions later.

[The prepared statement of Mr. Hunt appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Hunt.

Mr. Bullard?

STATEMENT OF BILL BULLARD, CHIEF EXECUTIVE OFFICER, RANCHERS-CATTLEMEN ACTION LEGAL FUND, UNITED STOCKGROWERS OF AMERICA, BILLINGS, MONTANA

Mr. BULLARD. Mr. Chairman, thank you for this opportunity. I represent the thousands of men and women who own and operate cattle operations all across this country as the CEO of R-CALF

USA. Our organization endeavors to ensure that our independent cattle producers can remain profitable long into the future.

I want to describe our industry to you. The United States cattle industry is the single largest segment of American agriculture. It produces $50 billion annually; 11 States produce over $1 billion a year. This industry is intrinsically important to the overall prosperity of rural America.

It is important that the Subcommittee realize that while the four major packers do control the steer and heifer market, that steer and heifer market represents only 27 million of the 45 million cattle that are sold every year. Our U.S. cattle industry is a dynamic industry, and in that industry, we have various value-added segments. So while we have 45 million cattle sold every year, 27 million are sold into this highly concentrated marketing structure consisting of just four firms. And it is this segment of the industry that serves as a portal to actually cause harm throughout the industry if there is any price distortion that occurs within this segment.

Our industry can be viewed as a pyramid. At the base of the pyramid, you have the seed stock producers—the breeders. The breeders sell breeding animals to the cow/calf producers. The cow/calf producers produce a new calf every year. They will keep that calf for 4 to 6 months. That calf is then sold to a backgrounder. A backgrounder will grow that animal through what might be called its adolescent years. The backgrounder could then sell that animal to a stocker. The stocker would run that animal for about 4 months. So it takes about 18 months from the time that an animal is birthed until it is actually sold in the steer and heifer market to one of these four packers.

Our industry in this pyramid, those segments that I described—the breeder, the cow/calf producer, the stocker, the feeder—we have about 970,000 of them left in the United States. And as you move up this pyramid, you get closer to the feeding sector. There are about 93,000 feeders left in the United States. But that industry is becoming increasingly consolidated as well because there are now fewer than 2,500 feeders that actually sell approximately 23 million cattle to these four meatpackers.

So what I have described is an industry, a dynamic industry that is intrinsically important to the prosperity of rural America, that is valuable in every State of the Union. But this industry has the price-making segment at the top of the pyramid, and any distortion in that price will reverberate all the way down through the industry. A 3-percent reduction in price, for example, which is about what they found in terms of detrimental impacts of further concentration in this industry, a 3-percent impact would reduce that $50 billion annual revenue generation by $1.5 billion, a loss of $1.5 billion. This would be damaging to the 970,000 independent producers as well as damaging to the rural communities that they support.

This industry has been besieged by market power for quite some time, and we have ample evidence to demonstrate this, and I have provided that in my written testimony.

For example, we have lost 40 percent of our producers just since 1980. We had 1.6 million cattle producers in 1980. We are down

to about 970,000 today. Our size of the U.S. cattle herd has been reducing for many, many years. We have decreased the size of the herd today to about where it was back in the 1950s. And while we have reduced the size of our production capacity by reducing our herd size, we have also been experiencing a disruption of the historical cattle cycle. That cattle cycle has provided a bellwether indicator of the competitiveness of this industry. And recently, USDA acknowledged that the analogous hog industry that is also experiencing a loss in its hog cycle, that loss is attributed to a changing market structure, a market structure that is evidenced by further consolidation and concentration.

I want to leave you with this. Our industry is in a state of emergency right now. We continue to experience contraction. This merger is going to exacerbate the current contraction of this industry, and like the hog industry, as already described, you had 667,000 producers in 1980, down to 67,000 today. You lost 90 percent of all the producers in that industry. We are going to see the same thing in the cattle industry unless the Department of Justice, and unless the U.S. Senate and the U.S. House, take specific action to reverse the present course. Because, like Congress was unaware of the tremendous exodus of hog producers, you will be unaware of the exodus of cattle producers, because it will happen one cattle operation at a time in one rural community at a time until we wake up one morning and say we have lost the critical mass within this industry to maintain a viable market.

Thank you.

[The prepared statement of Mr. Bullard appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Bullard.

Mr. Feuz, Dr. Feuz?

STATEMENT OF DILLON M. FEUZ, PROFESSOR, DEPARTMENT OF ECONOMICS, UTAH STATE UNIVERSITY, LOGAN, UTAH

Mr. FEUZ. Thank you, Senator Kohl, for the opportunity to speak to the Committee.

Chairman KOHL. I do not think your microphone is on.

Mr. FEUZ. Thank you, Senator Kohl. I want to begin my comments by just reiterating the change that has taken place in the packing industry over the last 20 years when you look at the major players—Tyson who acquired IBP, Smithfield who acquired Moyer Packing, and Packerland ConAgra who was a major player in 1987, exited the industry in 2002, and most recently, Swift who went out with the JBS acquisition of those.

I point that out as a fact that this is not a static industry, but one where firms continue to enter and exit the industry. From a pure economic point of view, I would have much greater concern about the level of concentration and market power if I did not see firms entering and exiting the industry.

Second, I point out that there likely is not excessive profits being generated in this industry due to the level of concentration, or you would likely see the players that are there remaining in that industry to capture those excessive profits. Certainly I do not think if IPB were strong enough they would have allowed Tyson to acquire them, nor would have ConAgra, a major agribusiness firm that con-

tinues to be involved in agriculture, divested themselves of both cattle feeding and beef packing had they been earning excessive profits due to concentration.

As I look specifically at this merger, I see three potential benefits. First of all, as JBS/Swift has noted, they bring outside capital and new ideas into an industry that is probably needing both. As you look at the packing industry over the last couple of years, margins have been very small in that industry, and certainly some of the existing players are probably in a financial condition that they would not be able to continue operations without an addition of capital.

Perhaps even more important is the addition of some new ideas, particularly, I think, in the export market area where JBS Company has shown a history of being very aggressive in the world export markets, and I think they can bring that level of expertise to the U.S. and increase our exports, particularly into some markets where we have previously not had access.

Another benefit, I think, has been highlighted somewhat by Mr. Hunt from U.S. Premium Beef. They have had one of the premier pricing grids for fed cattle, particularly upper-quality fed cattle that has been in the industry, that has allowed independent producers to receive a premium if they are producing a higher-quality animal. Unfortunately, in the present situation, transportation has restricted the producers that could really benefit from that because all those cattle had to be slaughtered basically in western Nebraska to national plants. With this merger, that will become much more geographically dispersed into the Northeast, the Wester markets, as well as throughout Iowa, Nebraska, Kansas, and Texas as there are greater plants that would have that grid available.

And, last, I think on the market power issue alone, perhaps three strong players competing for a limited supply of cattle will be more aggressive in the marketplace than what I view as currently two strong majors and one weak major within two regional competitors, one of which itself was probably in some financial difficulty. As I talked with one feedlot operator in Utah, he mentioned to me that perhaps one strong player in the market would be better than a weak or no player.

On a couple of cautionary notes, certainly the loss of a bidder in a marketplace is a concern. Going from four major players to three in the primary cattle feeding area will be of concern. However, if the plants stay open, you will still have the same competition for the number of cattle. Perhaps of greater concern would be in the culled cow and dairy market in the Southwest where you may be going from two independent firms—Smithfield and National—to one in those areas. That could be a concern.

Last, I want to close. I have heard several comments today about a concern for the overall food price level and what this merger may do, and I would suggest that if the Senate is concerned about the price of food, it would be much more advantageous to look at what I view as an ill- advised corn ethanol policy that is doing far more damage in the livestock industry and will continue for the next few years than what this merger or others would do in that industry.

Thank you.

[The prepared statement of Mr. Feuz appears as a submission for the record.]

Chairman KOHL. Thank you, Dr. Feuz.

Mr. Stumo?

STATEMENT OF MICHAEL STUMO, LEGAL COUNSEL, ORGANIZATION FOR COMPETITIVE MARKETS, LINCOLN, NEBRASKA

Mr. STUMO. Thank you, Senator Kohl. I would ask that my written comments be submitted to the record, please.

Chairman KOHL. It will be done.

Mr. STUMO. The Organization for Competitive Markets has members, including feeders—large, medium, and small—across the spectrum. They are not here speaking today because they are afraid. They are afraid of retaliation in the marketplace if they say their fears about the lack of competition when the packer buyers discipline them every week and every day in the market.

When my members speak to DOJ, they insist on confidentiality agreements so nobody will find out, so they won't lose yet another buyer. They insist on it. They wish competition. They appreciate the packers. They appreciate Tyson, Cargill, Swift, National, and Smithfield, all of them. But they do not appreciate the chokehold on market access that public policy and the packers have combined to create. That chokehold is choking off the number of open negotiated market shackle space in these plants that is available for these fellows and feedlots to sell into.

When you exert market power, you want to grab the bottleneck. In the oil market, in the oil merger of BP-Amoco, Cushing, Oklahoma, was the bottleneck pipeline where price was set. That is where you wanted to have your hands wrapped around. Here you want to have your hands wrapped around rationing shackle space.

There is the Great Plains. You will see the overlap between JBS plants and National Beef plants. People will tell you that feeders in that area all have four buyers. They do not. They may have three, two, or the small guys may beg for someone to come look at their cattle. It didn't used to be. Through the consolidation, people say it makes no difference. They come up with happy theories as to why it will be happy for everybody. We have heard them today. They are untrue. The results are that: a declining number of cow operations and declining cow herd. We have 300 million people in this country today, increased from 200 million in 1967. They eat a lot of beef. We should produce more beef to feed them. We don't. Oligopsony power is predicted to be inefficient because it depresses prices, it depresses output. Oligopsony in this industry has met that prediction. As we concentrate, we depress price, we depress output. We hear vague claims of overcapacity, but yet we are going to expand capacity. Which one is it?

If there is overcapacity, it is because of oligopsony depressing price and depressing production. And that is bad. We could produce more beef. We could produce more beef to feed the U.S. This is what public policy has wrought. It is poor performance. DOJ has failed.

DOJ gets all wrapped up in competitive conduct. The judges have not treated them well. Structure matters. Just as 65 miles an hour is the speed we set on the highway, it is clear everybody knows you

can drive safe over that, but it is highly likely to create more accidents than going the speed limit. Structure is the same. We can argue about whether it is going to be unreasonable practices or something, but it is highly likely we will have bad results like you see on the right. We have had. It is a poorly performing country when we eat more food, or ag sector.

DOJ has failed in the Smithfield versus Premium standard merger because in a marginally competitive market they allowed merger to monopoly in the Southeast U.S. Ghastly result. One packer. They allowed it. Not an objection.

Monsanto bought Delta and Pine Land Company. That merger was rejected in 2000, but they took another run at it and, by golly, this DOJ let it happen, with an insignificant divestiture of Stonefield. Thus, Monsanto has 50 percent of the cotton seed market in the U.S., 75 percent in some key regions. Prices go way up. They also choked off competing research by other competitors like Dupont, Syngenta, and others to kill the baby in the crib so there will not be competition in the future with future innovation.

We like innovation and choice, and we like competition. We do not have it. All the arguments that say we do are based, as you heard, perhaps, may, this could happen—that sort of thing. There is no proof. That is why your bill 1759 shifts the burden of proof so they have to actually prove it. They cannot just think in utter happy thoughts so judges accept it and ignore all the proof of anticompetitive harm.

Antitrust is out of balance. We could have a flourishing agriculture in dairy, beef, and pork. We could have lower seed prices, more choice and innovation in seed, corn, cotton, and soy. We do not because of failures at the Department of Justice. S. 1759 is a good start, and DOJ needs to stop allowing marginal competitive industries to become more noncompetitive.

Thank you.

[The prepared statement of Mr. Stumo appears as a submission for the record.]

Chairman KOHL. Thank you, Mr. Stumo.

Mr. Balto?

STATEMENT OF DAVID A. BALTO, SENIOR FELLOW, CENTER FOR AMERICAN PROGRESS, WASHINGTON, D.C.

Mr. BALTO. Thank you, Mr. Chairman, and thank you for the opportunity to testify on behalf of the Center for American Progress and the Consumer Federation of America. I speak from the experience of over a quarter century as an antitrust lawyer, the vast majority of which as an antitrust enforcer.

I frequently represent parties before the DOJ and the FTC, and there is something different when you represent farmers before DOJ. The standards that are effectively applied are different. The level of attention is not as great.

I represented the hog producers in Premium Standard/Smithfield merger, and DOJ permitted the merger concluding that you could truck a hog 400 miles. There was just simply no evidence of that. They made a mistake.

I have a simple message today. This merger poses a serious threat to competition to both consumers and to producers. Increas-

ing concentration in agricultural processing, leads to less compensation to the farmer and higher prices to the consumers. Somehow both lose.

This merger, by combining three firms and reducing the number of beef processors from five to three, will lead to a level of concentration that the founders of the beef trust, the people who the Sherman Act was passed to stop, the founders of the beef trust could not imagine in their wildest dreams.

Now, I have never listened to a more persuasive case about the vulnerability of a market than that presented in the testimony of Mr. Stumo and Mr. Bullard. They demonstrated in their testimony how weak the position of the producers are, how they are increasingly subject to manipulation because of vertical integration and the short window they have to sell. With that as the foundation, if you look at the traditional approach under the law or the Merger Guidelines, even going past concentration, this merger poses a substantial unilateral, anticompetitive effect. JBS and National compete head to head for producers. Taking one out of the market is going to lower compensation.

This is an environment ripe for coordination, tacit collusion. There are lots of cases involving tacit collusion. They are noted in my testimony. And it is a lot easier to collude when you have only got three firms around the table instead of five. I am not suggesting that these firms collude explicitly. No, there is no need to. In a market like this one where the information is so public, where it is so easy to know what each firm is doing, they do not need to meet in a smoke-filled room.

Do we have hope? No, I am skeptical. This is a time of incredibly lax merger enforcement. Our friends at the Justice Department have not gone to Federal court to challenge a merger in 5 years. They say in their testimony, Mr. Chairman, they bring agriculture cases. None of those cases involve monopsony power. None of them involve protecting producers from buyer power. None. No case have they brought protecting producers against buyer power for 9 years.

Now, 9 years ago, the Deputy Assistant Attorney General testified before the Senate, and he said no—no to mergers in this processing segment. And so what happened? People found other ways of doing efficient transactions that Dr. Feuz has noted.

What is the problem here? DOJ is allowing the perfect become the enemy of the good. They are looking for the perfect case. They use econometric tools that they know at best are imperfect at best, and based on that, they simply are permitting a wide range of mergers to occur.

Now, I am not in any fashion criticizing the dedicated staff. What I am concerned about is the leadership that is applied to the Division. What can we do? There have been no other industries with as many hearings on competition issues as agriculture and antitrust.

First, DOJ must carefully scrutinize this merger. My testimony is explicit. They need to engage the opponents in an open dialogue. Mr. Ross testified here today that he hears the concerns of the producers. Well, Mr. Ross and his supervisors are not in this hearing room right now. They walked out of this hearing as soon as they finished testifying. Whether they hear it, that is not the point.

They need to engage the producers in an active fashion. Mr. Bullard and Mr. Stumo, traveling here on their own expense, have gone and provided tremendous documentation of a severe competitive problem.

Second, I hope the Committee exercises its oversight power. It sounds like you are moving in that direction.

Third, the FTC and DOJ to their credit have conducted a series of policy hearings over the past several years. They held hearings on the Merger Guidelines. Professor Carstensen testified and said you need special standards for monopsony. Was that issue ever addressed in their report on the Merger Guidelines? No. Did they address agricultural issues in that report? No. Did they address monopsony issues in that report? No. They have to do a better job of addressing these issues in a more concrete fashion and taking these issues seriously.

Finally, passage of the proposed Grassley-Kohl bill is absolutely necessary to redressing the imbalance here, to protect the interests of not only family farmers but consumers, because both parties ultimately benefit if the marketplace is truly competitive.

Thank you.

[The prepared statement of Mr. Balto appears as a submission for the record.]

Chairman KOHL. Thank you very much, Mr. Balto.

Mr. Batista, many independent ranchers are concerned that once this merger, if it is approved, occurs, they will have little leverage with respect to the enormous buying power of the three remaining large meatpackers and that the prices they receive will decline. Why are they correct to be saying that?

Mr. BATISTA. Mr. Chairman, basically our view about this, who defines the market, the consumers do. This industry needs to work to expand demand here in the U.S. and outside the U.S. For us, the most important thing this industry needs is to expand demand for U.S. beef. U.S. beef in 2003 had the BSE problem. We need to reopen all these markets and to sell U.S. beef to different markets and to have more options to aggregate value for U.S. beef.

Chairman KOHL. Mr. Bullard, what is your thought?

Mr. BULLARD. Well, Mr. Chairman, the alarming irony behind the fact that during the period when our industry was contracting, both in terms of the number of cattle operations and the size of our cattle herd and the loss of our cattle cycle, that was happening at the same time that domestic consumption of beef was increasing dramatically. After 1993, we saw a significant increase in the demand—domestic consumption, and yet our industry was contracting. That is counterintuitive to competitive market signals. That counters Mr. Batista's claim that all they need to do is increase more demand and that will improve conditions for cattle producers.

As was discussed earlier, the increased income does not fall back through to the cattle producers. It is captured by this highly concentrated marketing structure. Until we can explain why in the past 4 years we have had the widest spread between U.S. production and U.S. consumption, these arguments are baseless.

Chairman KOHL. Mr. Stumo?

Mr. STUMO. We hear and have heard justifications all the time—and I characterize them as "happy thoughts without proof," and for some reason people in decisionmaking positions have just accepted them. We heard about the quality, the vertical integration, the quality. We have seed producer members, seed stock producer members, that is. They produce Angus beef. They produce natural beef. They produce lean beef. There is no sign on their farms or ranches that say these cattle must go to only this packer or to this type of a contract arrangement. Everyone sells—every one of the benefits that have been mentioned today could be achieved through ways that are not anticompetitive, through better management, through better marketing, through genetics that are not exclusive to any marketing method or any plant. Swift, JBS/Swift, has a plant sitting now in Grand Island, Kansas, with a good shell that burnt—part of it burnt down a couple years ago, but I know they have told livestock associations that it is a good plant, they could put it back into operation. That is a way they could expand in Grand Island, Kansas, right over there, for cheaper than paying triple the value of U.S. Premium Beef shares, which is basically buying market power to shut out a competitor.

We are going to have no change in capacity, no change in plants, no change in plant size, no change in genetics, no change in consumer demand, but a decrease in competition and a market closure for many producers.

Chairman KOHL. OK. Mr. Bullard, JBS/Swift will also acquire, as we discussed, Five Rivers, the Nation's largest feedlot. This one feedlot feeds and markets 2 million cattle annually. Why does JBS's acquisition of Five Rivers concern you, Mr. Bullard?

Mr. BULLARD. Right now, Five Rivers feedlots is owned by Smithfield, and as Mr. Batista explained, Smithfield's slaughtering operations are far removed from the feeding area where the feedlots exist. In other words, Smithfield is not presently able to use the cattle produced in Five Rivers in order to satisfy their demand needs—their slaughter capacity of their plants.

Instead, we believe Smithfield operates that Five Rivers feedlot presently as an independent feeder, probably selling to Cargill, Tyson, and National.

However, under this merger, JBS will be in close proximity to all of those feedlots. Those feedlots produce about 2 million cattle a year, which is about 7 percent of the steer and heifer slaughter every year. So JBS is going to be able to capture 2 million head and to use those animals strategically to keep from entering the competitive marketplace to purchase cattle from other producers.

In addition to that, with that level of vertical integration that will occur within our industry, JBS is going to have a distinct advantage because it is going to have what would essentially be insider information. It is going to know the future orders for beef when it is out competing in the market for feeder cattle—lighter cattle from the independent cow/calf producers and stockers and backgrounders.

So JBS is going to have information about the value of those animals long before independent producers will have, and as a result of that, producers will be disadvantaged, again, by the exploitation of market power by the major packers.

Thank you.

Chairman KOHL. Thank you.

Mr. Stumo and then Mr. Balto, what is your response and reaction?

Mr. STUMO. The post-merger company, if this yet another anticompetitive merger is allowed, will have 43,500 head per day capacity. If you multiply that times 250 kill days per year, you are at 10.6 million head.

Smithfield's website advertises Five Rivers as 2 million per year capacity. If you figure each animal has a $1,000 value as a thumb rule, that is $2 billion. Smithfield right now has an incentive to maximize value, has an incentive that the market be a proper market. Those cattle are relatively free agents, though they may be contracted and partially a problem in some areas.

If they become part of this final JBS/Swift, they become nearly 20 percent of their full capacity, but as far as their fed cattle subset of capacity, excluding the Holsteins and the culled cows, which are directly tied to the fed cattle market but yet a different market—they are sort of a basis spread there—we are basically taking one-and-a-half plant equivalence offline in the Midwest.

So not only do you lose one buyer in the Great Plains fed cattle base price setting region, you are not only losing 25 percent of the buyers in the region, you are also taking another plant and a half out of the market, so you are almost going—instead of four to three in that region, you are almost going four to two in many ways. And that is assuming—which please do not assume that there are buyers from every one of those plants in every feedlot when there are feedlots begging for one buy.

So it is a major, major problem and a major additional shift beyond a mere horizontal merger.

Chairman KOHL. OK. Mr. Balto?

Mr. BALTO. Well, Mr. Bullard and Mr. Stumo, as always, hit the nail on the head. Vertical mergers can facilitate collusion. Let me just give you a real-world example in another industry. The market of paper label stock.

Several years ago, UPM, a Finish company, wanted to acquire an American paper label stock manufacturer. There was another competitor Avery that was vertically integrated. Because Avery was a large supplier of paper label stock and also a competitor of those firms, it was able to facilitate collusion that eventually was attacked by the European Commission.

In other words, the agencies—Senator Hatch's question suggested whether or not vertical integration was generally innocuous. No, in this setting and many other settings, it is not. It provides a very useful tool to facilitate either tacit or explicit collusion, and that should be a serious concern investigated by the Justice Department.

Chairman KOHL. All right. Mr. Batista, if the Department of Justice ordered you to divest the Five Rivers feedlot as a condition of approving the deal, would you agree to do that, the divestiture as a condition of approving the deal?

Mr. BATISTA. Senator, this is not our intention because we have this deal with Smithfield which includes Five Rivers and the

Smithfield beef plants. Only I would like to comment some about Five Rivers here.

The annual turnover in Five Rivers is around 1.4 to 1.6 million head per year. It is not 2 million head per year. Five Rivers represents around 5 percent of the total U.S. cattle slaughter. When Five Rivers is running around this number, it will represent around 10 percent of our slaughter per year. Five Rivers today runs independently—it will continue running the same way it runs today. Five Rivers does not sell a lot of cattle in the spot market, but through contracts. In our view, sincerely, Five Rivers is part of the deal with Smithfield.

Chairman KOHL. What about you, Mr. Balto? Do you think we ought to place that as a minimum condition on a deal?

Mr. BALTO. I think if you really carefully study the testimony of Mr. Bullard and Mr. Stumo, you see this is a fragile market that any kind of acquisition should receive extremely serious scrutiny. And I doubt that a divestiture of Five Rivers and all of National's plants in the Plains States would be sufficient to remedy all those competitive concerns.

Chairman KOHL. Mr. Bullard, if the meatpacking firms gain lower prices for cattle because of their increased buying power, do you think it is likely that these price savings will be passed on to consumers?

Mr. BULLARD. We, in fact, see evidence to the contrary. In my written testimony—and if I need to, I would ask that it be submitted into the official record as well.

Chairman KOHL. It will be.

Mr. BULLARD. But in that testimony, you will find a chart that shows, for example, the hog industry. It shows the price spread between the price that producers receive for hogs versus what consumers are paying for pork in an industry that is even more vertically integrated than is the U.S. cattle industry. There we see an inverse relationship—an ever increasing cost to consumers for pork and a decreasing price paid to U.S. hog producers.

The cattle industry at this point in time and the chart in my written comments show that U.S. consumers are paying more for beef, and that while live cattle prices have indeed increased since 2003, the spread between what the producer receives and what the consumer pays is ever widening, indicating in economic terms that the market is becoming inefficient and inequitable for both consumers and producers.

So the answer to the question is no. If the meatpacker pays less for cattle, as we have seen over time, U.S. consumers will continue to pay whatever the retailer can charge and is accepted by consumers, and prices will continue to increase. We have lost the relationship, the direct relationship between the price of the raw commodity and the price of the commodity eventually sold to the consumer.

Chairman KOHL. Mr. Batista, do you agree with Mr. Bullard?

Mr. BATISTA. Basically, Senator, this market is very dynamic. This market is driven by supply and demand. When the price hits cycle, we have seasonal influences here in the U.S. in this time, the demand is better. In our view, the market is following the cattle

price and the beef price, following the same structure, following supply and demand.

Chairman KOHL. Anybody want to comment on his statement? Dr. Feuz?

Mr. FEUZ. A comment on a couple of things that have been discussed. One, the chart here on the right only shows half the picture in terms of we have had declining cattle numbers, but pounds of beef have actually -was at a record level in 2006. So when you look at the consumer market, they have seen more product.

In my opinion, the price level is not established at the packer level. The price level is established at the retail level. We can increase cattle numbers. We can increase beef production. We can force consumers to eat more. But it will be at a lower price. The packers work on a margin. They pass it down. Certainly that margin has widened because the costs have increased as well as what we have asked packers to do with that product has changed drastically in the last several years from going to producing—simply harvesting the animal and leaving the plant with carcass beef to all the value-added processes. Even if you look at how we sell hamburger in the retail industry today, a lot of that is in patty form, not in bulk. We already have the seasoning put in for taco meat, fajitas, et cetera. All those processes have been aimed at hitting consumer demand, increasing consumer demand, but one of the results of those will be a wide spread between the retail price and the farm-level price.

Certainly that can happen without packers or the retailers extracting an excessive margin due to market power.

Chairman KOHL. Thank you.

Mr. STUMO. Sir?

Chairman KOHL. Yes, sir, Mr. Stumo.

Mr. STUMO. Sir, that is untrue, what was just said. The data series excludes the further processing. We have heard for years that all this consolidation is necessary to become more efficient. If it has been so, we would have seen less in the margins with the same data series excluding adding seasonings to fajita meat. That is not part of it. We have seen widening margins because of market power. It is a poorly performing sector, and the consolidation apologists were wrong.

Mr. BULLARD. Mr. Chairman, if you would look at Figure 3 in my written comments, you would find that his depiction of the production in the U.S. is wrong as well; that, in fact, in the last few years the production of domestic beef produced from domestic cattle is about the same as it was back in the early 1980's, mid-1980's.

We have not seen a consummate increase in the production of beef while we have witnessed an alarming contraction in the number of cattle producers and the loss of our herd.

It simply is not true, and the chart is documented with USDA data to show it.

Thank you.

Mr. BALTO. Just to tie the loop on one other thing, just so nobody in this room is mistaken, these prices are not set. I mean, retailers do not exercise some kind of market power. That is not where the margin is coming in. As you well know and everybody knows, supermarket retailers are an intensely competitive market where

they have extremely small margins, and if there are increases in price, it is not substantially on the retail level.

Mr. HUNT. Mr. Chairman?

Chairman KOHL. Yes, sir, Mr. Hunt.

Mr. HUNT. I frankly do not know where to start, but I am not a practicing economist, but my family still is in the business, whether they be cow/calf producers, farmer feeders, they run feedlots, and certainly we are involved in processing. But I have a problem with the assumption—of leaving out the assumption that drought had anything to do with our supply of cattle within the United States.

In addition to that, we have seen record cow/calf prices in the last 5 to 10 years. You know what? I am happy for that. That is good for my family. That is good for our industry. Our goal is to add value to the top line.

We also know that our costs are going up dramatically, the costs of our inputs, the costs of our transportation. The only way that we as an industry can grow back is to add dollars to the top line.

Additionally, I am not—I may have misunderstood the answer, but what I thought I heard was the retailer was not taking the margin with the assumption the packer was. It is very documented that we have seen the worst packer margins in probably the last 30 years, in the last 3 years since BSE was discovered.

Chairman KOHL. All right. Mr. Batista, is it true that the Brazilian Government has subsidized your acquisitions of National and Smithfield—or Swift?

Mr. BATISTA. No, Senator, to my knowledge that is not the case. JBS today is a public company. We have had investments from BNDES, a federal development bank, in Brazil. BNDES, a federal public company, has normal investments in JBS stock and has also extended JBS modest loans at competitive rates. JBS is a public company, and BNDES has some participation, but there was a public offer and there are a lot of JBS shares traded on the Sao Paulo stock exchange in Brazil. I believe that a lot of U.S. investors have JBS shares.

Chairman KOHL. Mr. Stumo, Mr. Hunt in his testimony made the point that investment is needed in beef processing, and only JBS is willing to make that investment. Do you believe that there is merit in that argument?

Mr. STUMO. If this were a mere asset purchase of a company that was in trouble, it would be asset value plus maybe a premium, which is the opportunity cost, the investment. My understanding is—and I am not going to die on this sword, but my understanding is that the premiums—USPB shares were trading at 110, 120 among producers. It was nearly, you know, 2½ to 3 times the price. It is a typical premium you would see when you are procuring market power, not merely buying assets of a firm that is in trouble.

You see this causation argument between, well, firms are changing hands with other companies, thus the market is competitive. I do not know where that comes from. There is no economic text that would even support such a theory. You have firms changing hands if they are doing well, if they are doing worse.

If you have a new firm coming in, they will buy at an asset price plus a little bit of premium. But if they are buying market power,

it is worth a lot more because you are closing down a competitor. And that is what is happening here in my view.

Chairman KOHL. Well, thank you, gentlemen. It has been a good hearing. We will leave the record open for a week.

After hearing all the testimony, I remain concerned about the sharp consolidation in the meatpacking industry caused by this acquisition. I believe that these deals run the risk of substantially harming the cattle market. I hope very much that the Department of Justice continues to look at this and decides in a manner unlike what I believe that they are heading in the direction of.

But, at any rate, it has been good to have you. I think you have shed a lot of light, and we will do all we can to see that justice is served.

Thank you all for being here.

[Whereupon, at 4:22 p.m., the Subcommittee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

Responses of David Balto to Questions from Senator Kohl

1. If this merger is approved, buyers of beef –such as supermarkets, small grocery stores and butcher shops, and restaurants — will only have three national meatpacking firms to choose from. Is this sufficient for competition, or are you concerned that so few national suppliers will lead to higher prices paid by consumers for their beef?

Yes. I believe there will be significant competitive concerns if the number of providers of beef is reduced so that there were only three national beef meatpacking firms to choose among. Such a market would be highly concentrated according to the Department of Justice Merger Guidelines, one in which we could expect that the merger would lead to higher prices and less output.

It is important to recognize, however, that the impact on consumers is not divorced from the impacts on beef producers. Economic theory is clear that when an intermediary, such as a meatpacker, has buyer power they will exercise that power by reducing output, and that ouput reduction will lead to higher consumer prices. The testimony at the hearing was clear that this merger raises very serious concerns over the exercise of monopsony power, and that there appears to be a strong likelihood that the merger will result in lower payments to cattle producers. This reduction in output ultimately will lead to higher prices to consumers. Not only will any reduced compensation to cattle producers not be seen on the store shelf, but the prices on the store shelves will increase because of this merger.

2. Mr. Bullard of R-Calf has asserted that for two weeks in February 2006, the top four meatpacking firms ceased buying cattle on the open market. The meatpacking firms reduced slaughter rates rather than enter the cash market. As a result, cattle prices fell sharply. Cattle Buyers Weekly said at the time that the meatpackers' conduct was part of an effort to "try and get cattle bought cheaper."

Do you believe that JBS Swift's acquisition of the captive supply offered by the Five Rivers Ranch Cattle Feeding LLC ("Five Rivers") make it much easier for them to unilaterally engage in such conduct in the future to force cattle prices down?

Mr. Bullard has made a keen observation here that must be fully investigated by the Department of Justice. One of the reasons why vertical integration, such as the acquisition of captive supply described in the question, may be anticompetitive is that it may facilitate collusion. There are numerous examples in the beef industry where captive supply has been used to manipulate the price in the cash market. By acquiring Five Rivers, JBS will be in a far more effective position to facilitate collusion.

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3. Would a condition that JBS Swift be required to divest Five Rivers after these acquisitions make these acquisitions acceptable, or do you believe that it would still substantially harm competition even with such a divestiture? Please explain why.

A divestiture of Five Rivers might help to reduce some of the anticompetitive impact of the merger, but it clearly would not be sufficient to eliminate all of the potential anticompetitive impact. As described in the testimony, by controlling Five Rivers, JBS is in a better position to facilitate collusion among the remaining meatpackers. However, even if Five Rivers is divested, the meatpacking market in certain parts of the Plains area will continue to be highly concentrated, and this merger will substantially increase that level of concentration. Therefore, a divestiture of Five Rivers alone is not sufficient to resolve all the competitive concerns.

4. We've heard a lot of testimony about the number of beef packers across the country. But shouldn't we really evaluate this transaction based on its effect on local and regional geographic markets? Isn't it true that meatpacking plants mainly obtain their cattle from no more than a few hundred miles away?

The focus of the inquiry under the Merger Guidelines and merger law is on the consumer or producer who is affected by the merger. As an initial matter, the Justice Department should analyze competitive alternatives, including the geographic range of alternatives, from the perspective of an individual group of producers or consumers. For most producers, the distance to ship cattle is a relatively short distance and, therefore, in most situations, the appropriate geographic market to analyze the competitive effects of a merger may be local or regional.

5. Should the meatpacking firms gain lower prices for cattle because of their increased buying power, do you think it likely that these price savings will be passed on to consumers? What does the historical record in this industry tell us?

No. It is clearly not the case that lower prices paid to cattle producers results in lower prices to consumers. The evidence provided by the witnesses from R-Calf and the Organization of Competitive Markets was clear that even though compensation to cattle producers had decreased, those reductions has not resulted in lower prices to consumers. In some situations, the reduction in costs does result in lower prices, but that has not been true of the beef market. This merger, by increasing concentration, both on the buyer and seller side, is unlikely to result in lower prices to consumers.

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Questions from Senator Grassley

1. In your opinion, do you believe that the Justice Department has an appropriate understanding of the agriculture industry, and thus is appropriately evaluating mergers in the agriculture sector?

No. The general lack of enforcement in the agricultural industry is disappointing.

As I stated in my testimony, I believe that the professional attorneys in the Justice Department work very hard and are committed to their responsibilities to enforce the antitrust laws. One cannot truly evaluate the reasons for a lack of enforcement by the Department of Justice without having a clear understanding of their enforcement decisions. Almost all of the Justice Department's decisions not to bring an enforcement action are confidential, and therefore it is difficult to assess whether the Justice Department has an appropriate understanding of the agriculture industry. That is why I suggested in my testimony that the Committee ask the General Accounting Office to conduct an investigation of why the Department of Justice has not taken enforcement actions in various agricultural mergers.

Let me add one observation. It is critically important for government enforcement officials and the courts to recognize that the antitrust laws are not a "one-size-fits-all" approach. Many of the basic inquiries that are required by the Merger Guidelines do not work well when dealing with questions such as monopsony. There are unique economic factors in agricultural markets, such as the perishability of goods and the long-time commitments that farmers make that would suggest a different way of approaching merger issues. I think the Department needs to make a greater effort to recognize those industry-specific factors in their analysis of agricultural mergers.

2. How well does the Antitrust Division deal with consumer groups, agricultural producers, and other third parties representing the public interest, in particular with respect to the agriculture industry?

I have represented consumer groups and agricultural advocacy groups before the Department of Justice in various matters. Again, I believe the staff attorneys are polite and hard-working, but the Division needs to engage in a more open and interactive dialogue with these parties in their assessments of the competitive effects of the mergers. In addition, it often may be quite difficult to secure information from third parties about the impact of a perspective merger. One simple concrete approach to this problem is for the Department to travel to the areas most impacted by the merger and meet directly with farmers and

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producers. It is somewhat surprising that the Department conducts these mergers investigations without actually visiting the geographic area impacted by the merger. Finally, to get more of a local perspective on a merger, the Department of Justice should actively solicit the assistance of state attorneys general and make them full partners in their investigations.

3. Do you believe that the Justice Department does a good enough job at explaining why, after an investigation, it has or has not taken enforcement action?

As suggested above, the Department of Justice does not do an adequate job of explaining their reasons for either bringing or not bringing an enforcement action. There is only one merger — the Premium Standard/Smithfield merger — in which it issued a closing statement. Having worked on that investigation for several consumer groups and agriculture producer groups, I believe the statement failed to provide an adequate description for not taking an enforcement action and the reasons given in their decision not to bring an enforcement action seemed to be inconsistent with the actual facts.

4. Do you think that the current antitrust laws need to be amended to take into account the unique characteristics of the agriculture industry? How would you improve the way the Justice Department reviews agriculture sector mergers?

Yes. I have practiced antitrust law for over a quarter of a century and have held several senior-level positions. In my 15-year career as a public servant at the Antitrust Division in the Federal Trade Commission, I believe that the antitrust laws almost always work well in protecting the interests of consumers and producers. However, in the area of agriculture I think the statute is in serious need of revision. In particular, I believe that Congress should enact the Grassley-Kohl bill which provides an improved approach to and analysis to agricultural mergers.

5. In your opinion, do State Attorneys General have a role to play in agriculture mergers? Have they been active in challenging anti-competitive mergers and acquisitions? What about State Departments of Agriculture? Do they have a role to play in policing anti-competitive and abusive business practices in agriculture?

I believe that State Attorneys General and State Departments of Agriculture should play a more significant role in the investigation of agricultural mergers. The Department of Justice sometimes includes these agencies as participants, but often relegates them to a secondary role. I believe that these state entities should be full partners and that the Department of Justice should consult state enforcers on a regular basis on agricultural competition issues.

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6. Do you agree with the opinions of the JBS and National Beef witnesses about the benefits of the JBS merger? If you don't, what do you believe are the more significant problems presented by this transaction?

History has shown that mergers almost always fail in achieving the efficiencies that are sought. This may be for a variety of reasons, including the fact that merging parties have an overly optimistic view of the opportunities as a merger is being proposed.

In essence, JBS proposes that the merger will be procompetitive because they have better managers and a strong commitment to these facilities. Of course, management expertise is something that is readily attainable from any of a number of sources. These plants being acquired are profitable and do appear to operate at an efficient scale. The ultimate question any antitrust official must ask is "are the efficiencies specific to the merger, or can they be achieved through a less anticompetitive fashion?" In this case, the efficiencies do not appear to be merger-specific and should not justify this merger.

I believe this merger raises the threat of very substantial anticompetitive effects. The testimony of R-Calf and the Organization for Competitive Markets document at great length the competitive concerns raised by this merger, particularly in terms of its impact on cattle producers. The merger may lead to a significant decrease in compensation to cattle producers, harming those producers, reducing output, and ultimately raising prices to consumers.

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Follow Up Questions for Wesley Batista from Hearing Entitled "Concentration in Agriculture and an Examination of the JBS Swift Acquisitions

From Senator Kohl

1.Mr. Bullard of R-Calf has claimed that for two weeks in February 2006, the top four meatpacking firms ceased buying cattle on the open market. The meatpacking firms reduced slaughter rates rather than enter the cash market. As a result, cattle prices fell sharply. Cattle Buyers Weekly said at the time that the meatpackers' conduct was part of an effort to "try and get cattle bought cheaper."

A: JBS' business philosophy is to expand output and operate plants as close to full capacity as possible. We want to and intend to keep all of our plants full to maintain operating efficiency at the plant level.

2. Won't JBS Swift's acquisition of the captive supply offered by the Five Rivers Ranch Cattle Feeding LLC ("Five Rivers") make it much easier for JBS Swift to un ilaterally engage in such conduct in the future to force cattle prices down?

A: Nearly all Five Rivers cattle are already under contract today to JBS and National Beef. The proposed acquisition will not change this, we expect and intend that these cattle will be going to the same place that they are today. Furthermore, Five Rivers represents less than 5% of the cattle produced in the United States. Owning Five Rivers will not give JBS the ability to affect the price of cattle.

3.H ow will JBS Swift utilize Five Rivers? Will Five Rivers be used solely to supply JBS processing facilities or will the cattle there be bid on by all three major processors in a non-discriminatory way?

A: JBS intends to operate Five Rivers as a standalone business entity, which will act to maximize its independent business interests. JBS and Five Rivers will continue to comply with all applicable laws governing purchase and sale of cattle.

4.W ould you accept a condition that the cattle at Five Rivers be made available to all the remaining beef processors in a non discriminatory manner?

A: JBS will operate Five Rivers as a standalone business entity, which will act in its independent interest. JBS and Five Rivers will continue to comply with all applicable laws governing purchase and sale of cattle.

5. We've heard a lot of testimony about the number of beef packers across the country. But shouldn't we really evaluate this transaction based on its effect on local and regional geographic markets? Isn't it true that meatpacking plants mainly obtain their cattle from no more than a few hundred miles away?

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A: Competition for the purchase of cattle is and will remain intense following the proposed transactions. The transactions will leave intact numerous competitively viable options for feedlots to sell their cattle. Even looking at the "High Plains" or "Beef Belt" area today, the overwhelming majority of feedlots will either experience no change in the number of processors or will continue to have at least three (or five) competing processors within 250 (or 500) miles

As a practical matter, incremental transport costs per pound for the shipment of cattle are relatively low, and feedlots already can and do ship cattle great distances. Even R-Calf, which strongly opposes the proposed transactions, has publicly acknowledged that cattle in the U.S. are regularly shipped at least 300 miles. R-Calf and LMA have also publicly noted that feeder cattle ship virtually nationwide, meaning that any hypothetical attempt to lower prices paid to cattle producers would be quickly defeated as cow/calf operators diverted supply to other regions of the country.

6.W e have heard some analysts say that there is an overcapacity in the meatpacking industry, and predict that JBS Swift will close some plants after the merger is completed. Is this true? Do you believe there is overcapacity in the meatpacking industry? And do you expect to close any plants in the years ahead?

A: While marketplace conditions always influence operating decisions, JBS' business philosophy has always been to expand output and increase production, and we intend to continue to operate all of the plants being acquired as efficiently as possible. Operating the plants at higher – not lower – utilization rates is critical to achieving cost savings and other synergies expected to be realized from the transactions. JBS successfully implemented this strategy following its acquisition of Swift & Co. Swift's Greeley plant had been operating only one shift and had been considered for closure. After the acquisition, JBS kept the Greeley plant open, added a second shift, expanded cattle purchases and beef output, and significantly increased operating efficiency. JBS intends and expects to achieve similar results with the plants it will acquire from National Beef and Smithfield in the transactions.

7.W ith these acquisitions, there will be three large meatpacking firms controlling more than 80% of the market in the United States. Do you agree that any more consolidation or greater concentration would be anticompetitive?

A: No, I do not agree. The number of suppliers and concentration are not reliable predictors of how competitive a marketplace is. In fact, I believe that competition between JBS and the other large beef suppliers will actually become even more intense after the proposed transactions are completed,be cause JBS will be a more efficient, lower-cost supplier. Competition from numerous smaller processors – both upstream and downstream – will also remain intense. In addition, beef customers are highly sophisticated purchasers who have the ability to play one beef supplier off of another to assure that they receive competitive pricing

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From Senator Hatch

1. Mr. Batista, the United States' meatpacking industry has had a rough time over the past several years. Many in the meatpacking industry believe that there is a surplus in meatpacking capacity. Under a classic economic analysis there are two methods to eradicate overcapacity. The first option is to close down redundant facilities. The second is to expand the markets for the meatpacking industry. I have been informed that JBS Swift intends to use the latter course and expand the markets for American beef. The Korean government's recent decision to reopen their markets should assist in the implementation of this strategy. However, some continue to question if the expansion of American beef exports is truly the core of JBS Swift's strategy. Mr. Batista, JBS Swift has a history of buying meatpacking enterprises outside of your native Brazil. In particular, I understand that JBS Swift has recently acquired holdings in Argentina, Australia and Italy. Did JBS Swift encounter overcapacity in those markets? Was it JBS Swift's business plan to similarly increase revenue by purchasing those foreign holdings? If American beef export expansion is your goal, what international sales infrastructure does JBS Swift have, that U.S. Premium Beef and National Beef lack, to finalize those increased sales?

A: JBS has historically followed a business philosophy of increasing output and expanding sales. After we acquired Swift & Co. last year, we expanded operations, added more shifts, hired more employees, improved operating efficiency, and bought more cattle. JBS plans to continue this growth strategy by combining our established international marketing expertise with National Beef's expertise in branded and value-added beef programs in order to grow demand for U.S.be ef both domestically and worldwide. We agree that the recently announced, but not yet in effect, re-opening of South Korea to U.S.be ef exports creates significant new opportunities for ranchers and JBS to work together to expand output and increase export sales of U.S. beef. JBS has proven its expertise in international sales by its success in utilizing its international sales infrastructure. For example, when Russia reopened to U.S. beef imports, JBS, which has a sales office in Moscow, was poised and ready to take advantage of this opportunity, and was among the first companies to begin selling U.S. beef into Russia.

2. Mr. Batista, the future and the market effects of the Five River feedlots was one of the major topics of discussion during the hearing. In greater detail, please address the transaction as it relates to Five Rivers and explain how those facilities will be used after the merger. In addition, how will the proposed transaction impact independent feedlots or other producers?

A: JBS intends to operate Five Rivers as a standalone business entity, and it intends to continue to act in the market as it does today. Almost all Five Rivers cattle are already sold under contract today and to JBS and National Beef. Five Rivers represents less than 5% of the cattle produced in the U.S. Transferring ownership of

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Five Rivers to JBS will not in any way enable JBS to affect the price of cattle in the U.S Independent cattle producers will continue to have many alternatives for selling their cattle.

3.Mr. Batista,issues were raised about the reduction in the number of companies that would be bidding for cattle and the impact that could have on competition. One witness, Professor Dillon Fuez, testified competition could increase with three strong companies rather than two strong companies. He said that "as one considers the market power dynamics of the new beef packing industry if this merger were approved, it might well be that there is actually increased competition." What are your thoughts on the matter?

A: JBS will inject much-needed capital and bring expertise, best practices, and innovative management to a "stagnant' U.S. beef industry. The U S. beef processing industry desperately needs an infusion of new capital and new ideas. JBS is a long-time, family-owned operator of beef, pork and lamb processing plants with a long-term commitment to the industry, not a financial investor. We have a proven track record of successful operation in the U.S. beef industry in our acquisition of Swift & Co. Following the acquisition, JBS rapidly and successfully added shifts, expanded cattle purchases and beef output, increased efficiency, and grew demand for U.S. beef. Continuing that pattern of success, the proposed transactions will enable JBS to generate substantial cost savings and other synergies. JBS believes that the expertise and efficiency of the combined company following the proposed transactions will require other processors to compete even more vigorously post-transaction.

From Senator Grassley

1.Research to date shows significant economies of size associated with larger meatpacking plants. Today, nearly all fed cattle packing plants are large, efficient plants, slaughtering 1 million or more cattle annually per plant. Are there efficiency gains yet to be gained for individual plants? Since the plants that JBS plans to acquire are fixed plants in that they are not being expanded, will there be some type of coordination in the livestock/meat marketing channel that will make the plants more efficient? Where specifically are the efficiency gains then of merging already large, multi-plant firms?

A: JBS believes that there is always room for additional efficiency gains in this industry. This has been our experience after each prior transaction (e.g., our acquisition of Swift & Co. last year). Over and above improving efficiency in each plant (by implementing best practices), there are significant additional efficiency gains that will be realized from creating an expanded multiplant platform that combines the complementary plant locations and product strengths of JBS, National Beef and Smithfield. Combining the geographic locations of these plants will enable the merged firm to gain expanded access to premium cattle nationwide. The merged firm will be able to take full advantage of access to these cattle by bringing National

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Beef's expertise in branded and value-added programs to this expanded platform. This expanded geographic footprint will offer more efficient distribution of products to downstream customers and improve the merged firm's ability to provide customer services. Ranchers will also share in these benefits, because the merged firm's expanded geographic coverage will give cattle producers expanded access to the premium market for sale of cattle for branded and value-added programs.

2.T o date, research indicates gains in efficiency offset any loss from monopolistic elements. Efficiency gains can be viewed as positive by producers (translating into higher fed cattle prices) and consumers (translating into lower beef prices). What assurance can you give producers and consumers that monopoly elements will not someday – say from this merger – lead to a reversal and monopolization losses exceeding efficiency gains? In a time of rising prices at the grocery store, will you be able to pass on these efficiency savings to consumers and become more price competitive with other proteins?

A: The proposed transactions will not create "monopolization" market power for JBS, since other national, regional and local competitors will continue to participate in the market. Tyson, Cargill and numerous other processors will need to compete more vigorously with the merged firm due to its increased efficiency. Consumer prices will continue to be driven by supply and demand forces among many competitors.

3.U S Premium Beef has been a model of what producers can accomplish in terms of value enhancement. USPB has indicated their operations on behalf of investor-cattlemen will continue if this merger goes through. What assurance can you give producers that this model will be continued into the future with gains accruing directly to the investor-cattlemen?

A: USPB will remain a valued partner, and will remain a stakeholder in JBS following the completion of the proposed transactions. The expertise of the USPB members in branded and value-added beef programs is a critical source of the deal's synergies and strategic benefits. JBS does not anticipate changing in any way either the relationship with USPB or the operational role of its members. We anticipate that USPB members will realize significant benefits from the transactions, particularly because the transactions will increase demand for USPB members' premium-priced, value-added cattle. JBS was very pleased that USPB members voted overwhelmingly (over 90%) in support of the JBS-National Beef transaction. U.S. Premium Beef, "U.S. Premium Beef, LLC, Unitholders Overwhelmingly Vote to Approve Agreement to Sell National Beef Packing Company, LLC To JBS S.A.," press release, March 14, 2008, available at http://www.uspremiumbeef.com/USPB%20unitholder%20vote%20press%20release%20FINAL%20031408.pdf. We think this indicates that the USPB members share in our vision for the success of the combined company and recognize the benefits that they will realize as a result of the proposed transactions.

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4.I n Iowa, we produce more hogs than any other state However, the hog marketing channel is quite different from the beef cattle market channel. Hogs have tight genetics, are fed in confinements, and in general the process has very intensive control. One of Smithfield's strategies was to do the same thing with Five Rivers, but this did not work. Feeding capacity and slaughter capacity were located too far apart. Is JBS going to be able to coordinate this better? How do you plan to manage it? For example, the majority of hogs in Iowa are under production contract. Do you plan to develop production contracts in the future similar to the hog model, but just in beef?

A: JBS will continue to offer ranchers a variety of options for selling cattle (e.g., cash, alternative marketing arrangements) and will negotiate for the sale of cattle as it always has. We will continue to compete vigorously with other processors for cattle, and will utilize whichever forms of cattle purchase agreements producers choose to negotiate.

5.S ome cattlemen oppose packer ownership of cattle and feedlots. Opposition often focuses on leveraging packer owned fed cattle against cattle purchased in the open market. With the acquisition of Five Rivers Ranch Cattle Feeding, perhaps a bigger concern is JBS competing with its deep pockets for feeder cattle. How can JBS assure it will not push up the cost of feeder cattle to other feedlots? How soon will cattle from Five Rivers feedlots be funneled directly to JBS packing plants? What is JBS's philosophy on procurement of cattle? What percentage of cattle do you anticipate will be purchased on the spot market by your firm?

A: Five Rivers will operate as a standalone business entity. JBS will continue to participate in feeder cattle procurement to the extent that it makes business sense as part of our strategy to increase output, expand production, and grow the demand for U.S.be ef worldwide. A key part of our cattle procurement philosophy is to build partnerships and strong relationships with key stakeholders, including cattle producers. JBS' success is entirely dependent on having a reliable supply of cattle to fill its plants, and we are committed to working closely with producers to find the most efficient ways to achieve this.

6.Mov ing products both domestically and internationally is a necessity to compete globally. Can you explain your strategy for international exports? In other words, does JBS have the ability to access export markets that current packers do not? Do you believe that this merger will have any affect on our trading relationships with Mexico or Canada?

A: JBS has unique access to overseas distribution relationships for U.S. beef, and has significant expertise and experience in selling U.S. beef abroad. JBS has proven its expertise in international sales by its success in utilizing its international sales infrastructure. For example, when Russia reopened to U.S. beef imports, JBS, which has a sales office in Moscow, was poised and ready to take advantage of this

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opportunity, and was among the first companies to begin selling U.S. beef into Russia.

7.I s JBS planning to import beef to the United States? If so, what are the countries and the projected amounts?

A: JBS has no current plans to import beef into the United States beyond the small amount it imports today – and Swift did prior to its acquisition by JBS – from its (formerly Swift's) Australian operations.

8.A ccording to some news reports, JBS was found to have manipulated cattle prices in Brazil. Can you explain the allegations and the details of any settlement with the Brazilian government? Can you provide my office the written allegations by the Brazilian government and any consent decree, settlement or similar document?

A: The investigation to which you refer arose in the context of a meeting of representatives from several Brazilian beef processors to discuss a potential response to a proposed piece of tax legislation. Some time after this meeting, JBS, Mr. Artemio Listoni (an employee of JBS') and I were included as defendants in an antitrust investigation related to that meeting. Following the investigation, neither JBS, Mr. Listoni nor I were found to have manipulated cattle prices in Brazil or to have engaged in any other anticompetitive behavior. The investigation as it related to us was closed pursuant to a settlement agreement, under which we were not required to admit any wrongdoing and the parties involved paid fines limited to the minimum amounts established by law. In its statement regarding the settlement, the Brazilian authority stated that the alleged conduct related to a minor portion of JBS' turnover, and that the conduct under investigation was neither intended to nor did it have the effect of influencing cattle prices. We attach copies of this statement and the settlement agreement, along with English translations of these documents.

9.W hat percentage of your company is government owned, directly or through funds/companies in which the Brazilian government has an interest?

A: BNDES currently owns 12.95% of JBS' shares. BNDES is a federal development bank which is publicly traded on the Sao Paulo stock exchange in Brazil.

10. What part of the transaction in Australia and the U.S. is financed by the Brazilian government, through funds or entities in which the government has an interest?

A: The Brazilian government has not directly financed any part of the Australian or U.S. transactions. JBS is in the process of obtaining more financing from various investors in Brazil, including BNDES. When that process is complete, BNDES will own approximately 19.42% of JBS' shares.

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11. Could you please identify your directors and top management that are former Brazilian government officials. What are their names, current position, and former position in government?

A: An independent director on JBS' Board of Directors, Marcos Vinicius Pratini de Moraes, formerly acted as a Minister of Agriculture in Brazil.

12. Large firms operating in a highly concentrated industry raise questions for producers and consumers. Are JBS and the largest firms willing to increase transparency of their market behavior so as to reassure producers and consumers they continue to operate in the best interests of all Americans? This might involve sharing additional detailed financial data in a common format to GIPSA or DOJ? For example, would JBS be willing to submit its sources of capital for this acquisition to auditing agencies?

A: JBS will continue to comply with all applicable U.S.la ws, auditing requirements and regulatory reporting requirements.

From Senator Feingold

1.I have some serious concerns that the costs and other burdens of a national animal identification system will fall disproportionately on family farmers and ranchers. Mr. Batista and Mr. Hunt, do you support a national animal identification and tracking system? Do you have any plans to require participation in such a system for any part of your operations? How much are your companies prepared to contribute? Or are farmers and ranchers expected to shoulder the entire cost of the identification tags?

A: JBS does not take a position on the implementation of a national tracking system. If such a system is adopted, we will comply with all applicable U.S.la ws and regulations.

2.Mr. Batista, state meat inspection is an issue that the Chairman has been a great leader on. Do you believe meat from state inspected plants should be allowed to be shipped across state lines as long as it meets the same standards as meat imports?

A: JBS is and always has been committed to ensuring the quality and safety of its products and complying with all applicable meat safety rules and regulations. We will continue to comply with all applicable U.S.la ws and regulations.

3.Mr. Batista, what percentage of your company is government owned, directly or through funds/companies in which the Brazilian government has an interest?

A: BNDES currently owns 12.95% of JBS' shares. BNDES is a federal development bank which is publicly traded on the Sao Paulo stock exchange in Brazil.

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4.Mr. Batista, it has been reported that JBS was found to have manipulated cattle prices in Brazil. Can you explain the allegations and the details of any settlement with the Brazilian government? Can you provide the Committee the written allegations by the Brazilian government and any consent decree, settlement or similar document?

A: The investigation to which you refer arose in the context of a meeting of representatives from several Brazilian beef processors to discuss a potential response to a proposed piece of tax legislation. Some time after this meeting, JBS, Mr. Artemio Listoni (an employee of JBS') and I were included as defendants in an antitrust investigation related to that meeting. Following the investigation, neither JBS, Mr. Listoni nor I were found to have manipulated cattle prices in Brazil or to have engaged in any other anticompetitive behavior. The investigation as it related to us was closed pursuant to a settlement agreement, under which we were not required to admit any wrongdoing and the parties involved paid fines limited to the minimum amounts established by law. In its statement regarding the settlement, the Brazilian authority stated that the alleged conduct related to a minor portion of JBS' turnover, and that the conduct under investigation was neither intended to nor did it have the effect of influencing cattle prices. We attach copies of this statement and the settlement agreement, along with English translations of these documents.

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MINISTRY OF JUSTICE
ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE – CADE

SETTLEMENT AGREEMENT

The **ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE**, hereinafter referred to as **CADE**, herein represented by its President, Dr. Elizabeth Maria Mercier Querido Farina, pursuant to the provisions in article 8 (VII) of Law 8,884/94, dated 11 June 1994, in compliance with the collegiate decision rendered at the 411th Hearing of 28 November 2007, which minutes of proceedings are an integral part hereof, and **JBS S/A** (f/k/a Friboi Ltda.), hereinafter referred to as **COMMITTING PARTY** herein represented by José Marcelo Martins Proença (registered with the Brazilian Bar Association - São Paulo's Chapter under No. 105.435) as a Defendant in the Administrative Proceeding No. 08012.002493/2005-16, resolve to enter into this Settlement, to be governed by the following terms and conditions, all in accordance with the provisions in article 53 of the Law 8,884/94, as amended by the Law No. 11,482/07, in conjunction with Resolution CADE No. 46/2007.

Clause 1 – Presumption of Law

1.1 The execution of this Settlement does not constitute acknowledgment as to the matter of fact neither does it constitute plea of guilt of any unlawful act by the Committing Party, its shareholders, managers or servants, in connection with any and all matters being investigated in the Administrative Proceedings No. 08012.002493/2005-16.

Clause 2 - Purpose

2.1 Generally, the purpose of this Settlement is to safeguard, protect, and lay down the competitive conditions for the beef cattle purchase market in Brazil, as well as to suspend the Administrative Proceeding No. 08012.002493/2005-16 brought against the Committing Party to investigate possible violation of the public order, as provided under articles 20 and 21 of the Law 8,884/94.

2.1.1 In order to safeguard, protect and ensure market efficiency, the Committing Party may continue to offer, on its own account and under no agreements with the competition, discounted prices for cattle that do not meet the quality specifications (weight, gender, etc) established by the buyer.

Clause 3 – Obligations of the Committing Party

3.1 **Implementation of Compliance Program** – The Committing Party undertakes to implement internal rules against antitrust violations and to adopt a Competition Compliance Program, which program shall guide and curb any and all actions, internal or external, of the Company and its employees and servants in relation to third parties, particularly as regards suppliers, customers, competitors and trade associations.

3.1.1 The Committing Party shall submit such Compliance program to the CADE within 30 days as of the execution hereof.

3.1.2 The Committing Party agrees to widely communicate the Compliance Program and effective train all employees directly or indirectly associated to the operational and

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commercial activities, who shall be equally required to comply with the rules set forth under such program, subject to disciplinary action for violation.

3.2 **Money Contribution.** The Committing Party agrees to deposit a contribution in cash to the Natural Rights Fund, which contribution shall not constitute fine, penalty or sanction for antitrust violations, in the amount of thirteen million, seven hundred sixty-one thousand, nine hundred and forty-four Brazilian reais and forty-four cents (R$ 13,761,944.44). The conditions and structure of such deposit of money contribution are set forth in the Exhibit I.

Clause 4 – Term

4.1 This Settlement shall be in effect for one (1) year after the execution hereof.

Clause 5 – Dismissal

5.1 Upon the expiration of the term set forth in the Clause 4 above, and upon determination of the effective fulfillment of the obligations undertaken by the Committing Party under this Settlement, the Administrative Proceedings No. 08012.002493/2005-16 commenced to investigate a possible antitrust violation, on the grounds of articles 20 and 21 of the Law No. 8,884/94 shall be dismissed in connection with the Committing Party, as provided in the article 53(5) and (6) of Law No. 8,884/94.

Clause 6 – Noncompliance with this Settlement; and Fines

6.1 Any failure by the Committing Party to comply with this Settlement shall be mandatorily announced by the CADE's Board, under the terms of article 7(VI) of the Law No. 8,884/94, the Committing Party being assured the right to full defense and to produce evidence of its full compliance with its obligations.

6.2 Upon determination by the CADE's Panel of any noncompliance with this Settlement, the Administrative Proceedings No. 08012.002493/2005-16 against the Committing Party brought to investigate possible violation of the economic policy, on the grounds of the articles 20 and 21 of the Law No. 8,884/94 shall be reinstated and the regular investigation efforts resumed, with the Committing Party shall having full and unlimited right to defend itself.

6.3 In the event the CADE's Board determines that the main obligations of the Committing Party under this Settlement fail to be complied with, the Committing Party shall be further subject to a daily fine payable for the duration of the alleged noncompliance, in the amount of five thousand (5,000) UFIR, equivalent to five thousand, three hundred and twenty reais and fifty cents (R$ 5,320.50), as provided in the article 53(1)(II) in conjunction with article 25, both of Law No. 8,884/94.

6.4 Any delay, unreasonably or not previously approved, to provide the reports and information to the CADE shall be investigated thereby, in full observance of the Committing Party's right of defense. Upon determination by the CADE's Board that there has been a default of this Settlement, the Committing Party shall be subject to a daily fine of five thousand (5,000) UFIR, equivalent to five thousand, three hundred twenty reais and fifty cents (R$ 5,320.50).

Clause 7 – Concurrent Liability

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7.1 The CADE and the Committing Party, acknowledge and agree with their obligations under this Settlement, also on behalf of their employees, servants, subcontractors, and successors, whose actions they are required, under contract or the law, to oversee, monitor or be aware of. Therefore, the CADE and the Committing Party shall disclose thereto the entire contents of this Settlement.

Clause 8 – Publicity

8.1. The execution of this Settlement shall be made public by means of publication thereof on the Federal Official Gazette.

IN WITNESS WHEREOF, the parties set their hands on this Settlemeent in four (4) counterparts, same in form and substance.

Brasília, 28 November 2007.

Elizabeth Maria Mercier Querido Farina
President
Brazilian Anti-trust Agency – CADE

José Marcelo Martins Proença
JBS S/A (formerly Friboi Ltda.)

EXHIBIT I

1. Pursuant to Clause 3.2 of the Settlement, the Committing Party agrees to deposit to the Natural Rights Fund a money contribution in the amount of thirteen million, seven hundred sixty-one thousand, nine hundred and forty-four reais and forty-four cents (R$ 13,761,944.44). Such Money Contribution does not constitute fine, penalty, or sanction for violation of the economic order.

2. The Committing Party agrees to deposit such money contribution to the Natural Rights Fund pursuant to the following schedule: 30% of the amount, equivalent to four million, one hundred twenty-eight thousand, five hundred and eighty-three reais and thirty-three cents (R$ 4,128,583.33) to be deposited within 30 days and the balance in six (6) equal and consecutive deposits of one million, six hundred five thousand, five hundred and sixty reais and eighteen cents (R$ 1,605,560.18) on the 28th day of each subsequent month, such amounts being restated based on the SELIC rate as of the date of the first deposit of the balance amount.

3. In order to monitor the full compliance with the Committing Party's obligation to deposit such money contribution to the NATIONAL FUND OF NATURAL RIGHTS, the Committing Party agrees to file with CADE, within no later than three days after each deposit being effectively carried out, evidence of the deposit of amount referred to in the item 2 above.

4. The CADE's Panel shall address any delay, unreasonably or not previously approved, to deposit the Money Contribution or demonstrate compliance, pursuant to the Clause 6 of the Letter of Intent.

45064.032

MINISTRY OF JUSTICE
ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE – CADE

SETTLEMENT AGREEMENT

The **ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE**, hereinafter referred to as **CADE**, herein represented by its President, Dr. Elizabeth Maria Mercier Querido Farina, pursuant to the provisions in article 8 (VII) of Law 8,884/94, dated 11 June 1994, in compliance with the collegiate decision rendered at the 411th Hearing of 28 November 2007, which minutes of proceedings are an integral part hereof, and **ARTEMIO LISTONI,** employee of Friboi Ltda. in the year 2004, hereinafter referred to as **COMMITTING PARTY** herein represented by José Marcelo Martins Proença (registered with the Brazilian Bar Association - São Paulo's Chapter under No. 105.435) as a Defendant in the Administrative Proceeding No. 08012.002493/2005-16, resolve to enter into this Settlement, to be governed by the following terms and conditions, all in accordance with the provisions in article 53 of the Law 8,884/94, as amended by the Law No. 11,482/07, in conjunction with Resolution CADE No. 46/2007.

Clause 1 – Presumption of Law

1.1 The execution of this Settlement does not constitute acknowledgment as to the matter of fact neither does it constitute plea of guilt of any unlawful act by the Committing Party, its shareholders, managers or servants, in connection with any and all matters being investigated in the Administrative Proceedings No. 08012.002493/2005-16.

Clause 2 - Purpose

2.1 Generally, the purpose of this Settlement is to safeguard, protect, and lay down the competitive conditions for the beef cattle purchase market in Brazil, as well as to suspend the Administrative Proceeding No. 08012.002493/2005-16 brought against the Committing Party to investigate possible violation of the public order, as provided under articles 20 and 21 of the Law 8,884/94.

2.1.1 In order to safeguard, protect and ensure market efficiency, the Committing Party may continue to offer, on its own account and under no agreements with the competition, discounted prices for cattle that do not meet the quality specifications (weight, gender, etc) established by the buyer.

Clause 3 – Obligations of the Committing Party

3.1 **Money Contribution.** The Committing Party agrees to deposit a contribution in cash to the Natural Rights Fund, which contribution shall not constitute fine, penalty or sanction for antitrust violations, in the amount of 6,000 UFIRs, pursuant to the article 23 (III) of Law No. 8,884/94, that is: R$ 6,834.60 (six thousand, three hundred and eighty-four Brazilian reais and sixty cents). The conditions and structure of such deposit of money contribution are set forth in the Exhibit I.

Clause 4 – Term

4.1 This Settlement shall be in effect for one (1) year after the execution hereof.

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Clause 5 – Dismissal

5.1 Upon the expiration of the term set forth in the Clause 4 above, and upon determination of the effective fulfillment of the obligations undertaken by the Committing Party under this Settlement, the Administrative Proceedings No. 08012.002493/2005-16 commenced to investigate a possible antitrust violation, on the grounds of articles 20 and 21 of the Law No. 8,884/94 shall be dismissed in connection with the Committing Party, as provided in the article 53(5) and (6) of Law No. 8,884/94.

Clause 6 – Noncompliance with this Settlement; and Fines

6.1 Any failure by the Committing Party to comply with this Settlement shall be mandatorily announced by the CADE's Board, under the terms of article 7(VI) of the Law No. 8,884/94, the Committing Party being assured the right to full defense and to produce evidence of its full compliance with its obligations.

6.2 Upon determination by the CADE's Panel of any noncompliance with this Settlement, the Administrative Proceedings No. 08012.002493/2005-16 against the Committing Party brought to investigate possible violation of the economic policy, on the grounds of the articles 20 and 21 of the Law No. 8,884/94 shall be reinstated and the regular investigation efforts resumed, with the Committing Party shall having full and unlimited right to defend itself.

6.3 In the event the CADE's Board determines that the main obligations of the Committing Party under this Settlement fail to be complied with, the Committing Party shall be further subject to a daily fine payable for the duration of the alleged noncompliance, in the amount of five thousand (5,000) UFIR, equivalent to five thousand, three hundred and twenty reais and fifty cents (R$ 5,320.50), as provided in the article 53(1)(II) in conjunction with article 25, both of Law No. 8,884/94.

6.4 Any delay, unreasonably or not previously approved, to provide the reports and information to the CADE shall be investigated thereby, in full observance of the Committing Party's right of defense. Upon determination by the CADE's Board that there has been a default of this Settlement, the Committing Party shall be subject to a daily fine of five thousand (5,000) UFIR, equivalent to five thousand, three hundred twenty reais and fifty cents (R$ 5,320.50).

Clause 7 – Concurrent Liability

7.1 The CADE and the Committing Party, acknowledge and agree with their obligations under this Settlement, also on behalf of their employees, servants, subcontractors, and successors, whose actions they are required, under contract or the law, to oversee, monitor or be aware of. Therefore, the CADE and the Committing Party shall disclose thereto the entire contents of this Settlement.

Clause 8 – Publicity

8.1. The execution of this Settlement shall be made public by means of publication thereof on the Federal Official Gazette.

IN WITNESS WHEREOF, the parties set their hands on this Settlemeent in four (4) counterparts, same in form and substance.

Brasília, 28 November 2007.

Elizabeth Maria Mercier Querido Farina
President
Brazilian Anti-trust Agency – CADE

José Marcelo Martins Proença
Artemio Listoni

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Exhibit I

1. Pursuant to the Clause 3.1 of the Settlement, the Committed Party agrees to deposit to the Natural Rights Fund a money contribution in the amount of six thousand UFIRs, pursuant to article 23(III) of Law No. 8,884/94, equivalent to six thousand, three hundred eight-four reais and sixty cents (R$ 6,384.60). Such Money Contribution does not constitute fine, penalty, or sanction for violation of the economic order.

2. The Committed Party agrees to deposit such money contribution to the Natural Rights Fund pursuant to the following schedule: 100% of the contribution, that is, six thousand, three hundred eight-four reais and sixty cents (R$ 6,384.60) within 30 days.

3. In order to monitor the full compliance with the Committed Party's obligation to deposit such money contribution to the NATIONAL FUND OF NATURAL RIGHTS, the Committed Party agrees to file with CADE, within no later than three days after each deposit being effectively carried out, evidence of the deposit of amount referred to in the item 2 above.

4. The CADE's Board shall address any delay, unreasonably or not previously approved, to deposit the Money Contribution or demonstrate compliance, pursuant to the Clause 6 of the Letter of Intent.

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MINISTRY OF JUSTICE
ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE – CADE

SETTLEMENT AGREEMENT

The **ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE**, hereinafter referred to as **CADE**, herein represented by its President, Dr. Elizabeth Maria Mercier Querido Farina, pursuant to the provisions in article 8 (VII) of Law 8,884/94, dated 11 June 1994, in compliance with the collegiate decision rendered at the 411th Hearing of 28 November 2007, which minutes of proceedings are an integral part hereof, and **WESLEY MENDONÇA BATISTA,** officer of Friboi Ltda. in the year 2004, hereinafter referred to as **COMMITTING PARTY** herein represented by José Marcelo Martins Proença (registered with the Brazilian Bar Association - São Paulo's Chapter under No. 105.435) as a Defendant in the Administrative Proceeding No. 08012.002493/2005-16, resolve to enter into this Settlement, to be governed by the following terms and conditions, all in accordance with the provisions in article 53 of the Law 8,884/94, as amended by the Law No. 11,482/07, in conjunction with Resolution CADE No. 46/2007.

Clause 1 – Presumption of Law

1.1 The execution of this Settlement does not constitute acknowledgment as to the matter of fact neither does it constitute plea of guilt of any unlawful act by the Committing Party, its shareholders, managers or servants, in connection with any and all matters being investigated in the Administrative Proceedings No. 08012.002493/2005-16.

Clause 2 - Purpose

2.1 Generally, the purpose of this Settlement is to safeguard, protect, and lay down the competitive conditions for the beef cattle purchase market in Brazil, as well as to suspend the Administrative Proceeding No. 08012.002493/2005-16 brought against the Committing Party to investigate possible violation of the public order, as provided under articles 20 and 21 of the Law 8,884/94.

2.1.1 In order to safeguard, protect and ensure market efficiency, the Committing Party may continue to offer, on its own account and under no agreements with the competition, discounted prices for cattle that do not meet the quality specifications (weight, gender, etc) established by the buyer.

Clause 3 – Obligations of the Committing Party

3.1 **Money Contribution.** The Committing Party agrees to deposit a contribution in cash to the Natural Rights Fund, which contribution shall not constitute fine, penalty or sanction for antitrust violations, in the amount corresponding to 10% (ten percent) of the contribution to be paid by JBS S.A (f/k/a Friboi Ltda.), in accordance with article 23 (II) of Law nº 8,884/94, that is: R$ 13,761,944.44 (contribution by the company) x 10% = R$ 1,376,194.44 (one million, three hundred and seventy-six thousand, one hundred and ninety-four Brazilian reais and forty-four cents). The conditions and structure of such deposit of money contribution are set forth in the Exhibit I.

Clause 4 – Term

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4.1 This Settlement shall be in effect for one (1) year after the execution hereof.

Clause 5 – Dismissal

5.1 Upon the expiration of the term set forth in the Clause 4 above, and upon determination of the effective fulfillment of the obligations undertaken by the Committing Party under this Settlement, the Administrative Proceedings No. 08012.002493/2005-16 commenced to investigate a possible antitrust violation, on the grounds of articles 20 and 21 of the Law No. 8,884/94 shall be dismissed in connection with the Committing Party, as provided in the article 53(5) and (6) of Law No. 8,884/94.

Clause 6 – Noncompliance with this Settlement; and Fines

6.1 Any failure by the Committing Party to comply with this Settlement shall be mandatorily announced by the CADE's Board, under the terms of article 7(VI) of the Law No. 8,884/94, the Committing Party being assured the right to full defense and to produce evidence of its full compliance with its obligations.

6.2 Upon determination by the CADE's Panel of any noncompliance with this Settlement, the Administrative Proceedings No. 08012.002493/2005-16 against the Committing Party brought to investigate possible violation of the economic policy, on the grounds of the articles 20 and 21 of the Law No. 8,884/94 shall be reinstated and the regular investigation efforts resumed, with the Committing Party shall having full and unlimited right to defend itself.

6.3 In the event the CADE's Board determines that the main obligations of the Committing Party under this Settlement fail to be complied with, the Committing Party shall be further subject to a daily fine payable for the duration of the alleged noncompliance, in the amount of five thousand (5,000) UFIR, equivalent to five thousand, three hundred and twenty reais and fifty cents (R$ 5,320.50), as provided in the article 53(1)(II) in conjunction with article 25, both of Law No. 8,884/94.

6.4 Any delay, unreasonably or not previously approved, to provide the reports and information to the CADE shall be investigated thereby, in full observance of the Committing Party's right of defense. Upon determination by the CADE's Board that there has been a default of this Settlement, the Committing Party shall be subject to a daily fine of five thousand (5,000) UFIR, equivalent to five thousand, three hundred twenty reais and fifty cents (R$ 5,320.50).

Clause 7 – Concurrent Liability

7.1 The CADE and the Committing Party, acknowledge and agree with their obligations under this Settlement, also on behalf of their employees, servants, subcontractors, and successors, whose actions they are required, under contract or the law, to oversee, monitor or be aware of. Therefore, the CADE and the Committing Party shall disclose thereto the entire contents of this Settlement.

Clause 8 – Publicity

8.1. The execution of this Settlement shall be made public by means of publication thereof on the Federal Official Gazette.

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IN WITNESS WHEREOF, the parties set their hands on this Settlemeent in four (4) counterparts, same in form and substance.

Brasília, 28 November 2007.

Elizabeth Maria Mercier Querido Farina
President
Brazilian Anti-trust Agency – CADE

José Marcelo Martins Proença
Wesley Mendonça Batista

EXHIBIT I

Exhibit I

1. Pursuant to the Clause 3.1 of the Settlement, the Committing Party agrees to deposit to the Natural Rights Fund a money contribution in the amount of ten percent (10%) of the money contribution to be deposited by JBS S/A (formerly Friboi Ltda.), pursuant to the article 23(II) of Law No. 8,884/94, that is: R$ 13,761,944.44 (company contribution) x 10% = one million, three hundred seventy-six thousand, one hundred and ninety-four reais and forty-four cents (R$ 1,376,194.44) Such Money Contribution does not constitute fine, penalty, or sanction for violation of the economic order.

2. The Committing Party agrees to deposit such money contribution to the Natural Rights Fund pursuant to the following schedule: twelve (12) equal and consecutive deposits of one hundred fourteen thousand, six hundred eighty-two reais and eighty-seven cents (R$ 114,682.87), the first of which to be carried out within 30 days and the remaining deposits on the 28th day of each subsequent month, such amounts being restated based on the SELIC rate as of the date of the first deposit of the balance amount.

3. In order to monitor the full compliance with the Committing Party's obligation to deposit such money contribution to the NATIONAL FUND OF NATURAL RIGHTS, the Committing Party agrees to file with the CADE, within no later than three days after each deposit being effectively carried out, evidence of the deposit of amount referred to in the item 2 above.

4. The CADE's Board shall address any delay, unreasonably or not previously approved, to deposit the Money Contribution or demonstrate compliance, pursuant to the Clause 6 of the Letter of Intent.

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June 5, 2008

The Honorable Herb Kohl
Chairman
U.S. Senate Judiciary Subcommittee on
Antitrust, Competition Policy, and Consumer Rights
SH 308
Washington, D.C., 20510

Dear Chairman Kohl,

Thank you for the opportunity to testify at the United States Senate Judiciary Committee's Subcommittee on Antitrust, Competition Policy, and Consumer Rights ("Subcommittee") hearing regarding "Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions," held on May 7, 2008, and answer the written follow-up questions from Committee members that are restated below.

A. Questions from Senator Kohl

1. **You have asserted that for two weeks in February 2006, the top four meatpacking firms ceased buying cattle on the open market. The meatpacking firms reduced slaughter rates rather than enter the cash market. As a result, cattle prices fell sharply. Cattle Buyers Weekly said at the time that the meatpackers' conduct was part of an effort to "try and get cattle bought cheaper."**

   Do you believe that JBS Swift's acquisition of the captive supply offered by the Five Rivers Ranch Cattle Feeding LLC ("Five Rivers") makes it much easier for them to unilaterally engage in such conduct in the future to force cattle prices down?

Answer:

Yes, JBS/Swift's acquisition of the captive supply offered by Five Rivers Ranch Cattle Feeding, LLC ("Five Rivers") would make it much easier for JBS/Swift to unilaterally withdraw from the open market and force cattle prices lower. As stated in my written testimony submitted to the Subcommittee ("Written Testimony"), at pages 29-31, cattle prices were lowered when the top four meatpacking firms ceased buying cattle on the open market in February 2006. The acquisition of Five Rivers would accord JBS Swift with approximately 2 million cattle per year,[1]

[1] History of Smithfield Foods, attached as Exhibit 24, available at http://www.smithfieldfoods.com/Understand/History/.

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known as "captive supply" cattle, which it could strategically slaughter during one or more weeks without necessitating the purchase of cattle in the spot market. As stated in my written testimony at page 26 and supported by accompanied Exhibit 13, academic studies have shown that captive supplies hold down cattle prices. By virtue of its dominant market share, the unilateral withdrawal from the spot market by JBS/Swift for one week or more would most certainly have the effect of forcing cattle prices down.

Importantly, and in addition to the captive supply offered by Five Rivers is the less obvious captive supply offered by the U.S. Premium Beef, LLC ("U.S. Premium Beef") the majority owner of National Beef Packing Co. ("National"), and National. As more fully explained in Exhibit A, the captive supply arrangement between U.S. Premium Beef is intended to be transferred to JBS/Swift. Therefore, the combination of captive supply offered by both Five Rivers and U.S. Premium Beef, involving an estimated 2.68 million cattle annually, would accord JBS/Swift the ability to unilaterally withdraw from the spot market for extended periods of time, which withdrawal would force cattle prices lower.

2. **Would a condition that JBS Swift be required to divest Five Rivers after these acquisitions make these deals acceptable, or do you believe that the transactions would still substantially harm competition even with such a divestiture? Please explain why.**

Answer:

No. Even if JBS/Swift were to divest Five Rivers after these acquisitions, the proposed acquisitions of National and Smithfield Beef Group ("Smithfield") would still substantially harm competition. This is because:

a. The horizontal merger resulting from the consolidation of JBS/Swift, National, and Smithfield would effectively eliminate competition in the regional slaughter-ready cattle market defined by the overlapping meatpacker-procurement areas encompassing National in Brawly, California, and Smithfield in Tolleson, Arizona. *See* Written Testimony, at 24.

b. The horizontal merger resulting from the consolidation of JBS/Swift and National would eliminate a major competitor in the regional slaughter-ready cattle market defined by the overlapping meatpacker-procurement areas encompassing National in Liberal and Dodge City, Kansas, and JBS/Swift in Cactus, Texas. *See id.*

c. On a national level, the JBS/Swift acquisitions would combine 11 packing plants now owned by 3 meatpackers under the singly ownership of JBS/Swift. *See id.*, at 25.

d. Similar to the concerns arising from the vertical integration of JBS/Swift and Five Rivers is the separate concern arising from the vertical integration of the captive supply arrangement between U.S. Premium Beef and National, involving approximately 676,000 fed cattle annually, which captive supply arrangement is intended to be transferred to JBS/Swift. *See* Exhibit A.

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e. In essence, captive supplies exacerbate the horizontal problem of market power; eliminating captive supply will not eliminate harm to competition resulting from the JBS/Swift acquisition of National and Smithfield.

3. **We've heard a lot of testimony about the number of beef packers across the country. But shouldn't we really evaluate this transaction based on its effect on local and regional geographic markets? Isn't it true that meatpacking plants mainly obtain their cattle from no more than a few hundred miles away? Aren't the meatpackers near the feedlots the ones that are truly your alternatives for selling your cattle?**

Answer:

Researchers have, indeed, found that meatpacking plants mainly obtain their cattle from no more than a few hundred miles away. As explained in my written testimony at pages 19-24, and evidenced by the accompanied Exhibit 7, researches have defined the general cattle procurement area as the area around a 300-mile radius of packing plants. Based on information and belief, the cost of transportation and the risk of increased shrink (i.e., cattle weight loss experienced during transportation) are the primary factors that define the regional slaughter-ready cattle procurement areas surrounding meatpacking plants.

Thus, it is true that the meatpackers near feedlots are the ones that are truly the alternatives for selling cattle. However, and again based on information and belief, it is the prerogative of the owner of multiple meatpacking plants to determine whether or not to grant a feedlot access to a particular plant at a specified price, even if an alternative plant owned by the same meatpacker is equidistant from the feedlot and offering a higher price. In other words, a meatpacker must give a feedlot permission to sell to its meatpacking plant located in a different region. Where there are already few buyers for slaughter-ready steers and heifers, this region-by-region control by the meatpackers is evidence of abusive market power.

Evidence of market regionalization for slaughter-ready cattle is manifest in U.S. Department of Agriculture ("USDA"), Agricultural Marketing Service ("AMS") market reports. For example, the AMS reported weekly weighted average negotiated prices on June 1, 2008, for several regions:

Region	Weekly Weighted Price for 65-80% Choice Steers (per hundredweight)
Texas-Oklahoma-New Mexico	$95.88
Colorado	$94.80
Nebraska	$94.58
Kansas	$94.56
Iowa	$93.55

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See Exhibit B. The price disparity between these five regions is as great as $2.33 per hundredweight, or approximately $29 per animal based on a 1,250 pound steer. These price disparities cannot be fully explained by the location of slaughter-ready cattle and any transportation cost differences.

Recent dramatic increases in transportation costs reduce the maximum hauling distance for slaughter-ready cattle. Such fuel price increases combined with fewer buyers will further regionalize the market for slaughter-ready cattle, increasing the potential for meatpackers to exploit their market power.

The U.S. Department of Justice ("DOJ") and U.S. Federal Trade Commission ("FTC") horizontal merger guidelines typically apply what is knows as the SSNIP test (Small but Significant Non-transitory Increase in Price)[2]. The SSNIP test seeks to identify the smallest relevant market within which a hypothetical monopolist or cartel could impose a profitable significant increase in price, typically defined to be 5 percent. Applied to buyer power the SSNIP test would consider a small but significant *decrease* in price. We maintain that the 5 percent threshold is far too high in monopsony cases. For example, Iowa State University data show that the net returns (in current dollars) from feeding steers averaged only $16 per head over the 1994-2007 period. For a $1,000 per head fed steer, the 5 percent SSNIP test would allow a merger that would decrease price by $50 per head, which would mean that cattle feeders would be losing $34/head compared to the historical average. A price decrease of only 1.6 percent would completely eliminate the modest profits realized by cattle feeders over 1994-2007. The regional differences shown above are presently 2.4 percent. Therefore, criteria used by the DOJ and FTC to define markets and to define an acceptable level of market power in their merger approval process are inappropriate to cattle markets.

4. **Should the meatpacking firms gain lower prices for cattle because of their increased buying power, do you think it likely that these price savings will be passed on to consumers? What does the historical record in this industry tell us?**

Answer:

As revealed in Figure 5 contained in my written testimony at page 16, retail beef prices paid by consumers have been increasing at a much more accelerated rate than have cattle prices paid to farmers and ranchers over the past 20-plus years (note that this phenomenon is not a function of a demand shift toward more value-added products. *See* Written Testimony, at 16, 17.) These historical data show that the wholesalers (meatpackers) and retailers are capturing an ever greater share of the consumer beef dollar, strongly suggesting that price savings resulting from lower cattle prices have not been, and would not be passed on to consumers. Moreover, the USDA Economic Research Service ("ERS") found that retail prices are more rigid than cattle prices and there is a considerable lag time, distributed over almost a year, associated with changes in retail beef prices following changes in cattle prices and "upward movements in farm prices are followed about 24 percent more quickly at retail than are downward price movements." *See* Exhibit C, at 18. The ERS explained that "[r]etailers possibly expect that

[2] *See* Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, Revised April 8, 1997.

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downward movements [in cattle prices and/or wholesale prices] are likely to be temporary and wish to avoid marking prices down then back up again." *Ibid.* Thus, packers and retailers have the ability to capture profits when cattle prices fall, without sharing the savings associated with lower cattle prices with consumers.

Very basic economic theory is consistent with the facts stated above. Textbook monopsony theory shows that disproportionate buyer power in the cattle industry would generally depress prices paid for slaughter-ready cattle. Because slaughter-ready cattle prices have been depressed, there are fewer slaughter-ready cattle being produced (as evidenced by the shrinking U.S. herd). The dominant meatpackers are, therefore, purchasing fewer slaughter-ready cattle than they would in a truly competitive market (as evidenced by the unprecedented shortfall between domestic consumption and domestic production described at page 13 of my written testimony). Because they purchase fewer slaughter-ready cattle, less meat is provided to final consumers. Less meat on the retail market translates into higher retail prices and consumer harm. Thus, standard monopsony theory generally shows a lower price paid for slaughter cattle, a higher retail price, a wider farm-to-retail margin, consumer harm, and a loss in aggregate economic efficiency from the exertion of buyer power.

5. **In his testimony Mr. Hunt makes the point that investment is needed in beef processing and only JBS is willing to invest after the merger. Is there merit to this argument? From your perspective, are some of these meat processing companies failing?**

Answer:

As revealed in Figure 3 of my written testimony at page 13, domestic beef consumption has been increasing since the early 1990s, and continues to outpace domestic beef production. If, under this circumstance, what Mr. Hunt states is true, and firms are unwilling to invest in the beef processing industry, then there must be a systemic market failure in the beef processing industry – a failure that inhibits market entry. Data compiled by the USDA Grain Inspection and Stockyards Administration ("GIPSA") suggest that the current level of concentration in the beef processing industry has surpassed the optimal level of economies of scale. For example, GIPSA data show that in 2006 the profitability (measured by operating income as a percentage of sales[3]) of mid-sized and smaller packers was greater than the profitability of the four largest meatpackers.[4] In fact, the four largest meatpackers overall reported losses in 2006 while the fifth through eighth largest, and the ninth through twentieth largest overall reported profitable operations, with the twenty-first through fortieth largest meatpackers having overall reported near-record profitability in 2006 when compared to the past fifteen years.[5] These data suggest that the four largest meatpackers, which would include JBS/Swift, have failed to adequately adjust to changing market conditions, as has their moderate-sized counterparts, and have become antiquated monoliths. While I have no personal knowledge regarding whether any of the parties

[3] Packers and Stockyards Statistical Report, 2006 Reporting Year, U.S. Department of Agriculture, Grain inspection, Packers and Stockyards Administration, GIPSA SR-08-1, May 2008, at 6, attached hereto as Exhibit D (hereafter "Exhibit D").
[4] *Id.*, at 52, 56.
[5] *Id.*

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to the proposed JBS/Swift merger are failing, I would direct the Subcommittee's attention to modest-sized meatpackers such as Creekstone Farms Premium Beef and Harris Ranch Beef Company, both of which appear to be thriving in today's environment.

B. Questions from Senator Grassley

1. **What evidence do you have that this concentration in agriculture trend has been harmful to consumers? What evidence do you have that concentration in agriculture has been harmful to independent producers?**

Answer:

As revealed in Figure 4 contained in my written testimony at page 14, the ongoing concentration in the hog industry is generating unprecedented spreads between the price that consumers pay for pork and the price that farmers receive for their hogs. Alarmingly, Figure 4 reveals that in the more vertically integrated hog industry, consumer prices are increasing while the farmers' prices are decreasing. This demonstrates harm to consumers who are paying higher prices for pork while the value of hogs from which the pork is derived is declining. This unfavorable price-spread manifest in the U.S. hog industry portends price spreads in the U.S. cattle industry if, like the hog industry, it becomes further concentrated, both horizontally and vertically. Presently, as revealed in Figure 5 contained in my written testimony at page 16, retail beef prices paid by consumers have been increasing at a much more accelerated rate than have cattle prices paid to farmers and ranchers over the past 20-plus years (note that this phenomenon is not a function of a demand shift toward more value-added products in either the hog or cattle industry, *see* Written Testimony, at 16, 17). The harms evidenced by the increasing price spreads are market failure harms affecting both consumers and producers.

Other evidence of harm to consumers includes the increased incidence of food-borne illnesses that now originate in the increasingly concentrated meatpacker sector. For example, the U.S. Centers for Disease Control and Prevention ("CDC") stated that while declines in the incidence of certain food borne pathogens, including *E. coli* 0157 ("STEC 0157"), have occurred since 1996, "these declines all occurred before 2004."[6] Moreover, the CDC stated that that the incidence of STEC 0157 had increased in 2007 when compared to previous years and specifically mentioned that "21 beef product recalls for possible contamination with STEC 0157 were issued in 2007."[7]

In addition to the price-spread evidence that shows harm to cattle producers is the evidence showing that the U.S. cattle industry, as measured by the number of cattle operations and cattle inventories, has been shrinking at a phenomenal rate even while domestic beef consumption has been increasing. This counterintuitive outcome demonstrates another market failure harm to producers that is more fully explained in my written testimony at pages 9-14.

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[6] Preliminary FoodNet Data on the Incidence of Infection with Pathogens Transmitted Commonly Through Food – 10 States, 2007, U.S. Centers for Disease Control and Prevention, MMWR Weekly, 57(14); 366-370, April 11, 2008, attached as Exhibit E (hereafter "Exhibit E").
[7] *Id.*

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2. **There is less vertical integration of the cattle supply chain than is evident in the hog supply chain. Moreover, this proposed merger would make beef packers even more highly concentrated than pork packers. Is the live cattle industry less susceptible to packer control through vertical integration than is the hog industry?**

Answer:

The vertical integration of the U.S. cattle industry by the major meatpackers has been slower than in the U.S. hog industry. This is likely the result of the unique characteristics of the cattle industry, particularly the fact that cattle have the longest biological cycle of any farmed animal. *See* Written Testimony at 18. Because it takes approximately 15 to 18 months to rear cattle before they are ready for slaughter, and because of the extensive forage requirements needed to rear cattle, the cattle industry is less adaptable to the concentrated production practices common in the hog-rearing industry – practices that are more conducive to vertical integration by meatpackers – at least in the earlier stages of cattle production. However, after cattle reach approximately one-year of age on forage, and weigh approximately 700 to 900 pounds, they then become adaptable to a more concentrated production regime, i.e., they can be finished in large, concentrated feedlots. It is at this stage of the cattle production cycle – the final feeding stage – that meatpackers have focused their vertical integration efforts, and it is here that the proposed JBS/Swift merger intents to exert greater control over the live cattle production cycle by acquiring the nation's largest feedlot company – Five Rivers – and the current U.S. Premium Beef/National captive supply arrangement discussed more fully in my response above to Question A. 1.

3. **The significance of an ever-increasing price spread between prices paid to cattle producer and prices consumers pay for beef has been dismissed by industry analysts as a function of ever-increasing value-added beef products. Does the increase of value-added products explain increased beef price spreads?**

Answer:

No. As stated in my written testimony at pages 16-17, the ERS stated that the price spread data depicted in Figures 4 and 5 of my written testimony are *not* a function of a demand shift toward more value-added products. Moreover, the ERS explained that it calculates price spreads "based on a standard animal, cut up in a standard way at the packing plant, and sold in standard form through the retail store." *See* Exhibit F, at 4. Further, the ERS stated that all the beef cuts used in its calculation of retail composite prices are "relatively low value-added cuts," and "[a]ll the beef cuts are sold through the meat case." *Ibid.* Therefore, the increase of value-added products does not explain increased beef price spreads.

4. **In your opinion, does the Justice Department have an appropriate understanding of the agriculture industry, and thus is appropriately evaluating mergers in the agriculture sector? Do you believe that changes need to be made to the antitrust laws to take into account the specific characteristics of agriculture?**

Answer:

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No. The U.S. Department of Justice ("DOJ") has not yet demonstrated an appropriate understanding of the agricultural industry, particularly the livestock industry. Back in 2002 the General Accountability Office ("GAO") described the concentration in the U.S. beef packing industry as unprecedented, stating then that "no other manufacturing industry showed as large and increase in concentration since the U.S. Bureau of the Census began regularly publishing concentration data in 1947."[8] The GAO also revealed in 2002 that even as long ago as 1996, GIPSA could not conclude that the beef packing industry was competitive.[9] Yet, the DOJ has sat idle while the beef packing industry has become even more concentrated. The historical inaction on the part of the DOJ in protecting the livestock sector against anticompetitive mergers and consolidations reveal that antitrust laws should be made more prescriptive to reflect the specific characteristics of agriculture, particularly animal agriculture.

5. **Do you believe that the Justice Department does enough to monitor the market performance of an ever-consolidating agriculture industry? What would you propose the Justice Department do? Do you believe that the provisions that have been included in S. 1759, the Grassley/Kohl ACE Act, would help monitor market performance in agriculture?**

Answer:

No. As explained in my answer to Question B. 4 above, the DOJ has failed to monitor the market performance of the ever-consolidating agricultural industry, particularly the livestock sector. The DOJ must begin to apply the specific characteristics of the livestock industry when evaluating potential merger impacts and non-competitive behavior. For example, Clement E. Ward, Professor and Extension Economist at Oklahoma State University, argues:

> Price distortions of 3 percent or less were found in most studies [of the packing industry]. While these fall well short of regulatory agency standards related to merger impacts and non-competitive behavior, even seemingly small impacts on a $/cwt. basis may make a substantial difference to livestock producers and rival meatpacking firms operating at the margin of remaining viable or being forced to exit the industry.[10]

Thus, the DOJ must modify the standards it currently applies when evaluating merger impacts and non-competitive behavior because its current standards are likely irrelevant and inadequate to properly assess the livestock and beef industries. My response above to Question A. 3, which discusses the inapplicable SSNIP standard currently used by the DOJ to evaluate the livestock industry, is a specific example of a needed reform to the DOJ's merger evaluation process. Additionally, the provisions included in S. 1759 would improve the ability to monitor market performance in agriculture.

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[8] Economic Models of Cattle Prices, How USDA Can Act to Improve Models to Explain Cattle Prices, U.S. General Accountability Office [formally "Accounting Office"], GAO-02-246, March 2002, at 51.
[9] *See id.* at 50.
[10] A Review of Causes for and Consequences of Economic Concentration in the Meatpacking Industry, Clement E. Ward, Current, Agriculture, Food & Resource Issues, No. 3/2002/p.1-28, at 2.

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6. **In your opinion, has the Department of Agriculture done all it can under the Packer and Stockyards Act to address anti-competitive and abusive practices in agriculture? What more can the Agriculture Department do to improve enforcement of the Act?**

Answer:

No. In my opinion the USDA has failed completely its responsibility under the Packers and Stockyards Act ("PSA") to address anti-competitive and abusive practices in agriculture. R-CALF USA has previously submitted both complaints and requests for investigations to USDA-GIPSA only to have its complaints and requests summarily dismissed by the agency. The March 2006 report by the GAO that found that "GIPSA's senior management review panel became a log jam to the progress of investigations," and investigations were "thwarted by management delays . . . and by inaction on on-going investigations," substantiates my claim that USDA has utterly failed its responsibilities under the PSA to the detriment of U.S. livestock producers and consumers.[11] At the very least, GIPSA must adopt the recommendations made by the GAO to begin improving its dismal record.

7. **The efficiency gains for producers and consumers can only occur with sufficient competition from rival packing firms. Are two large rival firms sufficient competition? Isn't collusion among three large firms easier than among 5 or more? Are there a sufficient number of smaller, fringe firms that may comprise potential competitors should prices paid for fed cattle or received for beef products get out of line?**

Answer:

Two rival firms competing for slaughter-ready steers and heifers do not constitute a competitive market; nor do four rival firms constitute sufficient competition in the U.S. steer and heifer market. As stated in my answer to Question B. 4 above, the ERS could not conclude that the cattle industry was competitive in 1996, a year in which the 4-firm concentration ratio was about 80 percent and the Herfindahl-Hirschman Index ("HHI") was between 1,966 and 1,982.[12] Since that time the HHI exceeded 2,000 during several years, while the 4-firm concentration ratio remained at about 80 percent.[13] Having fewer than 4 firms achieve a concentration ratio in the U.S. steer and heifer market of about 80 percent would likely cause the HHI to increase by more than 100 points above its 2006 value of 1,826[14] – a condition that DOJ merger guidelines suggest would presumptively "likely create or enhance market power or facilitate its exercise."[15] It is important to note that the CME Board estimated that the proposed JBS/Swift merger would result in a dramatic 638-point increase to the HHI. *See* Written Testimony at 22.

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[11] *See* Packers and Stockyards Programs, Continuing Problems with GIPSA Investigations of Competitive Practices, U.S. Government Accountability Office, GAO-06-532T, March 9, 2006, at 8.
[12] Exhibit D, at 44.
[13] *Id.*
[14] *Id.*
[15] Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, Revised April 8, 1997, at 16.

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The DOJ's Horizontal Merger Guidelines confirm that mergers may diminish competition by enabling firms to more successfully or more completely engage in coordinated interaction.[16] It follows, therefore, that collusion among three large firms would be easier than among five or more firms. Moreover, in my written testimony at pages 29-31 is an example of collusive behavior that occurred among four firms in 2006 – behavior that would likely recur, and that could more readily accomplish the objective of forcing cattle prices lower if only three major firms remained in the market.

There are three factors that would prevent smaller, fringe packers from serving as viable, alternative markets in the event that the top four packers (or top three post-merger) refused to pay competitive prices for slaughter-ready steers and heifers. The first factor is the perishable nature of a slaughter-ready steer or heifer. A slaughter-ready animal cannot be put in storage when unfavorable market conditions emerge because it begins to degrade in quality and value within about a two-week period after it becomes slaughter-ready. Thus, producers of slaughter-ready steers and heifers must be able to timely access the market soon after their animals are ready for slaughter. The second factor is the disparity in slaughter capacity between the four largest firms and all other firms capable of slaughtering steers and heifers. Even the fifth and sixth largest beef packers have daily slaughter capacities that are about half the capacity as the fourth largest packer, and about four times smaller than the capacity of the largest packers. *See* Written Testimony, at 21. The third factor is the volume of slaughter-ready cattle produced each day in the United States. The U.S. slaughters approximately 103,800 steers and heifers each day of the 260 slaughter days in a calendar year.[17] Therefore, because of the need to timely access the market when cattle are ready for slaughter and the insufficient slaughter capacity of all but the largest four packers to timely slaughter approximately 80 percent (the approximate market share of the four largest firms) of the steers and heifers produced each day, cattle producers currently have no viable alternative market outlets and must depend on the four largest meatpackers to pay a competitive price for their cattle.

8. **The numbers of producers of all livestock continue to decline. However, independent cattle producers remain the largest body of producers in the United States. Could the shrinkage of the number of cattle operations in the U.S. be caused by something other than market power exerted by a concentrated packing industry? In other words, could the shrinkage simply be a function of some producers being more efficient and producing cattle cheaper than other producers? Despite the decline in the number of U.S. cattle operations and the reduced size of the U.S. cattle herd, isn't it true that due to improved genetics, technology, and management, the U.S. is producing more beef from each animal, suggesting that the decline in both the U.S. herd and the number of cattle operations is simply a function of improved industry efficiency?**

Answer:

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[16] Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, Revised April 8, 1997, at 18.

[17] See Written Testimony at 7 (this calculation is based on the annual slaughter of 27 million steers and heifers).

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It is true that independent cattle producers remain the largest body of livestock producers in the United States, despite the dramatic reduction from 1.6 million cattle operations in 1980 to 967,440 cattle operations in 2007 – a reduction of 40 percent.[18] Importantly, USDA data shows that the number of cattle operations with 100 to 499 head of cattle – the category most likely to contain the largest number of full-time independent cattle producers who are entirely dependent on a competitive cattle market for their livelihoods – fell over 25 percent during the same period, falling from 236,408 cattle operations to only 175,820 cattle operations.[19] Of these remaining cattle operations with 100 to 499 head of cattle, only 72,855 – less than half – are beef cattle operations.[20] The loss of over one-fourth of the core of the U.S. cattle industry's production sector – when from 1993 to 2002 domestic beef consumption increased 3.8 billion pounds and far outpaced domestic beef production[21] – suggests a systemic industry problem that cannot be explained in terms of economic efficiency.

The systemic problem in the industry – a persistent lack of profitability due to reduced competition – is revealed below by USDA data that show that during the decade preceding the extraordinary curtailment of import supplies resulting from the Canadian discovery of bovine spongiform encephalopathy ("BSE") in 2003, the average annual return to U.S. cattle producers was a negative $30.40 per bred cow:[22]

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[18] For 2007 data see Farms, Land in Farms, and Li9vestock Operations 2007 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, February 2008, at 15.
[19] For 2007 data see Farms, Land in Farms, and Li9vestock Operations 2007 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, February 2008, at 16.
[20] *Id.*, at 20.
[21] *See* U.S. Department of Agriculture, Foreign Agricultural Statistics Database, *Production, Supply and Distribution Online*, available at http://www.fas.usda.gov/psd/complete_files/LP-0111000.csv.
[22] U.S. Cow-Calf Production Cash Costs and Returns, 1990-95; 1996-99; 2000-2001, Economic Research Service/USDA, available at http://www.ers.usda.gov/data/farmincome/CAR/DATA/Appendix/Cowcalf/US9095.xls; http://www.ers.usda.gov/data/farmincome/CAR/DATA/History/CowCalf/US9699.xls; and http://www.ers.usda.gov/data/CostsAndReturns/data/current/C-Cowc.xls, retrieved from the Internet on October 18, 2002.

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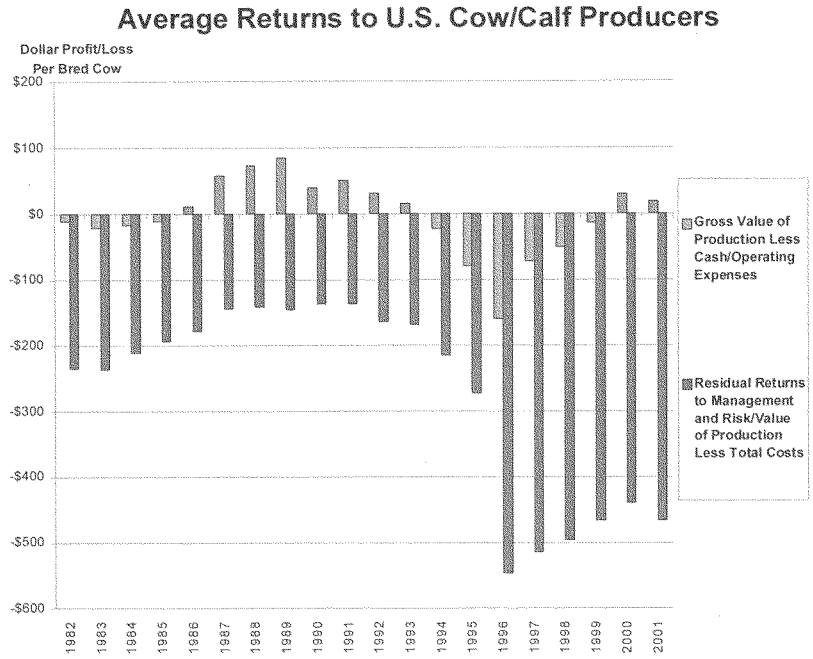

Although industry pundits attempt to dismiss concerns related to the shrinkage of the U.S. cattle industry by claiming the U.S. does not need as many cattle or cattle operations because improved genetics, technology, and management has enabled the U.S. cattle industry to produce more pounds of beef with fewer cattle, their claims are false. As shown in Figure 3 on page 13 of my written testimony, the U.S. cattle industry produced more beef in 1986 than it produced in either 2004 or 2005. In other words, when beef produced from live cattle imported from Canada and Mexico is subtracted from USDA's production data, which improperly includes such imported beef as domestic production, the truth about the dismal condition of the U.S. live cattle industry is revealed.

9. **Some have asserted that increased consolidation among processors allows the processors to achieve economies of scale through larger size. Do you agree with this assertion? Do you agree with the opinions of the JBS and National Beef witnesses about the benefits of the JBS merger? If you don't, what do you believe are the more significant problems presented by the JBS transaction?**

Answer:

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As stated in my answer above to Question A. 5. and more fully discussed here, data compiled by GIPSA suggest that the current level of concentration in the beef processing industry has surpassed the optimal level of economies of scale. For example, GIPSA data show that in 2006 the profitability (measured by operating income as a percentage of sales[23]) of mid-sized and smaller packers was greater than the profitability of the four largest meatpackers.[24] In fact, the four largest meatpackers overall reported losses in 2006 while the fifth through eighth largest, and the ninth through twentieth largest overall reported profitable operations, with the twenty-first through fortieth largest meatpackers packers having overall reported near-record profitability in 2006 when compared to the past fifteen years.[25] These data suggest that the four largest meatpackers, which would include JBS/Swift, have failed to adequately adjust to changing market conditions, as has their moderate-sized counterparts, and have become antiquated monoliths. The following chart derived from GIPSA data suggests that the maximum economy of scale is achieved by mid-sized meatpackers.[26]

Beef Packer Operating Income as a Percent of Sales (GIPSA/USDA data) by Size

Time Period	Big Four	5th to 8th	9th to 20th	21st to 40th
2006	-0.2	2.3	2.22	5.42
2005	0.92	1.69	4.47	3.51
Average 1992-2006	**1.46**	**2.34**	**3.86**	**1.77**

For the reasons contained above and in my written testimony, I disagree completely with the opinions of the JBS/Swift and National witnesses about the benefits of the JBS/Swift merger. The proposed merger by JBS/Swift would likely be the proverbial straw that breaks the camel's back. The level of horizontal and vertical integration achieved by this merger would both significantly lessen competition and increase the remaining packers' monopsony power, factors that would cause lower cattle prices throughout the $50 billion U.S. live cattle industry. In turn, we would experience an accelerated exodus of independent cattle producers from the industry, the hollowing out of rural communities would hasten as there would be a reduced need for the existing number of cattle-industry service industries, and U.S. consumers will have fewer choices in the marketplace while paying higher prices.

[23] Exhibit D, at 6.
[24] *Id.*, at 52, 56.
[25] *Id.*
[26] *Id.*, at 56.

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C. Question from Senator Feingold

1. **Mr. Stumo and Mr. Bullard, how will this acquisition affect the feeder cattle, Holstein and cull cow markets? How is the price for beef cattle related to the price for these other animals?**

Answer:

The JBS/Swift merger would result in at least two harms to the U.S. feeder cattle market. The first harm is indirect and would be caused by the lessening of competition in the market for slaughter-ready steers and heifers – the market that essentially sets the price for all classes of cattle sold, including feeder cattle. It is the expected, future value of slaughter ready steers and heifers that feedlots use to determine the price they will pay for feeder cattle. The calculation is relatively straightforward: The price a feedlot would pay for feeder cattle must be recovered when the feeder cattle are sold as slaughter-ready cattle, along with the feedlot's expenses for such items as interest, labor, fuel, feed, insurance, death loss, and transportation. In addition, a desired profit margin is included in the calculation. Thus, the lower the expected price for slaughter-ready cattle, the lower the price feedlots would be willing to pay for feeder cattle.

The second harm to the feeder cattle market is direct and would be caused by the merger of two competing feedlot entities – Five Rivers and U.S. Premium Beef unitholders – each of which is presently vertically integrated under a separate meatpacker subject to the JBS/Swift merger. This would result in the elimination of a significant buyer for approximately 2.68 million feeder cattle annually.[27] Combined and singularly, these two harms would substantially extend the geographic reach of the JBS/Swift merger's negative impact, far beyond the U.S. cattle feeding sector concentrated primarily in the Plains Region, as the two harms would permeate feeder cattle markets all across the United States, with all markets impacted by the indirect harm and potentially many, if not most, markets impacted by the direct harm.

The JBS/Swift merger would result in at least two harms to the U.S. Holstein market. The first harm would be the result of a lessening of competition in the steer and heifer market – the cattle industry's market-making market that provides the basis for prices for all classes of cattle, including Holsteins. The second harm is more fully described in my written testimony at page 27, where it is explained that packers currently subject cattle to the ongoing imposition of arbitrary muscle scoring that leads to significant price discounts. Holsteins are the primary class of cattle subject to these arbitrary discounts.

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[27] History of Smithfield Foods, attached as Exhibit 24, available at http://www.smithfieldfoods.com/Understand/History/ (Five Rivers slaughters approximately 2 million cattle per year); *see also* U.S. Premium Beef Frequently Asked Questions, available at http://www.uspremiumbeef.com/; *see also* How to Market Your Cattle Through U.S. Premium Beef, U.S. Premium Beef Website, available at http://www.uspremiumbeef.com/ ("Once a producer is an Associate of U.S. Premium Beef, they can market their cattle through this unique producer-owned beef company either by buying units or leasing the right to deliver their cattle to our plants [which are National plants]."), (calculation of 676,000 is based on "the 13 four-week delivery periods of the year").

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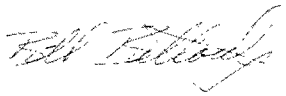
The JBS/Swift merger would result in at least two harms to the U.S. cull cow market. The first harm is, again, the lessening of competition in the market that sets the base price for all classes of cattle. The second harm, however, would result from a compounding of the first harm. The competition for cull cows includes farmers and ranchers who purchase the high-end of the cull cows in order to raise one more calf. The value of a cull cow that can raise one more calf is based on the expected, future value of feeder cattle. If feeder cattle prices are lowered due to the lessening of competition and exercise of market power, than the value of a cull cow that could raise one more calf would likewise be lowered. Thus, when feeder cattle prices are expected to remain low, there is less competition for the high-end of the cull cow market, which would likely result in lower overall prices for cull cattle.

Sincerely,



Bill Bullard
CEO, R-CALF USA

Attachments: Exhibits A-F

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Follow Up Questions for Peter Carstensen from Hearing Entitled "Concentration in Agriculture and an Examination of the JBS Swift Acquisitions

From Senator Kohl

1. In testimony before this Committee five years ago, Professor Cotterill of the University of Connecticut documented that increased concentration in both the milk processing industry and in retailing have resulted in farmers receiving less for milk and consumers paying more. Is this still the trend today? And when milk prices go up do farmers reap the benefit, or are these increased prices kept largely by the retailers and milk processors?

While a number of factors go into price changes, everything that I have seen suggests that the trend of an increasing spread between the farm gate price and the price to consumers continues. Farm prices for milk do have some relationship to the retail price of milk, but as Professor Cotterill detailed, that relationship is very limited. Basically, the fact that the spread between retail and farm gate prices has increased tells us that the majority of the price increases in products such as milk are not reaching the farmer.

2. According to a FTC investigation dating to 1917-1918, at that time the biggest five processors controlled 75-82% of the cattle market. As the result of threatened legal action, these five agreed to a consent decree where they would not own any interest in a stockyard, among other things. The Packers and Stockyards Act of 1921 was soon passed as a result. The current concentration in the beef industry rivals those numbers and if this deal goes through, and even surpasses them.

   Does this tell us anything about the health of this industry or the activity of antitrust enforcement in the agriculture sector? Should what was unacceptable level of concentration about a century ago now be ok?

The 1919 consent decree and the subsequent Packers and Stockyards Act when combined with government inspection and grading of beef, opened the way for major technological innovations in the beef industry that resulting in the 1960s in a highly competitive and efficient industry with low levels of concentration. Unfortunately, those gains have been wiped out by rapid concentration in the industry. The results include various kinds of opportunistic conduct by beef packers to exploit feed lot operators and the farmers and ranchers who supply steers and heifers for feeding. As I explained in my written comments, antitrust enforcers are fully aware of a number of these anticompetitive strategies and know that their existence implies actual or tacit collusion among the major buyers or unlawful exploitation of monopoly buying power. Yet there has been no enforcement action by either the antitrust authorities or the Department of Agriculture that also has oversight in this area under the PSA.

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The level of concentration today is an unacceptable as it was nearly 100 years ago. Such concentration frustrates technological innovation, facilitates exploitation of producers and consumers, and undermines the efficient, fair and open operation of the market.

3. Have you studied, or do you know of any studies, that have examined whether consolidation in agriculture has led to higher prices for consumers and/or lower prices paid to farmers?

My written statement references the RTI study done for GIPSA that is the most recent documentation of how farmers (there hog raisers) are harmed by the current levels of concentration. Professor Cotterill's work has addressed the impact of concentration on dairy prices in New England. Based on my own work, I am confident that increased concentration in milk buying in the Southeast has resulted in lower prices to dairy farmers and apparently higher prices to consumers. Mr. Bullard's statement has several very informative tables and references showing that there has been a steady increase in the spread between farm and consumer prices. At the same time, we also know that concentration has increased in both processing and retailing. Of course, other factors may have contributed as well, but the inescapable conclusion is that increased concentration in agricultural product markets has contributed to higher prices to consumers and lower prices to farmers.

From Senator Grassley

1. In your opinion, does the Justice Department have an appropriate understanding of the agriculture industry, and thus is appropriately evaluating mergers in the agriculture sector? For example, do you believe that the Justice Department understands monopsony problems in agriculture?

Based on its actions, or rather inactions, in agriculture, it appears to me that the Department lacks a good understanding of monopsony and buyer power problems in general, but in particular its analysis is very deficient with respect to agricultural markets.

2. Is the Justice Department doing all it can under the current antitrust laws to address concentration in agriculture?

No! It has many opportunities to do a much better job and has repeatedly failed to do so. I have laid out a number of clear examples of these failures in my written comments.

3. How can the Justice Department merger approval process be improved with respect to the agriculture sector? For example, the Justice Department Antitrust Division currently has guidelines that it utilizes when it reviews mergers. Do you believe that they are adequate with respect to agricultural mergers? Do you support the provision in my bill S. 1759, the Agriculture Competition Enhancement Act, which would require DOJ to craft guidelines specifically for

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agriculture transactions, taking into account the special characteristics of the agriculture industry?

As I stated in my written comments, S. 1759 is a good proposal exactly because it would require the creation of agriculture specific guidelines. Such guidelines are necessary to inform staff attorneys of the issues and analyses that are relevant to evaluating mergers in these markets. In addition, such guidelines would assist businesses in evaluating the potential for an antitrust challenge.

4. Do you believe that the Justice Department does enough to monitor the market performance of an ever-consolidating agriculture industry, including what happens to the marketplace after mergers have gone through? What would you propose the Justice Department do differently? Do you believe that the provisions that have been included in S. 1759 would help monitor market performance in agriculture?

In addition to lacking useful guidelines, it appears to me that the Department is understaffed with respect to the resources committed to overseeing conduct and structure in agricultural markets. I think S. 1759 would bring about improvements by requiring guidelines, by requiring retrospective review of questionable decisions, and by providing increased resources for enforcement in agriculture.

5. What is your opinion of the investigation process that the Justice Department conducts when it looks into a merger? Do you believe that the process could be more transparent and open? Do you believe that third parties are able to provide input on the merger? In your opinion, how good of a job does the Justice Department do in giving that input weight in their investigations? What would you do to improve the process?

In general the Justice Department approaches merger investigations in far to secret a manner. As a result, they do not communicate with those who complain about a merger and test the claims of the merging parties against the information and analysis that others could provide. Because of the secrecy of the process, it is impossible to tell how much credence the investigators give to third party comments. The Department should follow the practices of the FTC in merger investigations which include a willingness to be open with all interested parties about the analysis that is being made.

6. Do you think that the current antitrust laws need to be amended to take into account the unique characteristics of the agriculture industry? Do you support the burden shifting provision in S. 1759?

With some regret, I am forced to the conclusion that as antitrust law has evolved on a "one-size fits all situations" basis that it is no longer capable of taking account of the unique competitive issues that dominate agriculture. Hence, I support S. 1759 as a reasonable legislative response.

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7. Do you believe that the Department of Agriculture should play a greater role in reviewing mergers in agriculture? Why or why not? In addition, do you believe that the creation of the Special Counsel for Agricultural Competition at USDA contained in S. 1759 would be a beneficial thing?

While the Department of Agriculture has a long history of failing to appreciate the need for market regulation that will facilitate fair and open competition producing efficient markets and indeed has effectively empowered strategic conduct that has harmed farmers and consumers, nevertheless, it ought to be more actively included in the process of reviewing mergers. Its economists have significant expertise concerning these markets, have done essential econometric work and have the background to assist in better evaluation of proposed transactions. However, this contribution can not be usefully made without installing a different process within the Department for the creation and communication of this kind of analysis. Under the current situation, the likely responses from the Department would be unhelpful. Hence, the creation of a Special Counsel for Agricultural Competition as proposed in S. 1759 is a vital component to a strategy to make the USDA a useful participant in the analysis of mergers. The Special Counsel would also play a key role in causing the USDA to use its own latent authority to police markets to facilitate efficient and fair conduct.

8. Some opponents of S. 1759 argue that market conditions do not show monopsonistic prices for farm commodities or monopolistic prices for farm inputs, thus there is no need for this legislation. In addition, they argue that the bill would discourage investment in U.S. agriculture, and actually harm competition. Do you agree with these claims?

What discourages investment in farming itself is the existence of both monopsonistic prices for outputs and monopoly prices on inputs. The record is clear that both kinds of exploitation in fact are occurring in agriculture. Those who claim otherwise have not done a reasonable review of the record. Restoring fair and efficient conduct to markets for agricultural commodities and reducing the exploitation of farmers by input suppliers will increase the returns earned by farming and so increase the incentive for investment.

9. How do you rate the Justice Department's performance in pursuing anti-competitive and predatory business practices in the agriculture industry? Do you think they could do more? How would you suggest they improve in this area?

As my written statement makes clear, I think, the Department has failed to do an adequate job of enforcing antitrust law in agriculture. They certainly can and should do much more. They actually have information showing violations and have staff recommendations for litigation, but the leadership has chosen to ignore all of this.

10. Do you believe that the State Attorneys General have been as vigilant as they should be about these mergers in agriculture and competition issues in agriculture in general? Do you think they could do more? If you do, what should they be doing to address competition problems in agriculture?

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The states have played a lesser role than they might have. Too often, the most affected states are ones with only limited antitrust expertise. They also have had a tendency to see the issues in agriculture as "national" rather than local. The failure of the states to involve themselves in the recent Monsanto-Delta Land & Pine merger case until after the Department of Justice proposed a bad settlement highlights this problem. My suggestion is that the states through their national association should consider creating a shared staff to work on agricultural issues and provide support for specific states. In addition, the states should consider retaining private counsel to assist in evaluating and litigating if necessary, violations. Because federal antitrust law provides for the defendants to pay a reasonable attorneys' fee if they loose an injunction action, such counsel when successful would not be a drain on state resources.

11. What evidence do you have that this concentration in agriculture trend has been harmful to consumers? What evidence do you have that concentration in agriculture has been harmful to independent producers?

I have identified some empirical information in my written statement that supports the conclusion that increased concentration has harmed both consumers and producers. Mr. Bullard's statement contains additional supporting documentation.

12. Some have asserted that increased consolidation among processors allows the processors to achieve economies of scale through larger size. Is this assertion correct, and, if it is, can you outline some of the specific benefits that you believe the JBS merger will achieve through these economies of scale? Do you agree with the opinions of the JBS and National Beef witnesses about the benefits of the JBS merger? If not, what do you believe to be the more significant problems presented by this transaction?

The testimony from proponents of the JBS acquisitions in fact contained only the vaguest of claims of increased efficiency. So far as I can tell, most beef slaughter plants are at or near efficient scale. Certainly JBS is not proposing to consolidate any of the facilities it is buying. Moreover, we know that much smaller sized meat packers have successfully sold in the national and international markets. Thus, there are few if any inherent economies in combining more plants under a single management. Hence, I see no "merger specific" gains from this transaction.

On the other hand, as pointed out by the participants in the second panel, the merger is very likely to have adverse consequences on competition in the fed cattle market, the cow-calf market, and ultimately in the downstream consumer market for beef. Basically, the merger will reduce the number of major competitors in the buying market for fed cattle nationally from 5 to 3, will eliminate direct regional competition in California and Arizona reducing the number of buyers from 2 to 1, will eliminate direct competition in the great plains by reducing the number of potential buyers from 4 to 3. We also know that in quasi-auction markets such as fed cattle, the number of potential buyers is very important to workable competition. In addition, the vertical integration of the Smithfield feeding operation into JBS will result in a further reduction of market oriented buying.

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This in turn will mean that the buying market will have even less total demand. The incentive under existing market regulations to manipulate both the buying price and the futures price for fed cattle will increase substantially. This effect will in turn be reflected down to cow-calf operations as the prices feeders pay for cattle decline reducing the incentive to produce. In sum, this merger creates serious threats to the long term viability of the American market for cattle.

From Senator Feingold

1. Mr. Ross and Prof. Carstensen, since I was first elected to the Senate in 1992, there has been significant consolidation in practically the entire agricultural industry. According to the National Farmers Union's periodic reports on the "Concentration of Agricultural Markets," in that time period beef packers, pork packers, broilers, turkeys, milling, soybean crushing, dairy processing, dairy cooperatives and U.S. food retailing have seen significant increases in market share among the largest firms. Has this consolidation benefitted or harmed the farmers and growers who supply the markets? Similarly, what has been the impact on consumers?

As I have stated in my written statement, the increases in concentration, mostly the result of mergers, have resulted in clear harms to farmers. They get lower prices relative to what a more competitive market would have yielded. Similarly, consumers are harmed as well. They have higher prices and more limited selection of goods.

2. Mr. Ross and Mr. Carstensen, would a ban on packer ownership and other controls on captive supply have a positive or negative impact on competition in the beef industry? What would be the effect on the integrity of price discovery and consumer and producer prices?

Given the structure of the beef market, it is now essential to regulate the upstream integration of packers. Currently, much of the volume comes through either packer ownership or contracts whose exact terms are confidential. Moreover, not all feeders have access to such contracts. This creates inherent discrimination among producers that the packers can use to manipulate price. Finally, many packers use as the basis for contract prices the current price paid at the slaughter house for open market cattle bought during the same week as the contract cattle. This practice invites manipulation, was condemned unanimously by experts in September 2000 (see my written statement), but remains permitted by the USDA. There is a real and increasing need for better market regulation to ensure honest and open price disclosure.

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Feuz Responses

Follow Up Questions for Dillon Feuz from Hearing Entitled "Concentration in Agriculture and an Examination of the JBS Swift Acquisitions"

From Senator Kohl

1. If this merger is approved, buyers of beef -- such as supermarkets, small grocery stores and butcher shops, and restaurants -- will only have three national meatpacking firms to choose from. Is this sufficient for competition, or are you concerned that so few national suppliers will lead to higher prices paid by consumers for their beef?

I have not investigated the market between packers and wholesalers or large retailers. However, for the most part beef is sold as a fresh, perishable product. Beef packers have very limited storage. Therefore, their ability to control prices is much more limited than firms in an industry where inventories can be held off the market for an extended time period. I am not concerned that this merger will lead to higher consumer prices for beef.

2. Mr. Bullard of R-Calf has asserted that for two weeks in February 2006, the top four meatpacking firms ceased buying cattle on the open market. The meatpacking firms reduced slaughter rates rather than enter the cash market. As a result, cattle prices fell sharply. Cattle Buyers Weekly said at the time that the meatpackers' conduct was part of an effort to "try and get cattle bought cheaper."

   Do you believe that JBS Swift's acquisition of the captive supply offered by the Five Rivers Ranch Cattle Feeding LLC ("Five Rivers") make it much easier for them to unilaterally engage in such conduct in the future to force cattle prices down?

The table below contains the volume of negotiated sales for Nebraska fed cattle, Nebraska cash prices and USDA reported Choice box beef cut-out values for the first 12 weeks of 2006. I am not sure which weeks Mr. Bullard is concerned with but the correlation between negotiated sales (number of fed cattle purchased by packers in the cash market) and Nebraska Live and Dressed market prices for fed cattle is -.18 and -.16, neither of which are statistically significant. However, the correlation between Live and Dressed market prices and the value of Choice Beef is +.87 and +.86, both of which are statistically significant at the 95% confidence level.

The price of beef is primarily determined by the supply of beef (number of fed cattle and weight of fed cattle are the 2 main components) and the consumer demand for beef. Packers are margin operators: they capture value when they sell beef, they incur costs when they process fed cattle into beef, and they try and purchase fed cattle at a price that covers those costs and returns some profit. Historically, those profit margins have been relatively small and quite variable. This is the primary reason for a consolidated packing industry.

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Week Ending Date	Negotiated Cash Volume	Live Price	Dressed Price	USDA Choice Beef Cut-out
1/8/2006	46,097	$92.59	$148.67	$155.58
1/15/2006	68,281	$91.97	$147.66	$154.06
1/22/2006	57,211	$94.53	$151.92	$156.80
1/29/2006	37,956	$93.79	$149.53	$155.95
2/5/2006	45,061	$90.70	$144.59	$151.25
2/12/2006	50,891	$88.53	$143.40	$145.92
2/19/2006	39,401	$88.09	$140.53	$148.45
2/26/2006	82,496	$89.56	$143.00	$153.21
3/5/2006	59,740	$88.11	$141.80	$152.64
3/12/2006	55,918	$85.40	$136.58	$148.22
3/19/2006	62,757	$85.46	$136.40	$145.11
3/26/2006	54,361	$86.31	$137.54	$142.22

Source: USDA Market News, NEBRASKA WEEKLY DIRECT SLAUGHTER CATTLE - NEGOTIATED PURCHASES and NATIONAL WEEKLY BOXED BEEF CUTOUT AND BOXED BEEF CUTS - Negotiated Sales

The following text is copied verbatim from a fact sheet written by Clement Ward, Professor of Agricultural Economics, Oklahoma State University. It is the best concise summary I know of on the impact of captive supplies on fed cattle prices. I will use it as the basis for answering question 2, 3 and 4.

Captive Supply Price Relationships and Impacts
Clement Ward, Oklahoma Cooperative Extension Fact Sheets, AGEC-598

Estimated Price Impacts of Captive Supplies

Information presented above on prices and in F-597 on volume traded by pricing method seem to confirm that MPR increased the information available on captive supplies and price relationships compared with the previous price reporting system. That data also allow estimating the price impacts from captive supplies. A brief summary of previous research results is presented, followed by impacts estimated with data since MPR.

Previous Captive Supply Research Findings – Briefly, here is the situation that captive supplies create and the crux of the issue for cattlemen and others. When buyers purchase fed cattle by captive supply methods, the supply of cattle that can be purchased in the cash market is effectively reduced by the volume already committed to specific packers. That alone, would likely raise prices for the remaining cattle because other buyers, those without captive supplies, need to bid aggressively for a smaller supply of fed cattle. However, it also means that buyers with captive supply cattle committed to their plants need not be as aggressive in the cash market because they already have a portion of their cattle requirements met. That, in turn, may cause cash prices to decline. This is the essence of the captive supply debate. Can packers use their captive supply purchases to bid lower and depress prices paid for fed cattle purchased in the cash market? Data collected by the Grain Inspection, Packers and Stockyards Administration (GIPSA) have enabled the most detailed examination of captive supplies to date. Results from a

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captive supply model with five years of monthly captive supply data (1989-93) for the U.S. suggested that larger plants use captive supplies strategically (Barkley and Schroeder). Captive supply usage by larger plants increased as cash prices increased but not for smaller plants. Captive supply usage increased as cash price variability increased, more so for larger plants than smaller plants. Captive supply usage also increased as plant utilization increased. Lastly, for larger plants, contracting and marketing agreements were substitutes for packer feeding. Therefore, in summary, larger plants used captive supplies to increase plant utilization and to mitigate rising or more variable prices.

In one of the short-term impact approaches using transaction data for 1992-93 from packers nationwide, results indicated there was simultaneity in the decision to deliver forward contracted and marketing agreement cattle and the decision to purchase cash market cattle (Ward, Koontz, and Schroeder). The same simultaneity was not found for packer fed cattle. This suggests packers feed cattle for different reasons than they used contracts and marketing agreements. Packer feeding may have been motivated more by cattle feeding profit opportunities and maintaining a steady flow of cattle to the plant, and motivated less by using packer fed cattle strategically to reduce procurement costs via its influence on cash market prices. Use of captive supplies was associated with lower prices for fed cattle generally but the amounts were smaller than many cattlemen expected, ranging from $0.01-$0.41 per dressed hundredweight.

Since the GIPSA concentration study, economists have continued wrestling with the captive supply issue. At least three "theories" of captive supplies have been developed. While there are differences, all suggest captive supplies can be used strategically by packers.

GIPSA commissioned further empirical work with transaction data from the Texas High Plains for 1995-96. Findings were similar to those of Ward, Koontz, and Schroeder. Captive supplies were associated with a small negative decline in fed cattle prices (Schroeter and Azzam 1999). However, the authors proposed an economic argument indicating why this may occur, indicating that the negative relationship between captive supply volume and cash market prices may not be strategic in nature. In later work, Schroeter and Azzam (2004) argue the negative relationship stems from the timing of deliveries to packing plants from cattle feedlots. They found a negative relationship between volume of marketing agreement deliveries in one week and the expectation of a price change from the previous week.

Estimated Price Impacts with MPR Data – Several models were estimated at OSU with weekly data for the three-year period since the beginning of MPR. All models explained over 95% of the week-to-week variation in the five-state, weighted average, live weight fed steer price. Model results were consistent with previous research in some regards but differed somewhat in others.

Consistent with previous research, a small negative relationship was found between the volume of weekly formula priced trades and cash market prices. As formula priced volume increased, cash market prices declined slightly. This finding is consistent with the concerns expressed by many cattlemen regarding the impact of captive supplies on cash market prices. However, the magnitude was less than many cattlemen expect, similar to previous research.

No significant relationship was found between volume of forward contract cattle traded and cash market prices Fewer fed cattle were marketed by forward contract than any other marketing method in the MPR data and the relationship between forward contract prices and other prices was not as strong as the relationship among other pricing methods.

This research also considered the relationship between the extent of negotiated pricing and cash market prices. A reverse relationship was found compared with the finding for formula prices. A small but significant positive relationship was found between the volume of weekly negotiated trades and cash market prices. As more trades were negotiated, cash market prices

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increased. This, too, is consistent with those concerned about captive supplies and their support for returning to a higher percentage of negotiated transactions.

A surprising result was found for packer owned trades. The models consistently indicated a positive relationship between the volume of packer owned cattle delivered and cash market price. This is opposite what most cattlemen concerned about captive supplies would expect. Conceivably, the decision to deliver cattle from the packer's own inventory rests more with feedlot side of the business than with the packer procurement or processing side. More cattle may be delivered when cash market prices are high, thus showing better returns to the cattle feeding side of the business. Packers might also deliver more of their cattle when prices are high for a strategic reason, so as to swing supply-demand conditions more in their favor and lower future cash market prices.

References

Barkley, A.P. and T.C. Schroeder. "Long-Run Impacts of Captive Supplies." C.E Ward, T.C. Schroeder, A.P. Barkeley, S.R. Koontz. Role of Captive Supplies in Beef Packing. U.S. Department of Agriculture, Grain Inspection, Packers and Stockyards Administration, GIPSA-RR-96-3, May 1996.

Schroeter, J.R. and A. Azzam. "Econometric Analysis of Fed Cattle Procurement in the Texas Panhandle." U.S. Department of Agriculture, Grain Inspection, Packers and Stockyards Administration, Unpublished report. November 1999

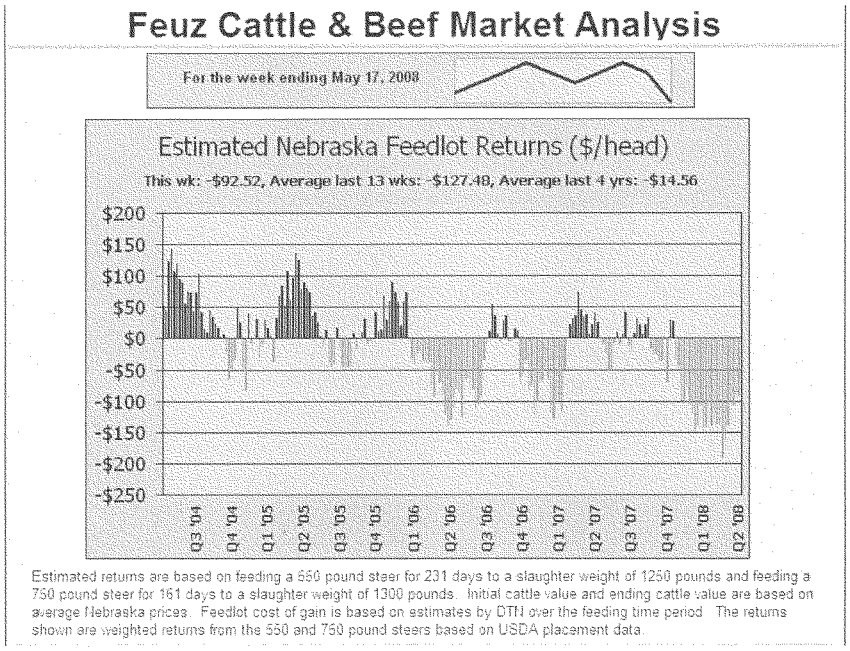
Schroeter, J.R. and A. Azzam. "Captive Supplies and Cash Market Prices for Fed Cattle: The Role of Delivery Timing Incentives." Agribusiness 20,3(2004).347-62.

Ward, C.E., S.R. Koontz, and T.C. Schroeder. "Impacts from Captive Supplies on Fed Cattle Transaction Prices." Journal of Agricultural and Resource Economics 23(1998)·494-514.

Based on my experience and based on the published research findings, some of which were summarized by Ward in the fact sheet, I do not believe that the purchase of Five Rivers feedlots will give JBS Swift the power to "force cattle prices down".

3. Would a condition that JBS Swift be required to divest Five Rivers after these acquisitions be desirable? Please explain why or why not.

I do not think that it would be that advantageous to force JBS Swift to divest of Five Rivers as part of this acquisition. First, ownership of cattle is not that profitable. The chart shows the predicted returns to Nebraska feedlots over the last four years.



Second, historically Monfort and then ConAgra were the beef packers with the greatest ownership of feedlot cattle. They were not the dominant packers. Third, even if ownership of cattle were banned and even if control via contract were banned, if large feedlots and large packers find it advantageous to have exclusive marketing agreements for supply management, then they can continue these arrangements with no contractual agreements.

4. Alternatively, would a condition requiring the cattle at Five Rivers be made available to all of the remaining beef processors in a non-discriminatory be a desirable remedy? Why or why not?

NO! Let the free market operate. I do not believe it is the role of government to be telling private firms who they must do business with. The cattle industry is a mature industry that continues to seek efficiencies to remain competitive. One of those efficiencies for both feedlots and packers is to harvest fed cattle at the appropriate time. Many feedlots have found it advantageous to seek out a relationship with a specific packer to be able to market cattle when the cattle need marketed. This ultimately results in a more consistent supply of beef, and a more consistent product to be offered to consumers.

5. We've heard a lot of testimony about the number of beef packers across the country. But shouldn't we really evaluate this transaction based on its effect on

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local and regional geographic markets? Isn't it true that meatpacking plants mainly obtain their cattle from no more than a few hundred miles away?

In partial response to your question, I copied part of the following government report:

Backgrounder Release No. 0062.96

USDA BACKGROUND REPORT ON MEAT PACKING INDUSTRY CONCENTRATION STUDY

February 14, 1996

Beef Sector

Defining Cattle Procurement Markets (Oklahoma State University with collaborators at Kansas State and Iowa State University)

One reason to define procurement markets is to determine if there is a potential for local price manipulation by a single or very few buyers; for example, if cattle cannot be easily and cheaply transported to take advantage of better marketing opportunities in other marketing regions. However, research conducted for this project suggests that fed cattle procurement markets behave as if cattle are traded nationally. Although regional differences do exist, predominantly east of the Mississippi and west of the Rockies, cattle movements and price adjustments among areas are sufficiently strong to promote similar prices among regions. Kansas and Nebraska tend to lead the price discovery process, and price linkages are strongest between the Midwest and Plains, the major feeding and slaughtering regions.

Although prices adjust quickly among areas as if the fed cattle procurement market were national, in fact, cattle are not transported long distances for slaughter. On average, packers obtained 64 percent of their cattle within 75 miles of their plants, 82 percent within 150 miles, and 95 percent within 270 miles. But low costs of transporting cattle, and the availability of multiple outlets (firms) within regions, likely diminishes opportunities for local price manipulation by significant amounts or for extended time periods.

Research has shown that regional fed cattle markets behave as if there were one national market. While packers do try and obtain cattle that are in close proximity to the plant, there are many instances where cattle are shipped greater than 500 miles to the plant.

I don't believe this merger would impact the regional market structure for fed cattle. Cull cow slaughter is different than fed cattle slaughter. Slaughter cull cows are often transported over 500 miles to a cull cow slaughter plant. The proposed merger would put under the same ownership an isolated plant in Arizona and one in California. Cattle producers in some areas served by these two plants may have had two independent bid for their cull cows. There would likely now only be one bid coming from one of the two

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plants. However, if those bids declined, there would likely be an arbitrager move into the market place to buy the cull cows and ship them to another location.

6. Should the meatpacking firms gain lower prices for cattle because of their increased buying power, do you think it likely that these price savings will be passed on to consumers? What does the historical record in this industry tell us?

Research at Kansas State found that an increase in captive supply led to a small increase in the farm to wholesale beef marketing margin. Their conclusion was that if captive supplies lead to a slightly lower cash market price, at least some of that cost savings was not passed on to consumers. I think it would be safe to assume that if beef packers were able to buy cattle cheaper, some, but not all, of those savings would be passed on to consumers.

7. We have heard some analysts say that there is an overcapacity in the meatpacking industry, and predict that JBS Swift will close some plants after the merger is completed. Do you believe there is overcapacity in the meatpacking industry? And do you expect JBS Swift to close any plants in the years ahead if it completes these transactions?

I believe there is overcapacity in the beef packing industry. I believe that closing a plant would not be compatible with the current objective of JBS Swift to be a dominant world beef firm. However, economic conditions change and management objectives change, and I would therefore not speculate on the long term possibility of JBS Swift closing one of its beef packing plants.

From Senator Hatch

1. Professor Feuz, what affect will this proposed merger have on Utah's ranchers and feedlot operators? What will happen to the meatpacking plant in Hyrum, Utah?

I don't believe that this merger will have any significant impact on Utah ranchers and feedlot operators. The majority of Utah calves are shipped to Colorado, Kansas and Nebraska to be fed. There is generally adequate competition in those areas for fed cattle. Utah feedlots only presently have the one plant in Hyrum which is close to them. It is presently owned by JBS Swift so the merger will not change that ownership. There is a potential advantage for Utah producers in that after the merger, producers would have much greater access to marketing cattle through the US Premium Beef cooperative. In the past, the pricing grid for cattle marketed through US Premium Beef has been favorable to producers. If that continues, Utah producers would be able to take advantage of that and still ship their cattle to Hyrum, rather than having to ship cattle to one of the National plants located in Western Kansas.

2. Professor Feuz, I have been informed that most experts agree that there is overcapacity in meatpacking industry. I understand that many meatpacking

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> facilities require modernization in order to efficiently prepare their products for consumers. The BSE episode of 2003 eliminated, almost overnight, the largest export markets for American beef. So, what happens if this merger does not proceed? What signal will it send to others who wish to invest in the meatpacking industry? Is that message that the regulatory hurdles are just too high? If this infusion capital does not occur, what happens to National Beef and Smithfield as well as the market as a whole?

I believe that the CEO of National Beef testified before the Senate sub committee that National was in some financial difficulty and that only JBS Swift had come forward with any offer. That would indicate to me that most individuals who possess the capital required to purchase National do not believe that they could earn a sufficient return on their investment. If this merger is not allowed by the government, I cannot see how that would instill any more confidence in investors to buy a beef packing plant. I am not in the position to speculate on the survivability of National Beef without this infusion of new capital. However, I do believe that it would be more troublesome to cattle producers to lose the three National plants due to bankruptcy than to lose one independent packing owner due to a merger.

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Follow Up Questions for Steve Hunt from Hearing Entitled "Concentration in Agriculture and an Examination of the JBS Swift Acquisitions

From Senator Kohl

1. Mr. Bullard of R-Calf has claimed that for two weeks in February 2006, the top four meatpacking firms ceased buying cattle on the open market. The meatpacking firms reduced slaughter rates rather than enter the cash market. As a result, cattle prices fell sharply. Cattle Buyers Weekly said at the time that the meatpackers' conduct was part of an effort to "try and get cattle bought cheaper."

   Won't JBS Swift's acquisition of the captive supply offered by the Five Rivers Ranch Cattle Feeding LLC ("Five Rivers") make it much easier for them to unilaterally engage in such conduct in the future to force cattle prices down?

   Answer:

   During February 2006, wholesale beef prices fell dramatically causing National Beef Packing, Co., LLC (NBP) to lose unprecedented amounts of money. NBP reduced the number of cattle it processed to meet the reduced customer demand and to mitigate losses.

   U.S. Premium Beef / National Beef was not a party to the transaction between JBS and Smithfield Foods. It is my understanding that most of the cattle fed by Five Rivers are contracted to either National Beef or JBS and therefore the market dynamics are not anticipated to change.

2. We've heard a lot of testimony about the number of beef packers across the country. But shouldn't we really evaluate this transaction based on its effect on local and regional geographic markets? Isn't it true that meatpacking plants mainly obtain their cattle from no more than a few hundred miles away?

   Answer:

   Beef processors can and regularly do purchase cattle from distances greater than a few hundred miles away. For example, National Beef routinely purchases cattle from as far away as 600 miles or more depending on regional price differences, transportation costs, premium for high quality cattle and specific beef customer product preferences. Competition for the purchase of cattle is intense and will remain so for the foreseeable future, and processors are willing to purchase cattle from a range of distances in order to meet their cattle requirements.

3. We have heard some analysts say that there is an overcapacity in the meatpacking industry, and predict that JBS Swift will close some plants after the merger is

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completed. Is this true? Do you believe that there is overcapacity in the meatpacking industry? And do you expect JBS Swift to close any plants in the years ahead?

Answer:

There currently is more beef processing capacity than there are fed cattle supplies in our industry. Several years ago, most experts were predicting the beef herd would soon begin rebuilding. However, a prolonged drought, alternative demands for grassland and higher feed and fuel costs appear to have caused the cow herd to shrink further thus aggravating the situation.

In fact, in a recent survey of its cow-calf producer members, CattleFax reported in the May 2008 Special Edition, that in 2007, 37 percent of the participants indicated they expanded their herd, 24% indicated they downsized and 39% remained the same. For the participants who indicated they downsized, 47% did so due to drought and 12% due to higher feed costs. Cattle Fax went on to say that, "Although a portion of the CattleFax survey participants did expand in 2007, this was not the case for the U.S. beef cattle industry as a whole. In 2007, beef cow numbers declined by 338,000 head. The largest declines occurred in regions where drought was the most severe. The bottom line of this portion of the survey is that as a whole, the participants are continuing to lean towards expansion as they are generally still profitable. But, the most limiting factors noted in 2007, drought and feed cost will continue to be detrimental looking at 2008. Longer term, increased input costs coupled with increased land values, will continue to be limiting factors in expanding the beef cow herd."

It is my understanding that JBS does not have plans to close plants.

Senator Hatch

1. Mr. Hunt, during the hearing there was a discussion about the spreads between retail beef and hog prices and what producers receive for cattle and hogs. However, little attention was focused on spreads related to the meatpacking business. Could you elaborate on this issue?

Answer:

The beef processing industry has experienced some of the worst losses in over 15 years. Since the discovery of BSE in the U.S. in late 2003, gross beef packer margins (boxed beef prices less the cost of cattle) have been historically narrow. The costs of cattle have been historically high, operating costs are increasing, capacity utilization is low and a disruption in our lucrative export markets have led to significant losses in beef processing over the past 4 Years.

2. Mr. Hunt, Mr. Balto, in his written testimony, stated "based on the preliminary public facts, JBS's proposed acquisition of Smithfield and National poses very serious competitive concerns and will likely harm competition in the purchase of cattle." How do you respond to this statement?

Answer:

The transactions will not reduce competition or change the competitive dynamics in the purchase of cattle. Looking simplistically at the number of larger beef processors in the U.S. is not an accurate or reliable predictor of how competitive the marketplace is. The beef processing industry is intensely competitive, and will remain so following the completion of the proposed transactions. The merged firm will continue to compete intensely with other beef processors for the purchase of cattle, including numerous regional processors who compete aggressively for high quality cattle.

Senator Grassley

1. Research to date shows significant economies of size associated with larger meatpacking plants. Today, nearly all fed cattle packing plants are large, efficient plants, slaughtering 1 million or more cattle annually per plant. Are there efficiency gains yet to be gained for individual plants? Since the plants that JBS plans to acquire are fixed plants in that they are not being expanded, will there be some type of coordination in the livestock/meat marketing channel that will make the plants more efficient? Where specifically are the efficiency gains then of merging already large, multi-plant firms?

Answer:

Most plants today sacrifice efficiency in order to meet customer requirements for a variety of specialty products that require extra trimming, slower chain speeds, etc. Having a multiple plant configuration allows these specialty products to be produced in fewer plants, thereby increasing overall efficiency and chain speeds allowing for more cattle to be processed in a given time frame.

In our two Midwest plant configuration, we have allocated twelve different specialty programs to one plant or another to gain as much efficiency as possible. Each program entails shorter runs, lower chain speeds & more downtime for changeovers, all of which reduce efficiencies and increase costs. If we are able to allocate these same twelve programs over five plants, we can make longer runs between changeovers and reduce downtime. Also, each plant has the opportunity to become very efficient at a particular

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specialty program which over time will result in more consistent product at a lower cost to our customers. It will also be an opportunity to focus certain programs geographically where the type of cattle necessary for a given program are more predominant. For example, high quality Angus cattle are more predominant in Nebraska. By focusing Angus specialty programs closer to where the cattle are, freight costs can be reduced which will result in higher prices to the producer and lower cost to the consumer.

2. U.S. Premium Beef has been a model of what producers can accomplish in terms of value enhancement. USPB has indicated their operations on behalf of investor-cattlemen will continue. What assurance can you give producers this model will be continued into the future with gains accruing directly to the investor-cattlemen?

   Answer:

   USPB is not being sold or liquidated as a result of this transaction. Through this transaction, USPB negotiated to maintain its unique design system of cattle at a level it currently realizes with the opportunity to expand into additional geographical areas of the JBS plant locations. Additionally, USPB will maintain a significant investment in processing through ownership of JBS stock, a level of equity investment greater than at formation in 1997.

3. Large firms operating in a highly concentrated industry raise questions for producers and consumers. Are JBS and the largest firms willing to increase transparency of their market behavior so as to reassure producers and consumers they continue to operate in the best interests of all Americans? This might involve sharing additional detailed financial data in a common format to GIPSA or DOJ? For example, would JBS be willing to submit its sources of capital for this acquisition to auditing agencies?

   Answer:

   I can not speak directly for JBS. However it is a public company subject to financial disclosers similar to the NYSE in the United States. Additionally, JBS will also be subject to mandatory price reporting in the United States. USPB will continue to comply with all applicable legal and regulatory requirements.

4. Agribusiness firms are showing record profits while farmers and ranchers are struggling to survive and consumer food costs continue to rise. How do you respond? Will the JBS merger make this situation worse for market participants and consumers?

   Answer:

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As discussed previously, over the last few years, U.S. beef processors have been experiencing the worst financial performance in decades. In contrast, U.S. cattle producers have realized some of the highest cattle prices in recent history.

It is my belief that JBS's decision to invest heavily in the U.S. beef processing industry will increase efficiencies and provide long term growth prospects for the industry, thus providing for aggressive bidding on cattle and the offering of high quality beef products designed to meet customer preferences. That is, I believe the JBS merger will make things better for market participants and consumers.

Senator Feingold

1. I have some serious concerns that the costs and other burdens of a national animal identification system will fall disproportionately on family farmers and ranchers. Mr. Batista and Mr. Hunt, do you support a national animal identification and tacking system? Do you have any plans to require participation in such a system for any part of your operations? How much are your companies prepared to contribute? Or are farmers and ranchers expected to shoulder the entire cost of the identification tags?

   Answer:

   USPB does not have a position on the implementation of a national animal identification and tracking system. If such a system is implemented, USPB will continue to comply with all applicable laws and regulations.

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U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C 20530

June 17, 2008

The Honorable Herb Kohl
Chairman
Subcommittee on Antitrust, Competition Policy and
Consumer Rights
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed are the responses for the record of Douglas Ross, Special Counsel for Agriculture, Antitrust Division, U.S. Department of Justice, to written questions received following the May 7, 2008, hearing held by the Subcommittee entitled, "Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions."

We hope this information is helpful to you. If we can be of further assistance, please do not hesitate to contact this office.

Sincerely,

Keith B. Nelson
Principal Deputy Assistant Attorney General

cc: The Honorable Orrin G. Hatch
Ranking Member

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Follow Up Questions for Doug Ross from Hearing Entitled "Concentration in Agriculture and an Examination of the JBS Swift Acquisitions

From Senator Kohl

1. **In 1999, John Nannes, the then-Deputy Assistant Attorney General in the Antitrust Division noted in Congressional testimony that the concentrated nature of the beef processing industry required special vigilance. He stated, "We are fully aware, for example, that the concentration level in the steer and heifer segment of the beef packing industry is very high, which makes it very likely that we would take a careful look even at transactions producing only a modest change in concentration."**

   In contrast, Mr. Ross, you were quoted on the website MeatingPlace.com saying, in reference to the JBS transactions, that a high level of concentration alone does not constitute a violation of antitrust law. While this may be true, it leaves a very different message from the previous Administration's concern about concentration in meatpacking. Without commenting on the merits of the JBS deal, don't these quotes suggest two very different approaches to antitrust enforcement in agriculture? Why do you have such a difference in approach from that taken by Mr. Nannes a decade ago?

Both of the quotes you cite are consistent with the approach applied under the Horizontal Merger Guidelines. The Antitrust Division analyzes mergers pursuant to the Guidelines developed jointly by the Department of Justice and the Federal Trade Commission, with whom the Division shares merger enforcement responsibility. Under this approach, market concentration and market share are factors in the antitrust analysis, but are not dispositive.

Section 2 of the Guidelines states that "market share and concentration data provide only the starting point for analyzing the competitive impact of a merger." The Commentary on the Horizontal Merger Guidelines indicates that the Division does not make enforcement decisions solely on the basis of market shares and concentration, but both measures nevertheless play a role in the analysis. Accordingly, mergers occurring in industries characterized by high shares in at least one plausible relevant market usually require additional analysis and consideration of factors in addition to market share. As Mr. Nannes went on to explain, "there may be other circumstances in which the prospects of new entry or other factors would cause us to conclude that the historic market share is not a good predictor of their future market share or market power. So we use the market shares as a starting point rather than an ending point for our analysis." *Competitive Issues in Agriculture and the Food Marketing Industry Before the H. Comm. On the Judiciary*, 106th Cong. 35-36 (1999).

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2. **Nearly two years ago, we received allegations of anti-competitive and monopolistic conduct by DFA, the nation's leading milk marketing cooperative. One allegation in Florida was that independent dairy cooperatives could not have their milk processed in plants affiliated with DFA unless the independent cooperative paid the processor millions of dollars above the cost of processing the milk. It was alleged that this and other anti-competitive conduct seriously harmed the ability of independent cooperatives to compete, and ultimately resulted in higher milk prices to consumers.**

   We were informed that the staff of the Antitrust Division recommended to Assistant Attorney General Barnett in September 2006 that the Justice Department pursue an antitrust case against DFA. If so, it appears that no action was ever taken on the recommendation. Are these allegations true? Why was no enforcement action taken against DFA? What is the status of the DFA investigation today? If it is still pending, what accounts for the delay in coming to a decision as to whether to bring an enforcement action?

The Division welcomes and listens to allegations of potential antitrust violations, and takes these allegations very seriously. If the Division determines that the antitrust laws have been violated, it will take appropriate enforcement action. While the Department does not discuss matters relating to its internal deliberations, I can tell you that the Antitrust Division has monitored actions of DFA and other participants in the dairy industry for potential violations of the antitrust laws, and will continue to do so.

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3. Many critics of antitrust enforcement in the Justice Department in recent years point to the Smithfield/Premium Standard merger, which the Justice Department did not challenge. They argue this merger created a monopsony in pork processing in the southeastern United States, and depressed the prices farmers received for swine. What is your response? Was this deal a merger to monopsony, and, if so, why did the Justice Department not challenge it?

The Division issued a detailed explanation of its decision to close its investigation of Smithfield's acquisition of Premium Standard Farms on May 4, 2007 (available at www.usdoj.gov/atr/public/press_releases/2007/223077.htm). After a careful investigation, the Division determined that the transaction was not likely to harm competition, consumers or farmers.

As part of its investigation, the Division considered the extent to which the transaction would allow the merged firm to lower prices paid to farmers in North Carolina, South Carolina and Virginia—an area in the southeastern United States in which Smithfield and Premium owned three of the four pork-packing plants. Despite the two companies' high share of pork-packing capacity in the area, the Division found that any attempt by the merged firm to lower prices paid—either to farmers who sell market-weight hogs, or to contract farmers who raise hogs for the merging parties—would likely be unsuccessful. First, the Division found that independent farmers at that time shipped, and had the ability to increase shipments of, market-weight hogs to plants outside the three states. In addition, independent farmers shipped and had the ability to increase shipments of weaner and feeder pigs (younger hogs that are lighter than market-weight hogs) to other states in the Midwest for finishing and slaughter. Second, the Division found that contract farmers retained at that time by Smithfield and Premium would switch, or credibly threaten to switch, to other firms that need hog-raising services, such as independent producers who own hog production operations in the area. That is, if Smithfield tried to lower prices to its contract finishers, those finishers could turn to the independent producers in sufficient numbers to negate Smithfield's incentive to exercise monopsony power against the contract finishers. Therefore, the Division concluded that the acquisition was not likely substantially to lessen competition.

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4. Has the Justice Department examined retrospectively mergers in the agriculture sector to determine what impact the deals had on prices paid to farmers or prices paid by consumers? If so, what has the Justice Department concluded?

If not, given the significant concern over agriculture concentration and the rise in food prices, does the Justice Department intend to study the issue?

When undertaking a new investigation or enforcement action in the same market or a related market as previous matters, the Department has an opportunity to assess competitive conditions as they developed subsequent to previous transactions. Furthermore, staff in the sections responsible for agriculture-related enforcement stay abreast of agricultural issues, keep up to date on market trends in those areas, and monitor conditions that would be relevant to our enforcement efforts. Performing more formal retrospective merger studies likely would consume significant time and resources that otherwise would be spent on enforcement matters. In addition, such studies are often inconclusive due to numerous intervening events that may impact actions after the merger. The Division keeps apprised of USDA studies of agriculture markets that have a bearing on our enforcement, as well as reports and articles from the trade press, private sector, and academic sources.

I would note that the Department and the FTC jointly held a merger workshop in February 2004 to study how effective the agencies' merger enforcement has been. And, as Special Counsel for Agriculture, I have led the Division's special outreach effort to speak with and listen to agricultural producers and organizations, which has been an important source of information for potential violations of the antitrust law that could lead to enforcement efforts.

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From Senator Grassley

1. **Could you please tell me what the Justice Department does to monitor market performance of the agriculture industry that has been consolidating over the last decade? What mechanism is there to learn whether or not the expected outcome when a merger occurred was or was not what was experienced 5 – 10 years later? Have you looked at the competitive impacts of agricultural mergers that have gone through recently to determine whether there have been any adverse results? For example, do you believe that the Smithfield PSF acquisition has resulted in a monopsony in Virginia, North Carolina and South Carolina?**

In general, the Division has two legal sections that are responsible for agriculture-related enforcement. Attorneys in those sections stay abreast of agricultural issues, keep up to date on market trends in those areas, and monitor conditions that would be relevant to our enforcement efforts. As a law enforcement agency, the Division generally focuses its resources on pending matters, and our compulsory process powers are focused on determining whether a violation of law exists in particular cases. Accordingly, the Division's conclusion to close its investigation of Smithfield's acquisition of Premium Standard Farms was based on legal and economic analysis of market facts and conditions that existed at that time, which indicated that any potential ability or incentive to exercise monopsony power were negated by market realities. The Division is confident in its conclusion that the acquisition was not likely substantially to lessen competition in the southeastern United States.

When undertaking a new investigation or enforcement action in the same market or a related market as previous matters, we do have an opportunity to assess competitive conditions as they developed subsequent to previous transactions. Performing more formal retrospective merger studies likely would consume significant time and resources that otherwise would be spent on enforcement matters. In addition, such studies are often inconclusive due to numerous intervening events that may impact actions after the merger. The Division keeps apprised of USDA studies of agriculture markets that have a bearing on our enforcement, as well as reports and articles from the trade press, private sector, and academic sources.

I would note that the Department and the FTC jointly held a merger workshop in February 2004 to study how effective the agencies' merger enforcement has been. And, as Special Counsel for Agriculture, I have led the Division's special outreach effort to speak with and listen to agricultural producers and organizations, which has been an important source of information for potential violations of the antitrust law that could lead to enforcement efforts.

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2. Many are concerned that increased consolidation in agriculture makes it easier for the larger market participants to engage in anti-competitive and predatory business practices. Do you agree? How does the Justice Department monitor, investigate and prosecute this kind of activity?

Section 2.0 of the Department of Justice/Federal Trade Commission Horizontal Merger Guidelines states that, "[o]ther things being equal, market concentration affects the likelihood that one firm, or a small group of firms, could successfully exercise market power." The Division applies the analysis set out in the Guidelines to ensure that mergers and acquisitions in agriculture—as in all industries—do not make it easier for firms to engage in business practices that harm competition. As part of this analysis, the Division examines the extent to which post-merger market conditions are conducive to unilateral or coordinated interaction, including the exercise of monopsony power, that harms consumers. In addition, the Division's enforcement of cases involving monopolization and unilateral anticompetitive conduct is extremely important. The Antitrust Division endeavors to apply consistent, objective standards in order to maintain aggressive enforcement of civil non-merger matters to protect competition in the important agriculture sector of our economy.

Staff in the sections responsible for agriculture-related enforcement stay abreast of agricultural issues, keep up to date on market trends in those areas, and monitor conditions that would be relevant to our enforcement efforts. And, as Special Counsel for Agriculture, I have led the Division's special outreach effort to speak with and listen to agricultural producers and organizations, which has been an important source of information for potential violations of the antitrust law that could lead to enforcement efforts.

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3. In your written testimony, you say that buyer market power depresses price and incentives to produce. Thus too few resources are productively used in the economy. That is exactly the result we are seeing in the beef industry as our cattle numbers and producer numbers decline, despite a growing U.S. population that increases overall beef consumption, is that not true?

The Division is committed to preventing anticompetitive mergers or conduct from harming the agricultural marketplace. The Division has pursued monopsony cases as appropriate, including cases in the agricultural industry, such as its challenge to the Cargill/Continental Grain merger (the case filing for this matter is available at www.usdoj.gov/atr/cases/indx159.htm). In the beef industry in particular, in 1993 and 1994 the Division received reports that Cargill's large meatpacking subsidiary Excel was looking into acquiring Beef America. Both of these packers were among the top five in the steer-heifer slaughter market, and our concerns that competition in livestock procurement might be adversely affected by the merger—the monopsony concern—led us to open an investigation. We aggressively questioned Excel and others in the marketplace, clearly communicating our concerns. A Cargill executive has publicly stated that our investigation convinced the parties to abandon the merger.

Generally, the Division analyzes the potential anticompetitive exercise of market power on the buyer side in the same manner as on the seller side. For mergers, our starting point is the Horizontal Merger Guidelines. Similar analysis goes into evaluating joint ventures and other collaborative conduct. Monopolization or attempted monopolization would also be analyzed in similar fashion on the buyer side as on the seller side. The Division is committed to preventing transactions or conduct from increasing buyer market power in violation of the antitrust laws.

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4. In your written testimony, you say that "the unifying theme of the guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise." Doesn't the JBS acquisition do just that?

The Horizontal Merger Guidelines describe the analytical process that the Division employs to determine whether to challenge a merger or acquisition. Under this process, the Division assesses whether the merger would significantly increase concentration and result in a concentrated antitrust market, properly defined and measured. The Division also assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. The Division analyzes whether entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern. The Division also assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. Finally, in certain cases, the Division assesses whether, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market. The process of assessing market concentration, potential adverse competitive effects, entry, efficiency and failure is a tool that allows the Division to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time. Market power also encompasses the ability of a buyer to depress the price paid for a product to a level that is below the competitive price, and thereby depress output.

The Division is currently reviewing the proposed JBS acquisition. You may be assured that the Division will conduct a thorough investigation of the proposed transaction's effect on competition, and if we determine that this transaction would substantially lessen competition in any relevant market, we will take appropriate enforcement action to prevent such harm from occurring.

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5. **At what time, if not now, does the continued consolidation of the meat packing industry become detrimental to either the cow-calf producer, independent feedlot operator, or to the consumer?**

The Division is committed to preventing anticompetitive mergers or conduct from harming competition in the agricultural marketplace. The Division will continue to enforce the antitrust laws fully and vigorously in the beef industry to ensure that consolidation does not substantially lessen competition.

6. **Can the Justice Department place any kind of pre-emptive limitations on the JBS merger because of JBS's ability and market power to depress live cattle prices? If so, what are those limitations?**

While I cannot comment specifically on the JBS transaction, which is currently pending before the Department. in general the Antitrust Division has the authority to seek conditions necessary to prevent a transaction from substantially lessening competition in violation of the antitrust laws. Whenever our investigation indicates that a particular merger is likely to substantially lessen competition in a specific relevant market, we aggressively pursue a remedy sufficient to prevent the threatened harm to competition, including litigation to obtain an adequate remedy or block the transaction altogether if necessary. If the Division obtains limitations on a transaction as a condition for the transaction to go forward, these limitations are subject to court review and approval, as being in the public interest, under the Antitrust Procedures and Penalties Act of 1974, 15 U.S.C. § 16 (also known as the Tunney Act).

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7. **Two competing cattle buyers in California and Arkansas exist today, and that competition will be substantially reduced – that is, there will only be one major buyer – if the JBS transaction goes through. Isn't that a problem? Also, reducing buyers from four to three is a 25% reduction in competition. Isn't that a pretty substantial reduction? In addition, Five Rivers Feeding Company will take at least one JBS plant equivalent off the market, thereby reducing bids for the equivalent number of independent cattle. Why is that not a problem?**

While I cannot comment specifically on the JBS transaction, which is currently pending before the Department, I can assure you that the Division will conduct a thorough investigation of the proposed transaction's effect on competition, and as part of its investigation, the Division will consider the transaction's impact on all relevant markets, including the effects of any potential reduction in production capacity or in the number of competitors in each relevant market. If the Division determines the transaction would substantially lessen competition or tend to create a monopoly in any relevant market, the Division will take appropriate enforcement action to prevent any harm to competition.

From Senator Feingold

1. **Mr. Ross and Prof. Carstensen, since I was first elected to the Senate in 1992, there has been significant consolidation in practically the entire agricultural industry. According to the National Farmers Union's periodic reports on the "Concentration of Agricultural Markets," in that time period beef packers, pork packers, broilers, turkeys, milling, soybean crushing, dairy processing, dairy cooperatives and U.S. food retailing have seen significant increases in market share among the largest firms. Has this consolidation benefited or harmed the farmers and growers who supply the markets? Similarly, what has been the impact on consumers?**

Many mergers pose no harm to consumers, and may produce efficiencies that benefit consumers in the form of lower prices, higher quality goods or services, or investments in innovation. Efficiencies such as these enable companies to compete more effectively, both domestically and overseas. However, if a particular transaction or business practice would pose a threat to competition—whether on the buyer side with respect to farmers and growers, or on the seller side with regard to consumers of agricultural products—the Antitrust Division will enforce the antitrust laws to prevent anticompetitive mergers or conduct from harming competition. As my testimony illustrates, the Division has been very active in the agriculture sector to ensure that concentration does not harm farmers, growers, or consumers.

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2. **Mr. Ross, in the past few years, I have noticed an increase in the number of partnerships, joint ventures and agreements to be the exclusive supplier of a certain retailer, such as an agreement between a large retailer and a meat packer to exclusively supply their stores with beef. To what degree does the Department of Justice examine these relationships when considering mergers and anti-trust issues? Does it change the examination if one of these partners is a cooperative? With the consolidation in both retailers and meat packers, is there even more reason for concern because these are more likely to be alliances between giants?**

Joint ventures, partnerships and exclusive supply arrangements are all part of the market facts that our analysis would take into account as part of a comprehensive understanding of the markets that the antitrust laws seek to keep competitive. While any of these can be evidence of efficiency-enhancing ways to participate in the economy, they can be anticompetitive as well. For example, in the corn wet-milling merger in 2002 between Archer Daniels Midland and Minnesota Corn Processors, the Division insisted that a joint venture with a competing corn wet miller be dissolved before the originally proposed merger could proceed because we found that it would have tended otherwise substantially to lessen competition in the market. Under the Capper-Volstead Act cooperatives are exempt from the antitrust laws when acting within the scope of the Act. The Division would take into account in any antitrust analysis whether an exemption was operative.

In three of the Division's recent enforcement actions involving agriculture, cooperatives have been involved, although none of these actions was affected by the Capper-Volstead exemption. First, in 2000 the Division challenged the proposed acquisition by the cooperative Dairy Farmers of America of the non-cooperative SODIAAL North America in an inquiry that found likely anticompetitive consequences for competition in branded butter in the Philadelphia and New York City metropolitan areas. Second, in December 2004, the Division forced the Eastern Mushroom Marketing Cooperative, the largest mushroom farmer cooperative in the country, to stop its practice of buying mushroom farms only to shut them down, and to agree to make farms it had previously shut down available to competing farmers. Third, in the acquisition by Dairy Farmers of America ("DFA"), a cooperative, of Southern Belle Dairy, we challenged the consummated acquisition as illegal due to the higher school milk prices it resulted in for 100 school districts in Kentucky and Tennessee; after prevailing on appeal, the Division obtained a consent decree requiring DFA to divest Southern Belle.

With respect to alliances between retailers and meat packers, consolidation in these markets would be a factor the Division would include in the analysis of the competitive factors as part of any enforcement inquiry or action. As the Horizontal Merger Guidelines make clear, however, size or concentration levels alone are not outcome-determinative, as all of our inquiries are fact- and case-specific, with the goal of ensuring that the effect of a proposed acquisition or merger is not substantially to lessen competition.

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3. **Mr. Ross and Mr. Carstensen, would a ban on packer ownership and other controls on captive supply have a positive or negative impact on competition in the beef industry? What would be the effect on the integrity of price discovery and consumer and producer prices?**

In the November 6, 2007 Statement of Administration Policy on H.R. 2419, the Administration expressed its strong opposition to a proposed prohibition on packer ownership of livestock, on the grounds that it would interfere with the freedom to contract, require divestiture of assets by entities that have operated legally, limit opportunities for farmers and ranchers to participate in marketing alliances and increase prices for American consumers.

4. **Mr. Ross, it has recently been reported that the former CEO of Dairy Farmers of America played a role in the unauthorized transfer of $1 million to former DFA Board Chairman Brubaker. Does the Antitrust Division or the Department of Justice more generally have authority to investigate such a transaction? If not, which agency or agencies have an oversight role?**

While I am aware of press reports that suggest the Department of Justice and the Commodities Futures Trading Commission may be investigating the transfer referenced in your question, I cannot comment specifically on any potential or actual investigation. Depending on the specific facts and circumstances regarding the transfer, either agency (or both) may have authority to investigate the matter.

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5. **Mr. Ross, dairy markets and the prices that feed into the FMMO system are also overseen to some degree by the USDA and CFTC. Is there a formal system or are there regularly scheduled meetings for coordinating oversight activities and sharing relevant information with these other agencies? How about the Chicago Mercantile Exchange, which oversees the cash cheese market? How frequently have such meetings, communications or referrals occurred?**

As reflected in an August, 1999 Memorandum of Understanding, the Antitrust Division has a long-standing positive working relationship with USDA on competition matters in the agricultural sector, and both attorneys and economists remain in regular contact with USDA on specific matters as well as on more general mutual concerns as appropriate. In addition, the Division and the USDA have instituted periodic meetings between "front office" officials at the two agencies to discuss both specific and general matters of interest.

The Division has also been in contact on appropriate occasions with the Commodities Futures Trading Commission. For example, in the Cargill/Continental matter, the Division's investigation included extensive consultations with officials from the CFTC, among others, to consider the impact of the proposed transaction on futures markets. After the final judgment was entered in that matter, three additional firms became eligible to make delivery on the futures contracts, reducing concentration in ownership of facilities eligible for delivery of the contracts and introducing a greater degree of competition among potential deliverers on the contracts. These changes reduced the likelihood of future attempts to manipulate prices established in the corn and soybean futures markets, and helped contracts function well in the settlement's aftermath.

The Division will continue to consult, when appropriate, with other government regulatory entities to take advantage of expertise that may be helpful for understanding the competitive dynamics of markets or industries in which those entities have extensive expertise, though the Division makes its own enforcement decisions in accordance with its distinct enforcement responsibilities.

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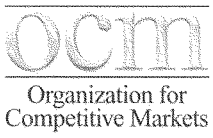

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June 3, 2008

The Honorable Herb Kohl
U.S. Senate
330 Hart
Washington, DC 20510
Via email:Margaret_Horn@Judiciary-dem.senate.gov

Re: "Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions"

Dear Senator Kohl:

Thank you for holding the hearing on the JBS/Swift acquisition. The Organization for Competitive Markets appreciates your concern, your co-sponsorship of S. 1759, and your request for a GAO study on concentration in agriculture. We also recognize and appreciate the hard work of Seth Bloom, Jeffrey Miller, Phil Karsting and Margaret Horn.

Please find enclosed my responses to your questions, and those of Senators Grassley and Feingold.

Respectfully,

Michael C. Stumo
General Counsel

Encl: As noted

Follow Up Questions for Michael Stumo from Hearing Entitled "Concentration in Agriculture and an Examination of the JBS Swift Acquisitions

From Senator Kohl

1. Mr. Bullard of R-Calf has asserted that for two weeks in February 2006, the top four meatpacking firms ceased buying cattle on the open market. The meatpacking firms reduced slaughter rates rather than enter the cash market. As a result, cattle prices fell sharply. Cattle Buyers Weekly said at the time that the meatpackers' conduct was part of an effort to "try and get cattle bought cheaper."

   Do you believe that JBS Swift's acquisition of the captive supply offered by the Five Rivers Ranch Cattle Feeding LLC ("Five Rivers") make it much easier for them to unilaterally engage in such conduct in the future to force cattle prices down?

   Answer: Yes. This is a market power grab. There are no efficiency gains. Plant size, management, type of processing all remain the same.

   Post-merger, three people will make cattle price decisions in the U.S. They are the head buyers for JBS, Tyson and Cargill. Every other company will merely follow. The Five Rivers portion of the acquisition will reduce the JBS demand for cattle, meeting the needs of at least 1.5 plant equivalents. The result will be more weeks of the year that competitive bidding for cattle is depressed or nearly eliminated.

2. Would a condition that JBS Swift be required to divest Five Rivers after these acquisitions make these acquisitions acceptable, or do you believe that it would still substantially harm competition even with such a divestiture? Please explain why.

   Answer: The divestiture of Five Rivers could be helpful if done in the right way. But competition will be depressed with the elimination of Smithfield and National as buyers.

   If Five Rivers is divested to another packer, or divested under terms that make the firm a captive supplier, then the result is not helpful. If Five Rivers is divested under terms that make it a competitive seller, then the result is more helpful. Another approach is to craft an open market purchase percentage guarantee for the merged entity that lasts indefinitely – i.e. does not expire.

   The combination of National and Swift in the plains is, in our view, at least as problematic as the Five Rivers portion of the acquisition.

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3. We've heard a lot of testimony about the number of beef packers across the country. But shouldn't we really evaluate this transaction based on its effect on local and regional geographic markets? Isn't it true that meatpacking plants mainly obtain their cattle from no more than a few hundred miles away?

   Answer: The local/regional market view is incomplete. The Great Plains region is a local/regional market for fed cattle. But that market serves as an index for other regional markets. One analogy may be the "manufacturers suggested retail price" in the auto industry. Auto dealership competition is local, but the MSRP set by Ford also has a substantial impact. The Great Plains region prices serve as that MSRP-analog for other regional bidding.

   Also, the feeder cattle market will be affected nationwide, because feeder cattle are regularly shipped more than 1,000 miles to the Great Plains. To the extent fed cattle prices are depressed, feeder cattle prices will go down because the break-even analysis (the calculation a feeder cattle buyer makes to determine what he/she can afford to pay for feeder cattle) will mathematically dictate that result.

4. Should the meatpacking firms gain lower prices for cattle because of their increased buying power, do you think it likely that these price savings will be passed on to consumers? What does the historical record in this industry tell us?

   Answer: No. There is no proof that consumers have benefited from past meat packing mergers. Industry makes those claims, and some ag economists have echoed those claims. But none have provided mathematical proof. Industry personnel are consulted and quoted, thus generating the "happy talk" as I mentioned in my oral testimony. The farm-to-retail price spread increases every year, even as concentration became greater. If efficiency gains occurred, the consumer did not benefit.

   Indeed, high food prices make concentration more risky. Buyer and seller power are enhanced. Bottlenecks can be easily controlled by these three companies. All the while they will claim that supply and demand works because prices go up and down, which is not the measure of market power.

5. In his testimony Mr. Hunt makes the point that investment is needed in beef processing and only JBS is willing to invest after the merger. Is there merit to this argument? From your perspective, are some of these meat processing companies failing?

   Answer: There is no merit to this argument by Mr. Hunt, who stands to gain handsomely from this acquisition. "Investment is needed in beef processing." What is "beef processing"? Beef processing is an industry. Does he mean that every beef processing company needs investment? Are there not alternative sources of capital besides dominant firms? Which

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company? Which aspect of the vertically integrated business? Smithfield Foods makes increasing net profits every year. The company is not failing. National Beef showed no signs of financial stress, and is a successful exporter. None of these companies have shown any financial records to support these claims, which are merely redundant of typical press releases issued to justify past mergers. Mr. Hunt has no data to support his vague claims.

From Senator Grassley

1. What evidence do you have that this concentration in agriculture trend has been harmful to consumers? What evidence do you have that concentration in agriculture has been harmful to independent producers?

   Answer: As to consumer harm, the farm to retail price spread has increased over the last 20 years. Lower cattle prices seldom, if ever, translate into lower consumer prices. In a competitive market, if cattle prices go down, consumer prices would follow.

   As to producer harm, market access has diminished for independent producers. Many of OCM's small producer members cannot attract a buyer to consider their cattle. Many of OCM's mid-sized and large producer members experience many weeks of the year when no competitive bids are offered, because captive supplies have filled the shackle space. Prices go down, and take two to three weeks to recover.

2. In your opinion, does the Justice Department have an appropriate understanding of the agriculture industry, and thus is appropriately evaluating mergers in the agriculture sector? For example, do you believe that the Justice Department understands monopsony problems in agriculture?

   Answer: The Justice Department employs very intelligent people, but OCM believes they are insufficiently worried about buyer and seller power in relation to farmers. OCM believes DOJ views agriculture as just another industry in the antitrust analysis.

   Agriculture is different because of (1) the disparity in power between farmers and industry as compared to other vertical players in other industries – i.e. each farmer has virtually zero market power; (2) the lack of substitution available to farmers for their input needs or sales product; (3) the local/regional nature of ag markets, which is sometimes confusing because national price averages and futures markets create the illusion of a national market; (4) the perishability of many agricultural products; (5) the disparity in sophistication between farmers and firms supplying inputs to or buying from farmers.

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The result is lack of market access, increased market power, and an increased farm to retail price spread in most commodity and food products.

3. Is the Justice Department doing all it can under the current antitrust laws to address concentration in agriculture?

   Answer: No. The Department of Justice allowed Monsanto to acquire Delta and Pine Land Company last year. That merger was abandoned in 2000 after DOJ pressure, but the current DOJ allowed it with insubstantial divestitures of cotton seed trait lines that are not sufficient to enable competition. The DOJ also allowed Smithfield to purchase Premium Standard Farms last year, enabling a southeastern U.S. pork packing monopoly. Justice stated that hogs can travel 700 miles, among other mis-statements, when justifying the decision to allow the merger. These were mistakes.

4. How can the Justice Department merger approval process be improved with respect to the agriculture sector? For example, the Justice Department Antitrust Division currently has guidelines that it utilizes when it reviews mergers. Do you believe that they are adequate with respect to agricultural mergers? Do you support the provision in my bill S. 1759, the Agriculture Competition Enhancement Act, which would require DOJ to craft guidelines specifically for agriculture transactions, taking into account the special characteristics of the agriculture industry?

   Answer: OCM supports S. 1759 as an essential start to correcting the problem. Agricultural guidelines should be created to distinguish agriculture from other industries in the manner I stated above. Pro-competitive effects or efficiencies are often accepted without proof, while proof of harm is always needed. The proper analysis, at this stage of concentration in agriculture, is to recognize claimed pro-competitive effects or efficiencies only when they are (1) mathematically proven by clear and convincing evidence; (2) not achievable by means other than merger; and (3) to the extent that the benefits are likely to be passed to consumers or producers.

5. Do you believe that the Justice Department does enough to monitor the market performance of an ever-consolidating agriculture industry, including what happens to the marketplace after mergers have gone through? What would you propose the Justice Department do differently? Do you believe that the provisions that have been included in S. 1759 would help monitor market performance in agriculture?

   Answer: The DOJ does not monitor the performance of the industry after a merger. They handle a transaction, make a decision, and do not look back. DOJ could benefit by crafting agricultural merger guidelines and forming a

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commission to include outside persons in production agriculture to analyze past mergers to determine whether competition was maintained. S. 1759 would assist this process greatly.

6. What is your opinion of the investigation process that the Justice Department conducts when it looks into a merger? Do you believe that the process could be more transparent and open? Do you believe that third parties are able to provide input on the merger? In your opinion, how good of a job does the Justice Department do in giving that input weight in their investigations? What would you do to improve the process?

   Answer: The DOJ investigative process has been open in the sense that OCM's input has never been denied. We do not feel great weight has been given to OCM's concerns, primarily because the evaluation of a merger is based more on personnel ideology, in our view, than ongoing standards. The factors for analysis should be created and should be published. Input could then be targeted more precisely, and the DOJ ideology of the day would be less of a variable.

7. Do you think that the current antitrust laws need to be amended to take into account the unique characteristics of the agriculture industry? Do you support the burden shifting provision in S. 1759?

   Answer: Yes. Amendments are necessary and S. 1759 is a good start. The courts have been hostile to antitrust in recent years, and no DOJ guidelines will change caselaw. Changes to the substantive law of agricultural antitrust should be considered, especially with regard to the presumptions of anti-competitive results and the increased skepticism of pro-competitive benefits.

8. Do you believe that the Department of Agriculture should play a greater role in reviewing mergers in agriculture? Why or why not? In addition, do you believe that the creation of the Special Counsel for Agricultural Competition at USDA contained in S. 1759 would be a beneficial thing?

   Answer: USDA should play some role in the review. However, USDA has been compromised by being a promoter of concentration unfortunately. Very little industrial organization expertise, the subspecialty applicable to antitrust economics, exists at USDA. Agricultural merger guidelines would assist in constraining the variable ideology of USDA personnel. Congress should create the Special Counsel for Agricultural Competition at USDA to professionalize the antitrust and competition expertise of the agency.

9. Some opponents of S. 1759 argue that market conditions do not show monopsonistic prices for farm commodities or monopolistic prices for farm inputs, thus there is no need for this legislation. In addition, they argue that the

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bill would discourage investment in U.S. agriculture, and actually harm competition. Do you agree with these claims?

Answer: These opponent claims are false. In poultry, hogs and cattle, market access has diminished greatly. Increasingly, a producer can sell only if he/she has a contract. In poultry, you may only grow birds if a processor bestows a contract on you. In hogs, the poultry scenario is true in the southeast, and may soon be true in the Midwest. In cattle, many weeks of the year have non-competitive bidding because of captive supplies and only contracts allow consistent market access. Free markets do not work this way.

Also, the farm to retail price spread in pork and beef continues increasing, showing consumer harm.

Lastly, all credible studies show a strong correlation between more captive supplies in livestock and lower prices. The pro-competitive claims are based upon anecdotal evidence and industry interviews, not facts.

10. How do you rate the Justice Department's performance in pursuing anti-competitive and predatory business practices in the agriculture industry? Do you think they could do more? How would you suggest they improve in this area?

Answer: The DOJ has performed poorly in ways discussed above. S. 1759 addresses many of these problems. Ultimately, the caselaw must be changed through legislation with a focus on shifting the burden of proof to the defendant to prove that the merger will not substantially lessen competition.

11. In your opinion, has the Department of Agriculture done all it can under the Packer and Stockyards Act to address anti-competitive and abusive practices in agriculture? What more can it do to improve enforcement of the Act?

Answer: No. The USDA has don nothing on this score. The USDA should issue regulations constraining captive supply and defining levels of concentration that are anticompetitive. The USDA should issue regulations making captive supply contracts tradeable and transparent, turning a market harming device into a pro-market device.

12. Do you believe that the State Attorneys General have been as vigilant as they should be about these mergers in agriculture and competition issues in agriculture in general? Do you think they could do more? If you do, what should they be doing to address competition problems in agriculture?

Answer: State Attorneys General could be more active. They are hampered by the caselaw problems discussed above.

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13. There is less vertical integration of the cattle supply chain than is evident in the hog supply chain. Moreover, this proposed merger would make beef packers even more highly concentrated than pork packers. Is the live cattle industry less susceptible to packer control through vertical integration than is the hog industry?

Answer: Smithfield was a vertical integration driver in the hog industry. It has created Five Rivers Cattle Feeding in the cattle industry. JBS plans to acquire that feeding company, which will produce enough cattle to fill the annual capacity of 1.5 major plants without participating in the open market. Cattle are not only susceptible to vertical integration, but well on the way. Policy makers can change this now with less pain than later action.

14. The significance of an ever-increasing price spread between prices paid to cattle producers and prices consumers pay for beef has been dismissed by industry analysts as a function of ever-increasing value-added beef products. In your opinion, does the increase of value-added products explain increased beef price spreads?

Answer: No. Value added products are not included in the USDA numbers giving rise to the price spread. The data would be worthless if you changed the data inputs to the time series. Thus, USDA properly does not include it. Industry analysts are wrong.

15. The efficiency gains for producers and consumers can only occur with sufficient competition from rival packing firms. Are two large rival firms sufficient competition? Isn't collusion among three large firms easier than among 5 or more? Are there a sufficient number of smaller, fringe firms that may comprise potential competitors should prices paid for fed cattle or received for beef products get out of line?

Answer: The big five firms are the market makers. Three rival firms are insufficient for competition in this buy-side, auction-style market characterized by substantial partial vertical integration. The fed cattle market is only marginally competitive now, and this JBS acquisition plan will substantially lessen competition. Collusion in an auction-style market is very easy, but "parallel behavior" is more likely. The firms can easily find out what their putative competitors are doing each day, gaining multiple important pieces of information on price, volume and behavior. They are unlikely to break an unspoken consensus on competitive behavior because it is too costly and is unlikely to outweigh the benefits of the tacit agreement.

Second tier firms are helpful, but are not market makers. The big firms establish the baseline price, and the small firms either gather cattle supplies from established relationships or bid prices up in small locales. They do not report prices to USDA and thus their bidding is not part of the USDA price reports.

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16. The numbers of producers of all livestock continue to decline. However, independent cattle producers remain the largest body of producers in the United States. Could the shrinkage of the number of cattle operations in the U.S. be caused by something other than market power exerted by a concentrated packing industry? In other words, could the shrinkage simply be a function of some producers being more efficient and producing cattle cheaper than other producers? Despite the decline in the number of U.S. cattle operations and the reduced size of the U.S. cattle herd, isn't it true that due to improved genetics, technology, and management, the U.S. is producing more beef from each animal, suggesting that the decline in both the U.S. herd and the number of cattle operations is simply a function of improved industry efficiency?

    Answer: OCM members that produce cattle worry most about lack of market access. They are most likely to quit the business if market access is reduced, sporadic, or terminated. Macro-factors unrelated to market power can cause a reduction in producer numbers. But the facts show that more captive supplies lower price. Fewer buyers in an auction-style market lower price. Vertical integration and horizontal concentration reduce market access. Efficiency gains are not passed to producers or consumers as shown by the increased farm to retail price spread; and the disconnect/nonresponsiveness between the farm price and the retail price. Also, standard monopsony theory predicts that price depression will result from monopsony power, reducing supply volume, and the result is bad for the economy because the economy does not produce at full capacity. The cattle industry is following that monopsony model. We could produce more cattle for our population. Better genetics, technology and management lower per animal production costs, but do not explain the decline in herd size.

17. Some have asserted that increased consolidation among processors allows the processors to achieve economies of scale through larger size. Do you agree with this assertion? Do you agree with the opinions of the JBS and National Beef witnesses about the benefits of the JBS merger? If you don't, what do you believe are the more significant problems presented by this transaction?

    Answer: No economies of size will result because the plant sizes will be the same. No multi-plant efficiencies have been claimed. The merging parties have multiple plants now, so little change will occur. If efficiencies are claimed, they must outweigh the market power harm, be unattainable through other means, and be passed on to consumers. This is a market power grab.

From Senator Feingold

1. Mr. Stumo and Mr. Bullard, how will this acquisition affect the feeder cattle, Holstein and cull cow markets? How is the price for beef cattle related to the price for these other animals?

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Answer: Feeder and Holstein prices are pegged to the fed cattle price. Holstein trade in a range – or basis – stemming from the fed cattle price. That basis range can vary. But if the fed cattle price is lowered, the Holstein price follows almost linearly. This is because Holsteins produce mostly hamburger, which fed cattle also produce. Holsteins have fewer high-value cuts than fed cattle, which explains the basis price reduction from fed cattle. But the retail market supplied is very similar.

Feeder cattle are priced using a break-even analysis. A buyer of feeder cattle must calculate the expected fed cattle price for gross revenue, and then subtract the cost of feed, medication, interest, yardage and other known costs. The result is the price that can be paid for a particular lot of feeder cattle. If the fed cattle price is lower, this will lower the break-even price for the feeders. If market access is restricted for fed cattle, this causes more risk which also depresses the break-even price… this is a risk premium. If more fed cattle buyers go out of business, there will be a decline in competition for feeder cattle. This latter result is being seen in many auction markets today.

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SUBMISSIONS FOR THE RECORD

Testimony of David A. Balto,
Senior Fellow, Center for American Progress

Before the Senate Judiciary Committee, Subcommittee on Antitrust, Competition Policy and Consumer Rights

"Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions"

Wednesday, May 7, 2008

Introduction

Mr. Chairman, Ranking Member Hatch, and other distinguished members of the Antitrust Subcommittee of the Antitrust Subcommittee of the Senate Judiciary Committee, I want to thank you for giving me the opportunity today to speak about the competitive problems that arise from increased concentration in agricultural markets and, specifically, on the competitive impact of JBS/Swift's proposed acquisitions of Smithfield and National.[1]

My testimony today is based on over a quarter century as an antitrust practitioner, the majority of which was spent as an enforcer in the Antitrust Division of the Department of Justice, and in several senior management positions, including Policy Director at the Federal Trade Commission ("FTC"). I currently regularly practice before both the agencies, and frequently represent consumer groups, producers, and other service providers, raising concerns about mergers under investigation by the Antitrust Division or the FTC.

My message today is a simple one: Based on the preliminary public facts, JBS' proposed acquisition of Smithfield and National poses very serious competitive concerns and will likely harm competition in the purchase of cattle.[2] Today's hearing and continued monitoring by this

[1] My testimony is also supported by The Consumer Federation of America. CFA is a nonprofit association of 300 consumer groups representing more than 50 million Americans that was established in 1968 to advance the consumer interest through research, education, and advocacy.
[2] My testimony focuses on the impact on cattle producers. As explained in my testimony it may also lead to higher prices to consumers.

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Committee are vital to assuring a competitive marketplace in agricultural markets. Unfortunately, the standards currently applied by the Antitrust Division of the DOJ have eroded and we are in a period of particularly lax merger antitrust enforcement. The Antitrust Division has not been to federal court to enjoin a merger in five years. They have not challenged an agricultural processing merger in almost a decade.

My testimony is divided into three parts.

I begin by providing the framework of the competitive analysis of the merger. This merger will reduce the number of national beef processors from 5 to 3. Permitting the consummation of these acquisitions will lead to lower prices to cattle producers, and, ultimately, higher prices to consumers. Second, I analyze whether the merger may on balance benefit consumers perhaps from increased buying power or the potential efficiencies of the merger. I conclude that those efficiencies are unlikely to be a substantial counterweight to the potential anticompetitive effects of the merger. Finally, I close with some general observations about how to improve the approach to agriculture competition issues.

Competition Analysis

I begin with three important concepts to consider in analyzing the potential impact of JBS' acquisitions.

First, the primary concern addressed by this panel is the potential exercise of monopsony power; that is, the power to decrease the price paid to cattle producers for their cattle. It is well recognized in antitrust jurisprudence that the antitrust laws condemn any exercise of market power, whether it harms producers, service providers, or the ultimate consumer or the producers of the product. Indeed, the legislative history of the Sherman Act is unequivocal: The statute was enacted, in part, to protect cattle producers from anticompetitive activity of the beef trust. As a leading DOJ economist observed "[i]n both houses of Congress, participants in debates often singled out the beef trust for condemnation, and they condemned it for reducing the prices paid to cattle farmers more than for raising prices to consumers."[3] This merger, by reducing the

[3] Gregory J. Werden, "Monopsony and the Sherman Act: Consumer Welfare in a New Light," 74 Antitrust L.J. 707, 714-16 (2007).

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number of competitors from five to three, poses the potential for a level of concentration that the founders of the beef trust in the late nineteenth century could not even imagine.

Second, some might suggest that the impact on cattle producers should not be a significant concern unless it can be demonstrated that the exercise of monopsony power would harm consumers. That view is inconsistent with the law and the purpose of the statute. The antitrust laws seek to prevent any misuse of market power, regardless of the victim. Indeed, economic theory teaches that in the end, the exercise of monopsony power leads to reduction of output and that output reduction will ultimately increase prices to consumers. Moreover, it seems relatively clear that recent agricultural processing mergers that may have increased "buyer power" have not led to lower prices for consumers.

Third, merger analysis needs to focus on the unique economic conditions of each market. In any matter involving beef processing, it is tremendously important to realize the fragile nature of competition. As the other witnesses will testify, beef producers can only sell their cattle in a short time window, or the cattle will degrade in quality and value. Moreover, many beef processors are vertically integrated, and this vertical integration offers the opportunity for several types of market manipulation. Each of these factors suggests that the DOJ should be even more concerned about the potential exercise of market power, because even a modest degree of market power will enable processors to harm competition.

What Are the Potential Anticompetitive Effects of the Merger?

Merger analysis begins with the definition of the relevant market. There should be little dispute on this issue: from the producer side of the equation that the relevant market is the purchase of cattle. Cattle producers simply have no alternative but to turn to a beef processor for the sale of their cattle.

The relevant geographic market can vary depending upon the alternatives of the cattle producer. Generally, in agricultural processing matters, the geographic markets are defined by the "draw areas" of the processing facilities. The scope of these draw areas is defined by the distance a producer can efficiently transport its product. We believe that those draw areas will be relatively limited, a distance of perhaps 200 miles.

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Based on this perspective there may be several geographically limited relevant markets.

One area of particular concern may be the Plains states of Nebraska, Colorado, Kansas, Oklahoma, New Mexico, and Texas. National's two processing facilities in Dodge City and Liberal, Kansas are less than 162 miles from JBS/Swift's facility in Cactus, Texas. For producers relatively close to those three facilities the merger may have a particularly substantial anticompetitive impact.

Once the markets are defined it is necessary to calculate concentration to gather some measure of the potential competitive effect. Concentration calculations are included in Appendix A. I have calculated concentration based on two groups of competitors: all beef processors and the five major beef processors.

Including all beef processors will understate the level of concentration for several reasons. First, some processors just process cows and are not an alternative for steers and heifers. Second, many processors are specialized and focus only on certain types of cattle. Other processors are too small to purchase entire lots. Finally, only the largest five processors act as the "market makers" and smaller processors do not have a significant impact on the bidding process. As the courts have held, only those alternatives which have the significant ability to restrain the exercise of market power should be considered as part of the relevant market. Thus, it would be reasonable to conclude that only the five largest firms (JBS/Swift, Smithfield, National, Tysons, and Cargill) should be included in the relevant market.

In any case, regardless of which firms are included the proposed acquisitions establish a prima facie violation under the law and the Merger Guidelines. In the broad national market of all processors, JBS/Swift's market share increases from 11.6 percent to 31.1 percent, and the HHI increases from 1370.4 to 2008. If only the five largest firms are included, JBS/Swift's market share increases from 15.9 percent to 38.1 percent and the HHI increases from 2507 to 3314.2.

As the Committee is aware, antitrust merger analysis as currently conducted by the Federal Trade Commission and Department of Justice is not simply a matter of counting the number of competitors and calculating

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concentration. Rather, the agencies have taken upon themselves the obligation of identifying the likely competitive effects of a merger: how the merger will lead to higher prices or less output. Thus, a central part of the analysis is to determine how the merger will lessen competition either by unilateral action by the merged firm or by coordinated action by the merged firm and other remaining firms. In this case, there are significant concerns of potential unilateral or coordinated effects.

Unilateral concerns arise when, because of a merger, the merged firm can unilaterally increase prices or reduce output substantially. The concern in this case is straightforward: The merger will reduce the number of bidders for a substantial number of producers from four to three, or perhaps from three to two. Economic theory predicts that the elimination of a bidder will likely result in lower bids for the products of producers. In fact, the Antitrust Division has challenged several mergers in which the number of bidders for services or goods were reduced from four to three. A careful analysis of the bidding histories of the merging processors would likely provide convincing proof that the proposed merger poses significant competitive concerns.

Let me turn to the concern of coordinated interaction. As the D.C. Circuit Court observed in its seminal decision in *FTC v. Heinz:* "The combination of a concentrated market and barriers to entry is a recipe for price coordination. . . . Where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels."[4] Preventing market environments that foster coordination is a central purpose of merger enforcement. As the leading antitrust treatise notes, tacit coordination:

> Is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.[5]

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[4] 246 F.3d 748 (D.C. Cir. 2001).
[5] 4 Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law* P 901b2, at 9 (rev. ed. 1998).

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These acquisitions raise very serious concerns of coordinated interaction. By reducing the number of significant bidders from four to three, collusion will be readily simplified. It is simply easier to reach agreement with fewer competitors.

Moreover, the nature of the beef processing market may facilitate coordination. As any antitrust enforcer will tell you, secrecy is the enemy of collusion: Where information about the nature of offers or agreements is secret it may be more difficult for firms to coordinate their conduct either explicitly or tacitly. However, in the beef processing market, information is relatively transparent. Auctions are conducted in a relatively public fashion and buyers may be well aware of the nature of each other's bids. Not surprisingly, the Department of Justice has brought several criminal cases against "buyer cartels" in auction settings and has, in fact, brought a criminal case against beef buyers for engaging in collusion.[6]

Finally, the acquisition of Smithfield by JBS may significantly improve the opportunities for collusion. Smithfield owns Five Rivers, the largest feed lot in the country. By acquiring Five Rivers, which supplies other processors, JBS will now have access to critical information about purchases and the bids made by its rivals. Moreover, to the extent that JBS' processing rivals are dependent on Five Rivers, JBS will be in the catbird seat, aware of the competitive initiatives of those rivals; and that, in turn, can lead to tacit collusion.

Because this hearing focuses on the impact on producers, that has been the focus of my testimony. But the increase in concentration from this merger also poses a significant threat to the consumers of beef. Prices of beef have increased recently, and additional concentration will likely not improve this trend. On the contrary, it could lead to higher prices and reduced choices for consumers. The oligopolistic nature of the market suggests that reducing the number of competitors from five to three will lead to tacit collusion. Some may suggest that any collusion is unlikely because the major supermarkets are sophisticated buyers with significant buying power. Of course, the fact that supermarkets may have been

[6] Statement of Joel I. Klein, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Hearing on Antitrust Issues in Agricultural Business, Senate Committee on Agriculture" (Jul. 27, 1999). Collusion in an agricultural auction setting is not that unusual. During the 1990s, tobacco manufacturers engaged in a conspiracy to depress prices to tobacco growers at auctions. The conduct was challenged in private antitrust litigation which ultimately secured extensive injunctive relief and damages of several hundred million dollars.

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victimized by an alleged cartel of chocolate manufacturers suggests that they are not immune from anticompetitive conduct by food processors.

Countervailing Factors

The next issue is whether there are significant efficiencies that may counterbalance the potential anticompetitive effects of the merger. The parties have not been particularly forthcoming about the potential efficiencies of the merger, but they face an appropriately difficult burden in demonstrating that these efficiencies are likely to outweigh the anticompetitive effects of the merger. The antitrust agencies and the courts consider only those efficiencies likely to be accomplished solely through the proposed merger. In other words, if there are other means of achieving these efficiencies short of merger, these efficiencies are not "merger-specific." Moreover, it is critical to recognize that merger-specific efficiencies count only to the extent that they do not arise from anticompetitive reductions in output or service. Ultimately, the parties must demonstrate that efficiencies "likely would be sufficient to reverse the merger's potential harm to consumers in the relevant market, e.g., by preventing those increases in the market."

Perhaps the parties may suggest that the merger will be procompetitive by increasing the buying power of JBS. Buying power should not be included in the calculus of procompetitive effects unless it results in lower prices to consumers. Again, history is instructive: If past acquisitions led to increased buying power consumers did not benefit. There is no evidence that those lower costs resulted in lower prices to consumers.

Another efficiency might arise from increased economies of scale. Sometimes the opportunities to combine multi-plant operations can lead to increased economies of scale. However, in beef processing, most plants seem to achieve significant economies of scale at relatively modest capacity. Each of the JBS/Swift, National, and Smithfield facilities probably operate at an efficient scale.

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The Weakening of Merger Enforcement

Some have observed that the current level of merger enforcement is substantially below that of the previous administration. A recent article published by the former chief economists of the Federal Trade Commission and the Antitrust Division of the Department of Justice strongly substantiates that merger enforcement appears to be significantly more lax than in the prior administrations.[7] They found "with no change in the underlying statute, the Clayton Act, the weight given to market concentration by the federal courts and by the federal antitrust agencies has declined dramatically." This is a critical issue for the proposed merger.

In the prior administration, the DOJ took a relatively tough stance toward beef processing mergers. It conducted an extensive investigation of a proposed acquisition by Cargill of Beef America and that investigation appeared to lead Cargill to drop its consideration of the transaction. In 1999, the then-Deputy Assistant Attorney General for the Antitrust Division noted in congressional testimony that the concentrated nature of beef processing required special vigilance:

> We are fully aware, for example, that the concentration level in the steer and heifer segment of the beef packing industry is very high, which makes it very likely that we would take a careful look even at transactions producing only a modest change in concentration."[8]

The Department's "tough cop on the block" stance may have deterred other types of proposed anticompetitive acquisitions. Certainly, it seems to me that if this transaction had been announced in 1999, it would have been challenged by the Department of Justice.

It appears that the Department is applying a more lax standard to mergers in numerous industries. In agriculture industry, for example, the Department approved Monsanto's acquisition of Delta Pine with divestitures, even though that same acquisition had effectively been

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[7] Jonathan B. Baker and Carl Shapiro, "Reinvigorating Horizontal Merger Enforcement" (Oct. 2007)
[8] Statement of John M. Nannes, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Hearing on Competitiveness in Agriculture, House Committee on the Judiciary" (Oct. 20, 1999).

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challenged by the Department in 1999.[9] Last year, the Department approved Smithfield's acquisition of Premium Standard, even though it led to a monopoly in the southeastern U.S. hog processing market.

It is vital for this Committee to fully examine why the Department has taken a more lax position on agriculture mergers than the previous administration. Each new antitrust administration notes with pride that politics do not matter and there is underlying consistency to the agencies' approach regardless of which party is in control. I certainly believe that is correct. But the current administration needs to explain why it takes a different stance on agricultural mergers than its predecessors.

Conclusion

No other industry has had as many congressional hearings in the past 12 years on competition issues as agriculture. Yet over the past seven years there have been no merger enforcement actions in the agricultural processing sector, no actions against anticompetitive practices, and no criminal enforcement actions. It is not surprising if farmers and producers believe that antitrust enforcement is failing to protect these markets. This is not to criticize my former colleagues at the staff level at the Department of Justice, who are dedicated, hard-working public servants. But it seems that after seven years of minimal enforcement we are on the wrong track, and that further hearings on the issues are insufficient. Let me make some modest suggestions to address this problem.

First, the Department should intensely investigate this merger. The preliminary public facts suggest a very significant competitive problem. The beef processing market is one with years of evidence of market manipulation, one which is ripe for collusion. As antitrust enforcers often observe "a merger is forever" and these acquisitions pose a threat of permanently weakening competition in a particularly vulnerable market.

In this investigation I have two suggestions. First, it is important for DOJ to focus on all groups of producers, especially smaller producers. Obviously, the easiest producers to contact will be those producers with

[9] The proposed consent decree faced an almost unprecedented level of opposition in the Tunney Act process. There were 12 comments opposing the proposed decree, including the comments of 13 state attorneys generals.

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large, sophisticated operations. Yet, those producers may be the ones who have a greater range of alternatives in response to anticompetitive conduct. It is vital to survey the smallest producers who may be the most vulnerable. Second, it is important to fully engage the opponents of the merger, such as my co-panelists, in a meaningful dialogue about their competitive concerns. Such a dialogue can be particularly important in testing the assertions made by the merging parties as to why a merger is not anticompetitive.[10]

Second, the DOJ and the FTC need to utilize all their tools to address agricultural competition issues. To their credit the FTC and DOJ have conducted hearings and workshops on various industries and substantive areas such as merger enforcement. In 2004, they held hearings on merger enforcement which included testimony on agricultural issues and monopsony analysis.[11] Yet the end product of those hearings—a "Merger Commentary"—did not address agricultural processing mergers, and only made a passing mention of one case involving monopsony (a health insurance case). This was clearly inadequate to address an issue that has been the subject of so many congressional hearings. Clearly, there needs to be greater analysis and transparency about DOJ's approach to both monopsony and agricultural issues. As a starting point, I suggest that the DOJ, along with the Department of Agriculture and the FTC, conduct hearings on agricultural competition issues, with a goal of issuing a report discussing the industry-specific factors that are central to competition analysis in these markets.

Third, the question that arises is why the Department has not taken enforcement actions in past merger agricultural processing investigations. I suggest that this Committee ask the General Accounting Office to conduct a study of the Department's decisions not to take enforcement actions in agricultural processing mergers.[12] That will better inform this Committee

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[10] Based on my experience in advocating against the Premium Standard/Smithfield merger, I believe the DOJ may not have had a complete view of the anticompetitive impact of the merger because they failed to engage in that type of dialogue. For a description of this issue see my letter to the Assistant Attorney General, Antitrust Division of May 2, 2008.

[11] There was extensive testimony about the reasons why special standards should apply to agriculture and monopsony issues. *See* C. Robert Taylor, "The Many Faces of Power in the Food System," presented to the DOJ/FTC Workshop on Merger Enforcement (Feb. 17, 2004); Peter C. Carstensen, "Buyer Power Merger Analysis: The Need for Different Metrics," prepared for the DOJ/FTC Workshop on Merger Enforcement (Feb. 17, 2004).

[12] This study could be patterned after either the GAO study on oil mergers, or the GAO study on divestitures in retail markets.

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and the thousands of farmers who depend upon a competitive market why there is not a greater degree of enforcement and the impact of the DOJ's enforcement decisions.

Fourth, it is important to focus on the unique factors involving agricultural markets. The agencies always suggest that their approach under the Merger Guidelines is equally applicable to all markets. But this "one size fits all" approach may lead to misleading results. A good example of this is the problems endured by the agencies in litigating hospital mergers. During the 1990s the FTC, DOJ, and state attorney generals lost seven consecutive hospital mergers. In part this was because they applied a test for defining geographic markets that was used in a wide variety of markets, known as the Elzinga-Hogarty test. This test almost inevitably led courts to define markets in an overbroad fashion, ultimately finding no competitive problems for the challenged merger. Over time the agencies recognized that the Elzinga-Hogarty test was not an accurate predictor for describing the geographic dimensions of hospital competition. In a recent case involving a merger between hospitals in suburban Chicago, the FTC successfully argued that the Elzinga-Hogarty approach was inappropriate for hospital markets. That experience presents an important lesson for antitrust enforcers: There may be general tools that can be used for analyzing the dimensions of competition, but those tools must be consistent with the marketplace realities. This is simply to suggest that the agencies need to apply tools in agricultural markets that fully recognize the dimensions of competition from the producers' perspective.

Finally, I agree with my co-panelists that the time may have passed to expect that the agencies have the necessary tools to adequately enforce the law. The trend in many agriculture markets is becoming clear: Producers receive less and consumers pay more. The past seven years of minimal enforcement show the inadequacy of the Merger Guidelines and the agencies' "one size fits all" approach. This Committee should support the enactment of the Grassley-Kohl bill, S 1759, which proposes changes to the merger review process that would give the USDA and the DOJ the tools to effectively protect competition.

I appreciate the opportunity to testify and look forward to your questions.

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Beef Processing Concentration: All Firms

Pre-Merger

Firm	Capacity Head/Day	Share	HHI
Tyson	32,600	23.6%	
Cargill	29,000	21.2%	
JBS Swift	15,850	11.6%	
National Beef	13,700	10.0%	
Smithfield	8,350	6.1%	
American Foods	6,500	4.7%	
Greater Omaha	2,700	2.0%	
Nebraska Beef	2,600	1.9%	
AB Foods	1,600	1.2%	
FPL Foods	1,500	1.1%	
Others	22,665	16.6%	
Total	137,065		1370.4

Post-Merger

Firm	Capacity Head/Day	Share	HHI
JBS Swift National Beef Smithfield	20,500	31.1%	
Cargill	29,000	21.2%	
Tyson	28,700	21.0%	
American Foods	6,500	4.7%	
Greater Omaha	2,800	2.0%	
Nebraska Beef	2,600	1.9%	
AB Foods	1,600	1.2%	
FPL Foods	1,500	1.2%	
Others	22,665	16.6%	
Total	137,065		2008.0

HHI Increase: 629.6

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Beef Processing Concentration: Five Major Firms

Pre-Merger

Firm	Capacity Head/Day	Share	HHI
Tyson	32,600	32.8%	
Cargill	29,000	29.1%	
JBS Swift	15,850	15.9%	
National Beef	13,700	13.8%	
Smithfield	8,350	8.4%	
Total	99,500		2507

Post-Merger

Firm	Capacity Head/Day	Share	HHI
Tyson	32,600	32.8%	
Cargill	29,000	29.1%	
JBS Swift National Beef Smithfield	38,100	38.1%	
Total	99,500		3314.2

HHI Increase: 807.2

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Statement of Wesley M. Batista
CEO, North America
JBS Swift and Company
Before the Senate Judiciary Committee,
Subcommittee on Antitrust, Competition Policy and Consumer Rights

Mr. Chairman, Senator Hatch and members of the Committee, thank you for the opportunity to introduce JBS Swift to the Committee and to discuss our commitment to invest in America's meatpacking industry.

Our goal through these transactions is to invest our skills, energy, expertise, and money to grow the U.S. meatpacking industry. We want to expand U.S. sales of beef and pork, domestically and around the world. In the process, we will keep and create U.S. jobs.

We are operators of beef, pork and lamb processing plants, not financial investors. My father started our business in 1955 when he slaughtered just one or two animals per day to supply restaurants in the new capital city of Brazilia. We are still a family business. I now run the U.S. and Australia operations. My younger brother runs the global group out of San Paulo. My mother, father, and four other siblings are actively involved in the company.

Our history is clear. When we acquired Swift last year, we expanded operations, we added additional shifts, we hired more employees, we improved operations, and we bought more cattle. With respect to the Smithfield and National facilities, we will do the same – buy more animals, expand operations and hire more workers.

This is unlike what other packers have done in the United States. In the last decade, other U.S. companies have closed down operations and laid off employees. We will take a different approach – we will keep plants open, make them more efficient, and expand sales of U.S. beef.

We also look forward to hiring more workers consistent with new changes in U.S. immigration law. We view the U.S. labor force as a great resource and will, of course, comply with all U.S. laws.

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A couple of questions have been raised that we would like to address. The first is our relationship with producers. We will continue to work with producers as we always have.

While there was some initial skepticism, I have had meetings with employees and community leaders in Garden City, Kansas; Greeley, Colorado; and Amarillo, Texas, and feel we are being embraced. I will continue to do community and employee meetings.

As we are doing right now, we will continue to compete aggressively for the purchase of cattle by all available commercial means. And we will increase our demand over time. This will benefit ranchers and feedlots.

There is one major region in the nation which contains the vast majority of all the major slaughtering plants for steer and heifers – that region is the beef belt. It includes northern Texas, Oklahoma, Iowa, Kansas, Nebraska, and Eastern Colorado. None of the Smithfield plants are in the beef belt. Most of the Smithfield plants handle primarily dairy steers and culled cows.

Regarding the crucial beef belt, after this merger, JBS, Cargill, Tyson, and regional and local plants will continue to compete intensely for the purchase of cattle. With cattle moving on trucks, there will be a variety of competing plants wanting to buy animals in the beef belt.

In terms of consumer prices, beef products are sold throughout the nation by numerous competitors of all sizes. JBS Swift sells primarily commodity beef and some case-ready beef and pork. In contrast, National Beef sells very successful, branded beef products and we plan to expand those operations. Swift and National will continue to sell into different, and competitive, national markets.

In fact, when selling to large national retailers like Wal-Mart and Costco, there will be intense competition among national, regional and local players.

I want to end with one final point. The JBS history in the U.S. is before you. Swift was floundering, had reduced its work force, shut down shifts, and sold plants before JBS purchased Swift. Then, after we bought Swift, we expanded operations, added shifts and hired more workers. We kept local managers.

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We are investing billions of our company's money in the United States, with a goal to grow the industry, hire more U.S. workers, and increase demand for U.S. beef and pork around the world.

We are fully cooperating with the Department of Justice review and hope that review can conclude as swiftly as possible so that we can implement our growth strategy on beef and pork.

We appreciate this opportunity to tell our story before this Committee and look forward to the answering your questions.

On a personal note, my family and I greatly enjoy living in America in our home in Fort Collins.

This is a great country and I like to think that my English is improving everyday.

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

Testimony

of the

Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America (R-CALF USA)

To the

United States Senate Judiciary Subcommittee on Antitrust, Competition Policy, and Consumer Rights

May 7, 2008

Presented By

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Thank you, Chairman Kohl and members of the Subcommittee, for this opportunity to testify about important issues affecting the United States cattle industry, particularly the likely effects the proposed JBS/Swift acquisitions would have on cattle industry competition.

I am Bill Bullard, CEO of the Ranchers Cattlemen Action Legal Fund, United Stockgrowers of America (R-CALF USA). R-CALF USA is a membership-based, national, non-profit trade association that represents exclusively United States farmers and ranchers who raise and sell live cattle. We have thousands of members located in 47 states and our membership consists of seed stock producers (breeders), cow/calf producers, backgrounders, stockers and feeders. The demographics of our membership are reflective of the demographics of the entire U.S. cattle industry, with membership ranging from the largest of cow/calf producers and feeders to the smallest of cow/calf producers and feeders. Our organizational mission is to ensure the continued profitability and viability of independent U.S. cattle producers.

Today I will present an overview that will describe the unique characteristics of both the U.S. live cattle industry and the U.S. live cattle market: characteristics that will demonstrate that the JBS/Swift acquisition would both lessen competition within U.S. cattle markets and facilitate the exercise of monopsony power to the detriment of the entire industry. All of the exhibits referenced in my written testimony are available on R-CALF USA's website listed on the cover page under the heading "Competition Issues."

SUMMARY AND RECOMMENDATIONS

The U.S. live cattle industry is a diverse and vibrant value-added industry that is both separate and distinct from the beef packing industry and highly susceptible to any further reduction in competition and any additional exercise of market power. The live cattle industry is the largest segment of U.S. agriculture. With annual revenues of approximately $50 billion, it contributes more to the prosperity of Rural America than any other agricultural segment, and this prosperity is distributed throughout the U.S., with 11 states generating more than $1 billion annually.

It is important that the Subcommittee realize that while the four major beef packers control approximately 80 percent of the market for slaughter-ready steers and heifers, that market represents only 27 million of the 45 million cattle that are marketed each year. In fact, when all slaughter cattle markets are considered, including cow and bull slaughter, the sales of live cattle that occur among and between the various value-added segments of the industry that are *not* sold to beef packers accounted for nearly 30 percent of the industry's annual revenue generation. In other words, though the slaughter-ready steer and heifer market is the industry price-maker, directly impacting the 60 percent of annual cattle marketed to the four major packers and indirectly impacting the remaining 40 percent of cattle sold to smaller packers and other cattle producers, it is a fallacy to believe, as the major packers would like you to believe, that the entire U.S. cattle industry is merely a supplier of packer inventories.

The U.S. cattle industry can be viewed as a pyramid, with 970,000 independent cattle-producing businesses filling its base. Most cattle operations have fewer than 50 head of cattle,

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and fewer than 80,000 beef cattle operations have herd sizes of more than 100 head. This group of fewer than 80,000 businesses would be at greatest risk of being forced to exit the industry due to the price effects of monopsony power because it is presumed that this group is comprised of more full-time cattle producers wholly dependent on competitive cattle prices for their livelihoods.

Like the packing industry, the feeding sector of the live cattle industry – the sector that fattens cattle in feedlots preparing them for slaughter – has become increasingly concentrated in recent years. Presently, at the apex of the cattle industry pyramid, are less than 2,500 feedlots that feed and sell the lion's share of slaughter-ready cattle, over 23 million head, mostly to the four major beef packers.

These fundamental industry facts are important to this Subcommittee's investigation of the proposed JBS/Swift acquisitions because they help demonstrate how even relatively small impacts on the price of 27 million steers and heifers can have a compounding impact on hundreds of thousands of cattle producers that generate $50 billion annually from the sale of 45 million cattle. A 3 percent price distortion, for example, would result in the loss of $1.5 billion to nearly 970,000 cattle operation, which would be a serious blow to thousands of rural economies. The viability of the numerous value-added segments of the U.S. live cattle industry is intrinsically tied to the price of the industry's principal product – slaughter-ready cattle, and it is this segment of the industry that is most susceptible to monopsony power wielded by an extremely concentrated beef packing industry and that serves as the portal through which monopsony power can invade the entirety of the U.S. live cattle industry.

The U.S. cattle industry has already partially succumbed to the exercise of market power emanating from a highly concentrated beef packing industry – at current concentration levels. The number of U.S. cattle operations is declining rapidly, with 40 percent of the operations in existence in 1980 having already exited the industry. The size of the U.S. cattle herd is contracting and the industry's bellwether cattle cycle, historically the indicator of competitive supply and demand signals, which rose and fell in 10 to 12 year cycles, is now disrupted, if not lost all together. The U.S. hog industry is further advanced in its consolidation with meatpackers and the U.S. Department of Agriculture (USDA) recently attributed the loss of the hog industry's cycle as a function of structural changes to the industry. Thus, there is a causal relationship between the loss of a competitive livestock cycle and a changed industry structure marked by concentration and consolidation.

The alarming irony is that the U.S. cattle industry continued its contraction during the decade after 1993, a period during which domestic beef consumption increased significantly. It is counterintuitive and contrary to competitive market principles that a decade of nearly continuous increases in domestic beef consumption would lead to domestic industry contraction rather than domestic industry revitalization. But, that is precisely what has already happened *without* the added burden of less competition and more market power that would become manifest if the JBS/Swift acquisitions are consummated.

The U.S. hog industry, which lost 90 percent of its participants since 1980, no longer is comprised of the critical mass of participants necessary to sustain a national, competitive market.

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The U.S. cattle industry, however, still consists of hundreds of thousands of independent businesses that can, indeed, sustain a robust, competitive market, provided it is protected from further erosion of competition and monopsony power. Despite its present, diminutive size, the U.S. hog industry provides valuable insights into the future of the U.S. live cattle industry should increased concentration in the beef packing industry and increased monopsony power continue unabated. It also reveals the harm to consumers arising from the meatpackers' excessive control over livestock production, which is evidenced by an upward trend in retail pork prices paid by consumers and a downward trend in hog prices paid to producers.

The characteristic nature of cattle and the characteristics of the U.S. live cattle market make the U.S. live cattle industry uniquely susceptible to monopsony power. These characteristics include for cattle:

1. The longest biological cycle of any farmed animal, making it difficult for the industry to react to changes in demand.

2. Slaughter-ready cattle are highly perishable products that must be marketed within a narrow window of time; otherwise, the animals would degrade in quality and value.

3. The feasibility of transporting cattle long distances decreases as cattle approach slaughter weight, resulting in the regionalization of markets defined by transportation constraints.

For cattle markets:

1. Concentration levels in the U.S. meatpacking industry are already among the highest of any industry in the United States and are considered by some researchers to be well above levels generally considered to elicit non-competitive behavior and result in adverse economic performance.

2. The live cattle market is inherently fragile. Researchers have found that regional competition for raw products, which would include competition for slaughter-ready cattle, is inherently less intense than is competition in processed food products.

3. The U.S. cattle market is highly sensitive to even slight changes in cattle supplies. The U.S. International Trade Commission has found that a 1 percent increase in fed cattle numbers is expected to result in a 2 percent decrease in price.

4. The cattle market is sensitive to shifts in cattle procurement methods, with price distortions ranging up to 3 percent in earlier studies, though some researchers now believe these earlier studies inappropriately focused on market outcomes and overlooked important elements of the competitive process in the beef packing industry.

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5. The packer demand for live cattle is bounded on a weekly basis by available slaughter capacity, which is a limiting factor on demand for cattle, i.e., slaughter capacity sets the weekly slaughter cattle-marketing limit.

6. The combination of the perishable nature of slaughter-ready cattle and limited weekly slaughter capacity creates market access risk for U.S. cattle producers within the U.S. cattle market. Market access risk refers to the availability of a timely and appropriate market outlet and evidence suggests that producers who choose forward contracts are willing to give up some revenue in order to secure market access

7. The Regional Herfindahl-Hirschman Indices (RHHI) are already exceedingly high in several regions of the U.S., where RHHI indices ranging from 2,610 to 4,451.

8. Transparency in the U.S. live cattle market is already limited as was reported by the Government Accountability Office (GAO) in 2005. The GAO reported on a number of deficiencies in the government's Livestock Mandatory Reporting system with regard to the transparency of the reporting system and accuracy of the data reported. And, it is likely the JBS/Swift acquisition would reduce price reporting due to the 3/70/20 confidentiality rule.

9. Researchers have found that individual producers within the U.S. cattle industry will agree to sign captive supply contracts even while knowing that the aggregate effect of captive supply contracts is to depress the cash market price and make all producers, including him/herself, worse off. This phenomenon was found to be a function of the individual producer's inability to coordinate action.

The JBS/Swift acquisitions would significantly increase the concentration of the beef packing industry and would facilitate significantly the exercise of market power. Albeit too late, a USDA study recently acknowledged that market power emanates from the similarly concentrated pork packing industry, concluding there was a "significant presence of market power in live hog procurement." This study also found a causal relationship between the use of captive supply livestock and depressed livestock prices, concluding that a small increase in packer-owned hogs caused cash market prices to decrease. Of particular concern is that the JBS/Swift acquisitions would result in both the increased use and effectiveness of captive supply cattle for purposes of depressing U.S. cattle prices by increasing the beef packing industry's ability to further restrict producer access to market outlets.

The present use of captive supplies and other strategies designed to effect market power by beef packers is already harming the U.S. live cattle industry. Empirical evidence shows that beef manufacturers have used their market power to coerce political support from producers. They have engaged in coordinated actions resulting in reduced prices for live cattle. They have imposed disparate discounts for similar quality specifications. They have imposed pricing strategies that defy competitive market fundamentals. And, they have begun to subdivide the cattle market by denying access to the market for certain subclasses of cattle.

The JBS/Swift acquisitions would exacerbate the monopsony power that presently enables the foregoing anticompetitive practices. To make matters worse, JBS/Swift has a history

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of being a bad actor, as evidenced by media reports that it engaged in anticompetitive practices against Brazilian cattle producers. Further, the vertical integration component of the JBS/Swift acquisitions – the acquisition of the nation's largest feedlot – would significantly intensify the degree of market power emanating from this holding because, unlike the present owner, JBS/Swift would have packing plants in close proximity to the feedlots and would have the daily slaughter capacity to slaughter all the cattle it feeds, thus increasing the percentage of captive supply cattle that are withheld from the cash market. In addition, JBS/Swift would have access to information regarding the value of feeder cattle it intends to purchase for feeding long before independent producers would have such information. The information available to JBS/Swift would be knowledge of the type and quantity of future purchasing orders for beef – essentially insider information – that would accord JBS/Swift a distinct advantage when competing against independent cattle producers for feeder cattle.

Finally, the JBS/Swift acquisitions would most likely violate both the spirit and express prohibitions contained in the Packers and Stockyards Act of 1921, which was designed to afford the U.S. live cattle industry with protections beyond the traditional concerns of efficiency and market competition. In particular, it was designed to prohibit unfair, deceptive, and manipulative acts and practices that have the effect of manipulating or controlling prices, such as those acts and practices described above, as well as to prohibit the creation of a monopoly. Inasmuch as creation need not occur instantaneously, the JBS/Swift acquisitions would clearly catapult the beef packing industry toward monopolization nationally, and would likely result in complete monopolization in certain geographic regions.

Consummation of the JBS/Swift acquisitions would likely be the proverbial straw that breaks the camel's back. The U.S. cattle industry remains in a continual state of contraction, and evidence of market power deployment abounds. Just as the U.S. live hog industry suffered a mass exodus of hundreds of thousands of producers, without Congress even knowing about it, so too could the U.S. cattle industry suffer the same consequence. Congress would not likely know about a cattle industry exodus either, as it would occur one cattle operation in one rural community at a time.

R-CALF USA appreciates the opportunity to express its concerns regarding the JBS/Swift acquisitions and, for the foregoing reasons, respectfully requests that the Subcommittee conduct a thorough, probing analysis of the JBS/Swift acquisitions and that it expand its investigation to include a thorough, probing analysis of the current market environment in which these acquisitions are proposed. R-CALF USA is confident that such a comprehensive investigation would reveal the need to forestall indefinitely the JBS/Swift acquisitions as well as to initiate immediate remedial action to halt the anticompetitive practices already prevalent within the U.S. live cattle industry.

I. The U.S. Cattle Industry is a Diverse and Vibrant Value-Added Industry that is Both Separate and Distinct from the Beef Packing Industry and Highly Susceptible to Market Power.

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As a preliminary matter, it is important that the Subcommittee realize that the U.S. live cattle industry is the largest segment of American agriculture. With gross receipts from the sale of live cattle at approximately $50 billion annually, the live cattle industry contributes more to the prosperity of Rural America than any other agricultural segment, and this prosperity is widely distributed throughout the U.S., with 11 states generating more than $1 billion annually.[1]

It is equally important that the Subcommittee realize that the U.S. live cattle industry is a value-added industry separate and distinct from the U.S. beef packing industry.[2] While the four major beef packers – Tyson, Cargill, JBS/Swift, and National Beef Packing Co. (National) – currently control approximately 80 percent of the steer and heifer slaughter in the United States,[3] these major beef packers are involved in transactions for the purchase of only about 27 million[4] of the 45 million cattle that are marketed each year.[5] Thus, the four major packers that control 80 percent of the U.S. steer and heifer slaughter, and which have worked diligently to perpetuate the misperception that the U.S. live cattle industry is merely a supply source for packer inputs, is involved in the direct purchase of only 60 percent of the 45 million sales transactions that annually contribute $50 billion to the United States' economy. In fact, when total beef packer slaughter is included, which would include U.S. cow and bull slaughter, the sale of live cattle *not* destined for sale to the beef packing industry accounted for over 27 percent of the live cattle industry's annual revenues.[6]

B. Like the Beef Packing Industry, the Feeding Sector of the U.S. Live Cattle Industry has become Increasingly Concentrated.

The structure of the U.S. cattle industry is like that of a pyramid. Filling the base of this pyramid in 2007 were 967,440 cattle operations, including both dairy and beef cattle operations.[7] This represents 40 percent fewer U.S. cattle operations than existed in 1980, which numbered 1.6 million at the time.[8] Of the 967,440 remaining cattle operations, only 757,900 are beef cattle

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[1] *See* U.S. Farm Sector Cash Receipts from Sales of Agriculture Commodities, 2004-2008F, U.S. Department of Agriculture, Economic Research Service, available at http://www.ers.usda.gov/briefing/farmincome/data/cr_t3.htm.
[2] *See* 2007 North American Industry Classification System (NAIS) Codes and Titles, U.S. Census Bureau, available at http://www.census.gov/naics/2007/NAICOD07.HTM (the live cattle industry is a subset of the U.S. agriculture industry whereas beef packers are a subset of manufacturers of nondurable goods).
[3] *See* Packers and Stockyards Statistical Report, 2005 Reporting Year, Table 27 – Steer and Heifer Slaughter Concentration by 4, 8, 20, and 50 Largest Firms for Selected Years 1980-2005, U.S. Department of Agriculture, Grain Inspection Packers and Stockyards Administration, February 2007, at 44, available at http://archive.gipsa.usda.gov/pubs/2005_stat_report.pdf.
[4] *See* Livestock Slaughter 2007 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, March 2008, at 13 (the actual number of steers and heifers slaughtered was 27,297,800 head and the total number of cattle slaughtered in the U.S. was 33,145,000 head), available at http://usda.mannlib.cornell.edu/usda/current/LiveSlauSu/LiveSlauSu-03-07-2008_revision.pdf.
[5] *See* Meat Animals Production, Disposition, and Income 2006 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, April 2007, at 8, available at http://usda.mannlib.cornell.edu/usda/current/MeatAnimPr/MeatAnimPr-04-27-2007.pdf.
[6] *See id.* (the percentage was calculated using the 2006 value of production ($35,740,774,000) and the 2006 cash receipts from marketing ($49,148,364,000) (note that the cash receipts from marketing understate the actual cash receipts because it excludes interfarm sales within the same state. *See id.*, at 27.)).
[7] *See* Farms, Land in Farms, and Livestock Operations, U.S. Department of Agriculture, National Agricultural Statistics Service, Sp Sy 4 (08) a, February 2008, at 14.
[8] *See* Federal Register, Vol. 72, No. 152, Wednesday, August 8, 2007, at 44,681, col. 2.

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operations, and the vast majority of these operations (585,050) have fewer than 50 head of cattle.[9] Only 78,360 beef cattle operations have herd sizes of more than 100 head.[10] While all 757,900 beef cattle operations would be harmed by the lessening of competition and increased exercise of market power that would result from the JBS/Swift acquisitions, it is most likely that producers within the class of operations with more than 100 head, the class with fewer than 80,000 operations, would be at greatest risk of being forced to exit the industry due to lower cattle prices, based on the presumption that this class is comprised of more full-time cattle producers wholly dependent on competitive cattle prices for their livelihoods.

Moving toward the top of this pyramid are cattle feeders that feed cattle in feedlots until they reach slaughter weight, at which time the cattle would be sold directly to beef packers for slaughter. Like the beef packing industry, feedlots have become increasingly concentrated. In 1995, 41,365 feedlots marketed 23.365 million cattle.[11] By 2002, only 2,209 feedlots marketed 23.637 million cattle.[12] The remaining 4.070 million cattle fed in feedlots in 2002 were fed in 93,000 feedlots with capacities of less than 1000 head.[13]

C. The Concentrated Feeding Sector is the Portal through Which Market Power Invades the Entire U.S. Live Cattle Industry.

Thus, while 45 million cattle are marketed annually within the base of the cattle industry pyramid among and between 967,440 cattle operations, the vast majority of steers and heifers slaughtered each year are funneled through only about 2,200 feedlots, which in turn sell the lion's share of 27 million steers and heifers to only four major beef packers. And it is here, at the apex of the pyramid, where 60 percent of the cattle marketed annually are marketed to only four beef packers, that the price of cattle is established, and this price, whether competitive or not, is the price that becomes the basis for pricing the remaining 40 percent (18 million) of cattle that are *not* sold to the four major meatpackers. This is because the price for slaughter-ready steers and heifers received by cattle feeders is transferred, at least in part, backward throughout the live cattle production cycle, impacting seed stock producers, cow/calf producers, backgrounders, and stockers. The market for slaughter-ready steers and heifers – the market directly impacted by the JBS/Swift acquisitions – is the price-making market for the entire $50 billion U.S. live cattle industry.

The significance of these basic facts about the U.S. live cattle industry is profound, particularly when evaluating the potential impacts from the proposed JBS/Swift acquisitions. For example, if the Subcommittee were to look only at the JBS/Swift acquisitions' direct impacts, i.e., the impacts on the sale of only 27 million cattle annually, and found such impacts to be "small," the Subcommittee would completely miss the compounding impacts that even a

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[9] *See* Farms, Land in Farms, and Livestock Operations, U.S. Department of Agriculture, National Agricultural Statistics Service, Sp Sy 4 (08) a, February 2008, at 14.
[10] *Ibid.*
[11] Structural Changes in Cattle Feeding and Meatpacking, Clement E. Ward and Ted C. Schroeder, Managing for Today's Cattle Market and Beyond, Oklahoma State University and Kansas State University, respectively, attached hereto as Exhibit 1.
[12] Cattle Final Estimates 1999-2003, U.S. Department of Agriculture, National Agricultural Statistics Service, Statistical Bulletin Number 989, April 2004, at 75.
[13] *Ibid.*

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small lessening of competition or exercise of market power in the slaughter-ready steer and heifer market would have on the annual sale of 45 million cattle and, consequently, on the welfare of hundreds of thousands of independent cattle producers and thousands of rural communities that depend on a vibrant, competitive U.S. live cattle industry.

Indeed, noted Oklahoma State University economist Clement E. Ward found that "[r]esearch to date suggests price impacts from packer concentration have been negative in general, but small."[14] He found that most studies found price distortions of 3 percent or less, though he explained that "even seemingly small impacts on a $/cwt. basis may make substantial difference to livestock producers and rival meatpacking firms operating at the margin of remaining viable or being forced to exit an industry."[15]

In 1999, economists at Utah State University found it "surprising in the face of greatly increased packer concentration" that many studies found no or very limited ability of packers to exploit feeders/ranchers and consumers.[16] These researchers found that most of the studies used to identify market power (reduced-form modeling approaches) focused on market outcomes and "overlooked important elements of the competitive process in the beef packing industry."[17]

Notwithstanding the potential that most studies have overlooked important elements of the competitive process but nevertheless found "small" negative impacts due to packer concentration and monopsony power, the application of even a 3 percent price distortion on the entire $50 billion live cattle industry would result in a loss of $1.5 billion to U.S. cattle producers. Importantly, this is the level of harm that likely accrues today, even without the additional market concentration and consummate increase in market power that would be expected from the JBS/Swift acquisitions. Importantly, the concentrated feeding sector is the portal through which even small market-power induced price distortions can invade and cripple the entire U.S. live cattle industry.

D. The U.S. Cattle Industry has Already Partially Succumbed to Increased Market Power

The U.S. cattle industry has already partially succumbed to the exercise of market power emanating from the highly concentrated beef packing industry – at current concentration levels, and it is uniquely susceptible to the exercise of market power. The effects of market concentration and market power have contributed to 1) the rapid decline in the number of U.S. cattle operations as discussed above and shown in Figure 1 below:

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[14] Packer Concentration and Packer Supplies, Clement E. Ward, Oklahoma Cooperative Extension Service, AGEC-554, at 554-5, attached hereto as Exhibit 2.
[15] A Review of Causes for and Consequences of Economic Concentration in the U.S. Meatpacking Industry, Clement E. Ward, Current Agriculture Food and Resource Issues, 2001, at 2, attached hereto as Exhibit 3.
[16] Testing for Market Power in Beef Packing: Where are We and What's Next?, Lynn Hunnicutt, Quinn Weninger, Utah State University, August 1999, at 5, attached hereto as Exhibit 4.
[17] *Id.*, at 1

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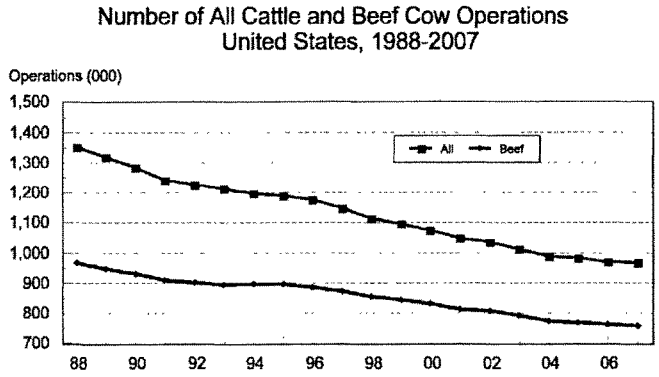
Figure 1



Source: Farms, Land in Farms, and Livestock Operations, 2007 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, February 2008, at 14.

Figure 1 shows that the U.S. live cattle industry experienced contraction inverse to the increased concentration by the top four steer and heifer slaughter firms, which rose from 35.7 percent in 1980 to 81.1 percent in 2004.[18] The effects of market concentration and market power have contributed also to 2) the contraction of the U.S. cattle herd and the disruption, if not the loss of the historical cattle cycle – itself a bellwether indicator of the declining competitiveness of the U.S. live cattle industry – as shown in Figure 2 below.

[18] Testing for Market Power in Beef Packing: Where are We and What's Next?, Lynn Hunnicutt, Quinn Weninger, Utah State University, August 1999, at 1, attached hereto as Exhibit 4.

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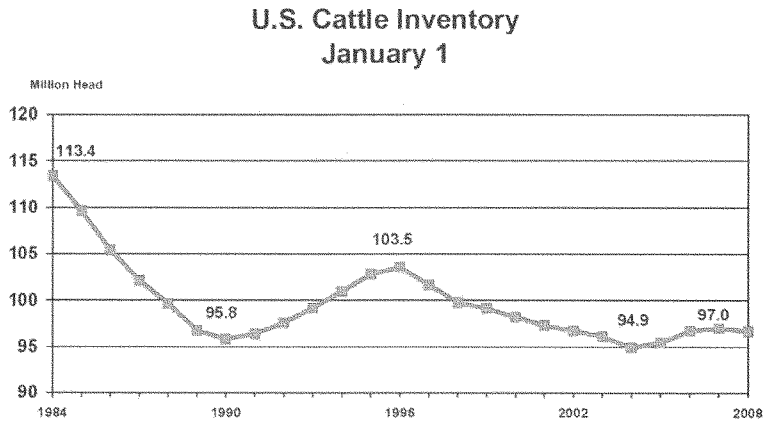
Figure 2



Source: Cattle, U.S. Department of Agriculture, National Agricultural Statistics Service, February 2008, at 1.

The U.S. Government Accountability Office ("GAO") explained that the U.S. live cattle industry is subject to a historical cycle, referred to by "increases and decreases in herd size over time and [] determined by expected cattle prices and the time needed to breed, birth, and raise cattle to market weight," factors that are complicated by the fact that "[c]attle have the longest biological cycle of all meat animals."[19] The U.S. cattle cycle has historically occurred every 10-12 years.[20] In 2002 the USDA acknowledged that "the last cycle was 9 years in duration; the present cycle is in its thirteenth year, with two more liquidations likely."[21] In late 2005, the USDA declared that the U.S. was "in the early herd expansion stages of the new cattle cycle."[22] However, in late 2007, the USDA began cautioning the industry, stating that "[s]ome analysts suggest the cattle cycle has gone the way of the hog and dairy cow cycles."[23] These analysts, according to the USDA, "suggested that the cattle cycle has returned to its liquidation phase."[24]

The foregoing discussion reveals that the historical U.S. cattle cycle began to function erratically during the last decade and continues doing so today, suggesting that the competition-

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[19] Economic Models of Cattle Prices, How USDA Can Act to Improve Models to Explain Cattle Prices, U.S. Government Accountability Office (formally the General Accounting Office), (GAO-020246, March 2002, at 30.
[20] *See* The U.S. Beef Industry: Cattle Cycles, Price Spreads, and Packer Concentration, Kenneth H. Mathews et al., U.S. Department of Agriculture, Economic Research Service, April, 1999, at 3, attached as Exhibit 5.
[21] Interagency Agricultural Projections Committee, *USDA Agricultural Projections to 2011, Staff Report WAOB-2002-1, February 2002, available at* http://www.ers.usda.gov/publications/waob021/waob20021.pdf, obtained from internet on October 17, 2002.
[22] Livestock, Dairy, & Poultry Outlook, U.S. Department of Agriculture, Economic Research Service, December 16, 2005, at 8, available at http://www.ers.usda.gov/publications/ldp/dec05/ldpm138t.pdf.
[23] Livestock, Dairy, & Poultry Outlook, U.S. Department of Agriculture, Economic Research Service, December 19, 2007, at 5, available http://www.ers.usda.gov/Publications/LDP/2007/12Dec/ldpm162.pdf.
[24] *Id.*

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induced demand/supply signals that once led to expectations about changes in cattle prices have been disrupted. While cattle industry analysts ponder this phenomenon, in February 2008 the USDA attributed a similar disruption that was occurring in the U.S. hog industry cycle to the hog industry's new structure. The USDA declared that the "New Hog Industry Structure Makes Hog Cycle Changes Difficult to Gauge," and stated, "The structure of the U.S. hog production industry has changed dramatically in the past 25 years."[25] This "dramatically" changed structure includes the consolidation of the industry, where "fewer and larger operations account for an increasing share of total output."[26]

As *was* the case in the hog industry, a functioning cattle cycle, itself, is an indicator of a competitive market. The USDA succinctly explained:

> The cattle cycle refers to cyclical increases and decreases in the cattle herd over time, which arises because biological constraints prevent producers from instantly responding to price. In general, the cattle cycle is determined by the combined effects of cattle prices, the time needed to breed, birth, and raise cattle to market weight, and climatic conditions. If prices are expected to be high, producers slowly build up their herd size; if prices are expected to be low, producers draw down their herds.[27]

The recently acknowledged disruption of the historical U.S. cattle cycle, as discussed above, is a bellwether indicator that competition has lessened in the U.S. live cattle industry; and, as the USDA now succinctly concludes for the analogous hog industry cycle disruption, there is a causal relationship between this phenomenon and a changed industry structure marked by increased consolidation.

The alarming irony, as shown in Figure 3 below, is that the U.S. cattle industry was contracting, both in terms of the number of cattle operations and herd size, during the decade after 1993 when domestic beef consumption began increasing significantly. The polynomial trend lines in Figure 3 reveal that domestic beef production could not keep pace with increased domestic beef consumption and the volume of domestic cattle slaughter trended downward in the face of this favorable consumption/demand situation.

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[25] Livestock, Dairy, & Poultry Outlook, U.S. Department of Agriculture, Economic Research Service, February 15, 2008, at 14, available at http://www.ers.usda.gov/Publications/LDP/2008/02Feb/ldpm164.pdf.

[26] Hog Operations Increasingly Large, More Specialized, Amber Waves, U.S. Department of Agriculture, Economic Research Service, February 2008, available at http://www.ers.usda.gov/AmberWaves/February08/Findings/HogOperations.htm.

[27] Cattle: Background, Briefing Room, U.S. Department of Agriculture, Economic Research Service, updated June 7, 2007, available at http://www.ers.usda.gov/Briefing/Cattle/Background.htm.

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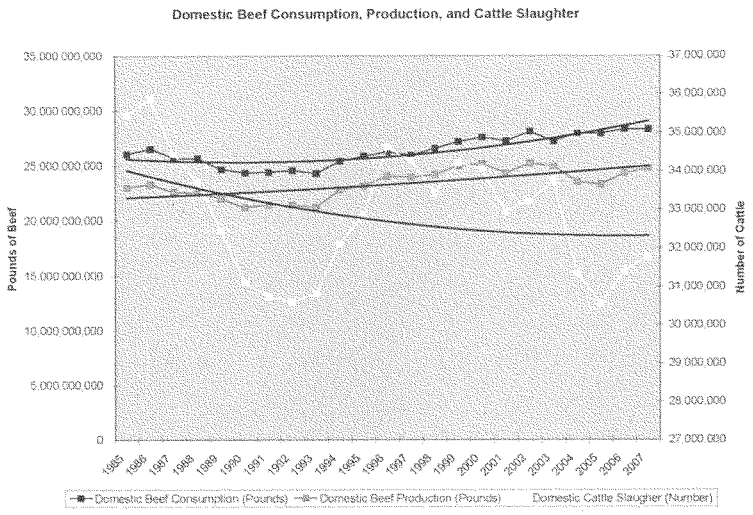
Figure 3



Data Source: **Domestic beef consumption data obtained from USDA-FAS.[28]**
Domestic beef production calculated by subtracting beef-equivalent weights of imported cattle from production data compiled by USDA-ERS.[29]
Domestic slaughter calculated by subtracting imported cattle numbers from commercial U.S. slaughter.[30]

Another unfavorable phenomenon revealed by Figure 3 is that the shortfall between domestic production and domestic consumption, during each of the years 2004, 2005, 2006, and 2007, was greater than at any time in recent history (at least since 1961).

The foregoing data run counter to competitive market principles that suggest a decade of nearly continuous increases in beef consumption would lead to industry revitalization, not industry contraction. R-CALF USA respectfully requests that the Subcommittee rigorously investigate this counterintuitive profile of the U.S. cattle industry to determine the true extent to which market concentration and market power has irreparably harmed the U.S. cattle industry.

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[28] *See* U.S. Department of Agriculture, Foreign Agricultural Statistics Database, *Production, Supply and Distribution Online*, available at http://www.fas.usda.gov/psd/complete_files/LP-01111000.csv.
[29] *See* Table 94, Beef Supply, Utilization, and Per Capita Consumption, 1970-2005, Red Meat Yearbook, U.S. Department of Agriculture, Economic Research Service, available at http://usda.mannlib.cornell.edu/MannUsda/viewDocumentInfo.do?documentID=1354.
[30] *See* Table 1, Commercial Cattle Slaughter, Red Meat Yearbook, U.S. Department of Agriculture, Economic Research Service, available at http://usda.mannlib.cornell.edu/MannUsda/viewDocumentInfo.do?documentID=1354.

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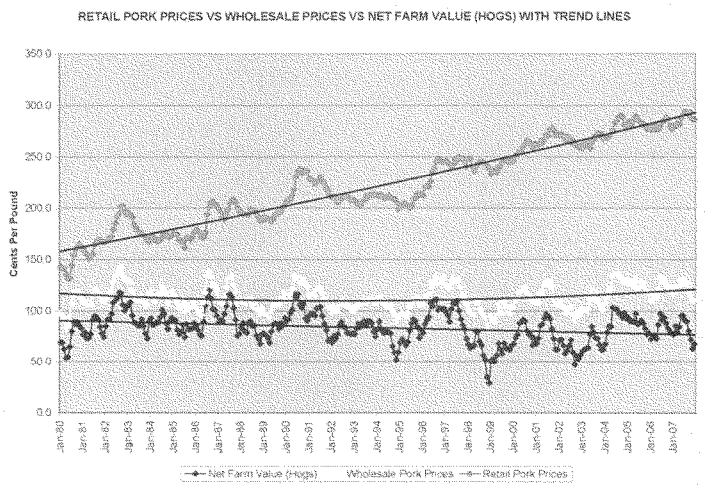
The proposed JBS/Swift acquisitions should not be allowed to proceed without conclusive evidence showing that the U.S. live cattle industry is not already subject to harmful market power exercised by the highly concentrated beef packing industry.

1. The New, More Consolidated Structure of the U.S. Hog Industry Provides Insights For the Future of a Further Consolidated U.S. Live Cattle Industry.

As shown in Figure 4 below, during the past 25-plus years, beginning January 1980, the new, more consolidated hog industry structure has resulted in a downward trend in live hog prices paid to producers and an upward trend in retail pork prices paid by consumers and wholesale pork prices received by packers, along with an ever widening spread between farm prices and wholesale prices and retail prices.

Figure 4



Data Source: USDA Economic Research Service.[31]

[31] *See* Meat Price Spreads, Data Set for Historical Monthly Price Spread Data for Beef, Pork, Broilers, Turkeys, and Eggs, U.S. Department of Agriculture, Economic Research Service, available at http://www.ers.usda.gov/Data/meatpricespreads/.

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With respect to the U.S. live cattle industry, the relevant question the Subcommittee should ask when assessing the potential impacts of additional concentration in the beef packing industry, as would occur under the JBS/Swift acquisitions, is whether the merger would likely cause the U.S. live cattle industry to lose the critical mass of participants necessary to sustain current levels of competition that take place among and between its various subparts?

Again, the U.S. live hog industry, once analogous to the U.S. live cattle industry in that it too sustained a vibrant industry consisting of hundreds of thousands of producers, has already experienced such a *fait accompli*. According to the USDA, during the period 1980 to 2004, when the concentration by the top four hog slaughter firms increased from 33.6 percent to 61.3 percent, the number of U.S. hog and pig operations declined from 667,000 in 1980 to only 67,000 by 2005.[32]

The Subcommittee must not ignore this inverse relationship, evinced by historical data, between increased concentration in the meat packing industry and marked decline in the size of the U.S. live hog industry. Fortunately for the U.S. live cattle industry, there were significantly more U.S. cattle operations than U.S. hog and pig operations when the contraction of the two agricultural industries accelerated in 1980. With only 67,000 U.S. hog and pig operations remaining, the diminutive live hog industry lacks diversity and robust competition among and between its various subparts, with only 10 percent of its cash receipts generated from sales other than to pork packers.[33] The U.S. live hog industry's present ability to contribute significantly to the gross domestic product of more than just a handful of states has also been reduced, with only 3 states generating gross incomes of more than $1 billion annually.[34]

In contrast, the U.S. live cattle industry, characterized by the remaining 967,440 cattle operations, still has the critical mass of participants necessary to generate significant revenues among and between its various subparts (as discussed above, 27 percent of the industry's revenues are from sales to buyers other than beef packers).

2. Although a Synchronous Trend Appears in the Relationship between Retail Beef Prices and Live Cattle Prices, Warning Signs of Impending Danger are Evident.

Figure 5 below reveals the relationships between retail beef prices paid by consumers, wholesale beef prices received by packers, and live cattle prices received by producers over the same 25-plus years during which the cattle industry, like the hog industry, was contracting. This is also the same period that the beef packing industry began its accelerated concentration. While the trend lines generally show that retail beef prices, wholesale beef prices, and live cattle prices are synchronous and directed upward, thereby lacking the obvious inverse relationship present in the hog and pork prices depicted in Figure 4 above, the trend lines nevertheless show an obvious

[32] *See* Federal Register, Vol. 72, No. 152, Wednesday, August 8, 2007, at 44,681, col. 2.
[33] *See* Meat Animals Production, Disposition, and Income 2006 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, April 2007, at 16, available at http://usda.mannlib.cornell.edu/usda/current/MeatAnimPr/MeatAnimPr-04-27-2007.pdf.
[34] *See id.* (Only the states of Iowa, Minnesota, and North Carolina generated gross incomes from hogs of over $1 billion in 2006.).

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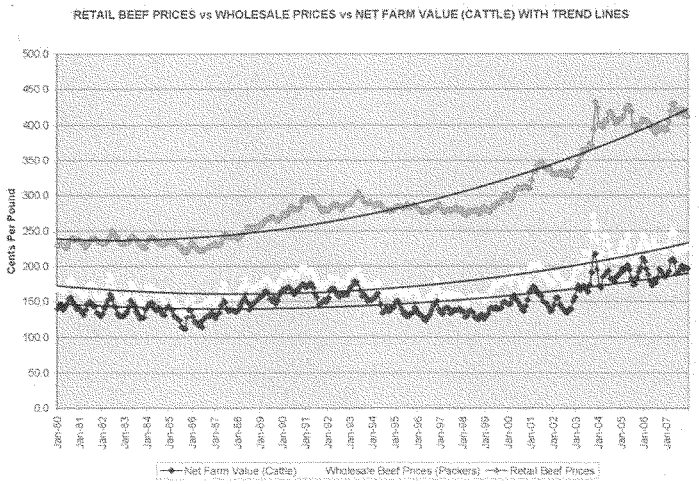
acceleration of the ever-widening spread between retail beef prices and cattle prices and wholesale beef prices and cattle prices. This evidence suggests there is an increased exercise of market power that enables the beef packing industry to extract a disproportionate profit from the sale of beef to retailers when compared to the share of the profits the cattle industry realizes when selling cattle to the beef packer.

Figure 5



Data Source: USDA Economic Research Service.[35]

Both Figures 4 and 5 reveal increasing price spreads. The USDA Economic Research Service (ERS) stated that "increasing price spreads can both inflate retail prices and deflate farm price."[36] Both of these outcomes are evident in Figure 4 that depicts retail pork prices, wholesale pork prices, and net farm hog prices, i.e., the trend lines show that retail pork prices and wholesale pork prices are inflating while net farm prices for hogs are deflating. It is important to note that the ERS explained that increasing price spreads are *not* a function of a

[35] *See* Meat Price Spreads, Data Set for Historical Monthly Price Spread Data for Beef, Pork, Broilers, Turkeys, and Eggs, U.S. Department of Agriculture, Economic Research Service, available at http://www.ers.usda.gov/Data/meatpricespreads/.

[36] Beef and Pork Values and Price Spreads Explained, U.S. Department of Agriculture, Economic Research Service, at 2, attached as Exhibit 6.

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demand shift toward more value-added products.[37] The ERS states that "[a]nalysts who cite increasing value-added as a factor in pork and beef price spreads misunderstand how these are calculated."[38]

The price spreads depicted in Figures 4 and 5 can be used to "measure the efficiency and equity of the food marketing system."[39] Thus, if the price spreads reveal inefficiency and inequity under the present, highly concentrated structure of the food marketing system, as is asserted by R-CALF USA, then this inefficiency and inequity would be expected to worsen should the beef packing system become further concentrated as contemplated by the JBS/Swift acquisitions.

The price spreads in Figures 4 and 5 reveal the costs and profits within the concentrated marketing systems that convert livestock into consumable meat. Innovative technologies can reduce price spreads and economic efficiency increases when price spreads drop.[40] The ERS recognizes that "[b]oth consumers and farmers can gain if the food marketing system becomes more efficient and price spreads drop."[41] And, it states that "[h]igher price spreads translate into lower prices for livestock."[42]

However, Figures 4 and 5 reveal what the USDA found in 2004 – that "the total price spreads show[ed] a weak upward trend when corrected for inflation,[43] has only worsened since 2004. The ever-increasing price spread between net farm values for cattle and hogs and wholesale prices and retail prices for beef and pork demonstrate the presence of market power, and the added harmful element of an inverse relationship between net farm values and wholesale prices and retail prices, which is already evident in the hog industry, portends the negative consequence to the U.S. cattle industry should the JBS/Swift acquisitions be consummated.

The continual increase in the price spread between producer prices, wholesale prices, and retail prices strongly suggests that the marketplace is becoming more inefficient and more inequitable for U.S. cattle producers and U.S. consumers, a condition that would only be expected to worsen under the increased concentration and vertical integration contemplated by the JBS/Swift acquisitions.

E. The U.S. Live Cattle Industry is Uniquely Susceptible to Market Power

The characteristic nature of cattle and the characteristics of the U.S. live cattle market make the U.S. live cattle industry uniquely susceptible to monopsony power. These characteristics include for cattle:

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[37] Beef and Pork Values and Price Spreads Explained, U.S. Department of Agriculture, Economic Research Service, at 2, attached as Exhibit 6.
[38] *Ibid*
[39] *Id.*, at 3.
[40] Beef and Pork Values and Price Spreads Explained, U.S. Department of Agriculture, Economic Research Service, at 3, attached as Exhibit 6.
[41] *Id.*, at 3.
[42] *Id.*, at 8.
[43] *See id*, at 10.

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1. The longest biological cycle of any farmed animal, making it difficult for the industry to react to changes in demand.[44]

2. Slaughter-ready cattle are highly perishable products that must be marketed within a narrow window of time; otherwise, the animals would degrade in quality and value.[45]

3. Feasibility of transporting cattle long distances decreases as cattle approach slaughter weight. Researchers have found that the distance of the seller from the slaughtering plant affects the choice of cattle procurement methods[46] and that "most cattle are purchased for a specific plant from within a 100-mile radius of that facility, whether the owning firm had one or several slaughtering plants."[47] The researchers found that the cost of transporting cattle long distances creates a limited procurement area for meat packing plants, resulting in higher packer concentration within certain states than nationally.[48]

For cattle markets:

1. Oklahoma State University Economist Clement Ward asserts that concentration levels in the U.S. meatpacking industry are already among the highest of any industry in the United States, "and well above levels generally considered to elicit non-competitive behavior and result in adverse economic performance."[49]

2. Researchers have found that regional competition for raw products, which would include competition for slaughter-ready cattle, is inherently less intense than is competition in processed food products.[50] Based on this finding, the Subcommittee should review the JBS/Swift acquisitions with the understanding that competition for slaughter-ready cattle is inherently fragile, even without the added burden of monopsony power that would be expected to increase following the increased horizontal concentration and vertical integration proposed by the JBS/Swift acquisitions.

3. As confirmed by the United States International Trade Commission (USITC), the U.S. cattle market is highly sensitive to even slight changes in cattle supplies. The USITC found that the farm level elasticity of demand for slaughter cattle is such that

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[44] Economic Models of Cattle Prices, How USDA Can Act to Improve Models to Explain Cattle Prices, U.S. Government Accountability Office (formally the General Accounting Office), (GAO-020246, March 2002), at 30.
[45] GIPSA Livestock and Meat Marketing Study, January 2007, Volume 3, at 5-4, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_3.pdf.
[46] Examining Packer Choice of Slaughter Cattle Procurement and Pricing Methods, Oral Capps, Jr., et al., Agricultural and Resource Economics Review, April 1999, at 21, attached hereto as Exhibit 7.
[47] *Id.* at 15.
[48] *Id.* at 16.
[49] A Review of Causes for and Consequences of Economic Concentration in the U.S. Meatpacking Industry, Clement E. Ward, Current Agriculture Food and Resource Issues, 2001, at 1, attached hereto as Exhibit 3.
[50] Captive Supplies and the Cash Market Price: A Spatial Markets Approach, Mingxia Zhang and Richard J. Sexton, Journal of Agricultural and Resource Economics, 25(1): 88-108, at 90, fn 7, attached as Exhibit 8.

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"each 1 percent increase in fed cattle numbers would be expected to decrease fed cattle prices by 2 percent."[51]

4. As confirmed by the Grain Inspection Packers and Stockyards Administration (GIPSA) Livestock and Meat Marketing Study (LMMS), the cash cattle market is sensitive to shifts in cattle procurement methods. The LMMS found that a 10 percent shift of the volume of cattle procured in the open market to any one of the alternative procurement methods is associated with a 0.11 percent decrease in the cash market price.[52] The comprehensive econometric analysis documented in *Pickett v. Tyson Fresh Meats, Inc.*, which covered the period 1994-2004, showed an even greater sensitivity to shifts is cattle procurement. The analysis showed that for each 1% increase in captive supply cattle, cattle prices decreased 0.155%.[53]

5. The packer demand for live cattle is bounded on a weekly basis by available slaughter capacity, which is a limiting factor on demand for cattle, i.e., slaughter capacity sets the weekly slaughter cattle-marketing limit.[54]

6. The combination of the perishable nature of slaughter-ready cattle and limited weekly slaughter capacity creates market access risk for U.S. cattle producers within the U.S. cattle market. The GIPSA LMMS study defines market access risk as "the availability of a timely and appropriate market outlet"[55] and proffered that the results of the study may suggest that "farmers who choose forward contracts are willing to give up some revenue in order to secure market access. . ."[56]

7. The Regional Herfindahl-Hirschman Indices (RHHI) are already exceedingly high in all nine cattle procurement regions. In studying regional differences in procurement and pricing methods (resulting in part from transportation constraints) researchers calculated the RHHI for nine regional procurement areas for meatpacking plants.[57] Values for RHHI in the nine regions ranged from a low of 2,610 to a high of 4,451, though the RHHI values in three regions were deleted to avoid disclosure.[58] The researches found that a 1 percent increase in regional firm concentration as measured by the RHHI raises the probability that packers would use packer fed arrangements

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[51] U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects, United States International Trade Commission (Publication 3697; May 2004) at 44, fn 26, available at http://hotdocs.usitc.gov/docs/pubs/2104f/pub3697.pdf.
[52] *See* GIPSA Livestock and Meat Marketing Study, January 2007, Volume 3, at ES-5, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_3.pdf.
[53] *See* Trial Transcript in *Pickett et al v Tyson Fresh Meats, Inc. (IBP, Inc.)* Civil No. 96-A-1103 N, U.S. District Court for the Middle District of Alabama, Northern Division.
[54] *See* Beef Pricing and Other Contentious Industry Issues, Special Report, Kevin Grier and Larry Martin, George Morris Centre, March 16, 2004 (an analysis of the live versus beef price disparity in Canada), attached as Exhibit 9.
[55] GIPSA Livestock and Meat Marketing Study, January 2007, Volume 3, at 5-4, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_3.pdf.
[56] *Id.* at 2-36.
[57] Examining Packer Choice of Slaughter Cattle Procurement and Pricing Methods, Oral Capps, Jr., et al., Agricultural and Resource Economics Review, April 1999, at 16, attached hereto as Exhibit 7.
[58] *Id.*, at 16.

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by 3.18 percent.[59] Based on this research, the proposed JBS/Swift acquisitions, which would necessarily increase the RHHI in one or more of the nine procurement regions, would be expected to shift more cattle into packer feeding arrangements, which are known to facilitate market power and decrease fed cattle prices, as was more fully discussed in Item 2 above.

8. Transparency in the U.S. live cattle market is already limited as was reported by the Government Accountability Office (GAO) in 2005. The GAO reported on a number of deficiencies in the government's Livestock Mandatory Reporting system with regard to the transparency of the reporting system and accuracy of the data reported.[60] Included among the deficiencies found was the exclusion of a large percentage of cattle transaction data.[61] In addition to the lack of transparency and accuracy of marketing transaction data already impacting the U.S. live cattle industry, the so-called 3/70/20 confidentiality guidelines that structurally limit reports of transactions in concentrated regions may be significantly impacted by the proposed JBS/Swift acquisitions. The confidentiality guidelines that may well restrict or eliminate the reporting of currently reported cattle transaction data following the proposed JBS/Swift acquisitions include the requirement that at least 3 reporting entities provide data at least 50 percent of the time during a 60-day period; no entity may provide more than 70 percent of the data during a 60-day period; and no entity may be the only reporting industry more than 20 percent of the time during a 60-day period.[62]

9. Researchers have found that individual producers within the U.S. cattle industry will agree to sign captive supply contracts even while knowing that the aggregate effect of captive supply contracts is to depress the cash market price and make all producers, including him/herself, worse off.[63] The researchers explained that it is the producer's inability to coordinate action that enables a packer to obtain acceptance for exclusionary contracts, and "as long as the producer is offered at least as much as could be received in the spot market in the equilibrium with captive supplies, the producer's equilibrium strategy is to ACCEPT the contract."[64] Based on this finding, U.S. live cattle producers would likely be defenseless against the increased monopsony power expected to be exercised as a result of the proposed JBS/Swift acquisitions. Indeed, the acquisition of Five Rivers feedlots by JBS/Swift would most likely cause such a shift to occur, given that the acquisition would place JBS/Swift in closer proximity to the feedlots than is the current packer-owner.

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[59] Examining Packer Choice of Slaughter Cattle Procurement and Pricing Methods, Oral Capps, Jr., et al., Agricultural and Resource Economics Review, April 1999, at 21, attached hereto as Exhibit 7.
[60] U.S. Government Accountability Office, Livestock Market Reporting: USDA Has Taken Some Steps to Ensure Quality, but Additional Efforts Are Needed, GAO-06-202 (Dec. 2005).
[61] *Id.*, at 10.
[62] USDA Announces New Confidentiality Guidelines for Livestock Mandatory Reporting Program, U.S. Department of Agriculture, Release No. 0132.01, August 3, 2001, attached hereto as Exhibit 10.
[63] Captive Supplies and the Cash Market Price: A Spatial Markets Approach, Mingxia Zhang and Richard J. Sexton, Journal of Agricultural and Resource Economics, 25(1): 88-108, at 98, attached hereto as Exhibit 8.
[64] *Ibid.*

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II. The JBS/Swift Acquisitions Would Result in Direct Harm to U.S. Cattle Feeders by Reducing Competition, Creating Market Power, and Facilitating the Exercise of Market Power in the Slaughter-Ready Steer and Heifer Market.

Section I above described the U.S. live cattle industry's inherent vulnerability to any further reduction in competition and any increase in market power or increased exercise of market power that would manifest with increased consolidation of the *existing* structure of the beef packing industry. This section describes how the proposed JBS/Swift acquisitions would specifically create additional market power, and facilitate the exercise of that market power in the U.S. steer and heifer market, which, as described in Section I above, is the portal through which the harmful effects of market power would endanger the entire U.S. live cattle industry.

A. The JBS/Swift Acquisitions Would Significantly Increase Concentration and Result in an Extremely Concentrated Market.

As shown in Figure 6 below, the proposed JBS/Swift acquisitions would significantly increase the capacity concentration in the U.S. steer and heifer slaughter by changing the current four-firm capacity concentration, which USDA estimates at 79.1 percent,[65] to an estimated four-firm capacity concentration of approximately 91.2 percent.[66] This estimate represents a 12.1 percent increase in capacity concentration as a result of a 33 percent decrease in the number of firms that would compete for this 91.2 percent share of the market, with the number of competing firms shrinking from 6 to 4.[67]

Figure 6

Pre- and Post-Merger Capacity Concentration in U.S. Steer and Heifer Slaughter

	Tyson	Cargill	JBS-Swift	National	Smithfield	American	Total Capacity
Pre-Merger Daily Slaughter Capacity Estimates							
AMI Data*	30,875	25,850	15,800	13,000	7,600	5,200	98,325
Hendrickson/Heffernan Data**	36,000	28,300	16,759	13,000			94,059
CME Group Data***	32,600	29,000	15,850	13,700	8,350	6,500	106,000
Pre-Merger Average of All Daily Capacity Estimates	33,158	27,717	16,136	13,233	7,975	5,850	104,070
Pre-Merger Average of Daily Capacity for Top Four Firms	33,158	27,717	16,136	13,233			90,244
Post-Merger Average Daily Capacity for Top Four Firms	33,158	27,717	37,345			5,850	104,070

Pre-Merger USDA estimate of Four-Firm Capacity Concentration 79 1%****
Post-Merger Estimate of Four-Firm Capacity Concentration (Using USDA Estimate Where Current CR-4 = 79 1%) 91 2%

Notes:

* AMI data are attached as Exhibit 2.
** Hendrickson/Heffernan data are attached as Exhibit 3.
*** CME Group data are attached as Exhibit 4.
**** *See* footnote 44.

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[65] Packers and Stockyards Statistical Report, 2005 Reporting Year, Table 27 – Steer and Heifer Slaughter Concentration by 4, 8, 20, and 50 Largest Firms for Selected Years 1980-2005, U.S. Department of Agriculture, Grain Inspection Packers and Stockyards Administration, February 2007, at 44, available at http://archive.gipsa.usda.gov/pubs/2005_stat_report.pdf.
[66] This estimate assumes that American Foods Group is included as a slaughterer of steers and heifers.
[67] Three of the top 6 meatpacking plants are involved in the JBS-Brazil Merger, which would reduce the number of plants that presently control the estimated 91.2 percent of capacity from 6 to 4.

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Though R-CALF USA does not venture an estimate of the increased Herfindahl-Hirschman Index ("HHI") that would result from the JBS/Swift Acquisitions, the CME Group did and estimated the increase to be dramatic, growing by 638 points.[68]

B. The Increased Concentration Created by the JBS/Swift Acquisitions Would Facilitate the Increased Exercise of Market Power in the U.S. Steer and Heifer Market.

Although the USDA data discussed in Section I suggests that the contraction of the U.S. live hog industry was more severe than was experienced by the U.S. live cattle industry, despite a smaller four-firm concentration ratio of the pork packing industry, there is a measurable difference in the degree to which the concentrated pork packing industry was able to exercise its inherent market power. For example, the pork packing industry exploited the live hog industry's greater propensity toward vertical integration of the entire live hog production cycle – from birth to slaughter – and captured earlier in the industry's concentration process a larger proportion of slaughter-ready hogs before they entered the open cash market, where the base-price for all hogs marketed continues to be established. The recently completed GIPSA Livestock and Meat Marketing Study ("LMMS") found that during the period October 2002 through March 2005, the pork manufacturing industry captured 20 percent of its slaughter-ready hogs through the alternative procurement method of direct ownership;[69] about 57 percent of hogs were captured through marketing contracts, forward contracts or marketing agreements; and fewer than 9 percent of hogs were procured in the open market.[70] Among the conclusions of the LMMS was: "Based on tests of market power for the pork industry, we found a statistically significant presence of market power in live hog procurement."[71] Further, the LMMS concluded that there was a casual relationship between the increased use of non-cash hog procurement methods and lower prices for hogs:

> **Of particular interest for this study is the effect of both contract and packer-owned hog supplies on spot market prices; as anticipated, these effects are negative and indicate that an increase in either contract or packer-owned hog sales decreases the spot price for hogs.** Specifically, the estimated elasticities of industry derived demand indicate
>
> - a 1% increase in contract hog quantities causes the spot market price to decrease by 0.88%, and
>
> - a 1% increase in packer-owned hog quantities causes the spot market price to decrease by 0.28%.

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[68] *See* Daily Livestock Report, CME Group, A CME/Chicago Board of Trade Company, Vol. 6, No. 44, March 5, 2008, attached as Exhibit 11.
[69] *See* GIPSA Livestock and Meat Marketing Study, January 2007, Volume 4, at 2-13, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_4.pdf.
[70] *See id.*
[71] *See* GIPSA Livestock and Meat Marketing Study, January 2007, Volume 4, at ES-3, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_4.pdf.

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> A higher quantity of either contract or packer-owned hogs available for sale lowers the prices of contract or packer-owned hogs and induces packers to purchase more of the now relatively less expensive hogs and purchase fewer hogs sold on the spot market.[72]

The LMMS found that procurement methods that facilitated the exercise of market power by the concentrated pork packing industry are currently less developed by the concentrated beef packing industry. For example, the study found that only 5 percent of live cattle were procured through packer-ownership and only 33.3 percent of cattle were procured by forward contracts and marketing agreements, leaving nearly 62 percent of the cattle procured through the open market,[73] which continues to set the base price for all marketed cattle. Although alternative procurement methods for cattle destined for slaughter are currently less developed than for hogs destined for slaughter, the LMMS nonetheless found a causal relationship between the increased use of alternative slaughter-ready cattle procurement methods and a decrease in the cash market price for slaughter-ready cattle under the current structure of the beef manufacturing industry. As stated above, the LMMS found that a 10 percent shift of the volume of cattle procured in the open market to any one of the alternative procurement methods is associated with a 0.11 percent decrease in the cash market price.[74]

C. The More Regional Scope of the U.S. Steer and Heifer Market When Compared to the Feeder Cattle Market Makes it More Susceptible to Monopsony Power Emanating from a Concentrated Market.

Figure 7 below lists the plant locations for each of the five largest beef packers:

[72] *See* GIPSA Livestock and Meat Marketing Study, January 2007, Volume 4, at ES-2, 3, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_4.pdf.
[73] *See* GIPSA Livestock and Meat Marketing Study, January 2007, Volume 3, at ES-4, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_3.pdf.
[74] *See id.*, at ES-5.

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Figure 7

Plant Locations for Five Largest Beef Packers

Tyson[75]	**Cargill**[76]	**JBS-Swift**[77]	**National Beef**[78]	**Smithfield**[79]
Kuna, ID	Fresno, CA	Cactus, TX	Brawly, CA	Souderton, PA
Geneseo, IL	Friona, TX	Greeley, CO	Liberal, KS	Tolleson, AZ
Denison, IA	Dodge City, KS	Hyrum, UT	Dodge City, KS	Plainwell, MI
Emporia, KS	Schuyler, NE	Grand Island, NE		Green Bay, WI
Holcomb, KS	Fort Morgan, CO			
Dakota City, NE	Plainview, TX			
Lexington, NE	Wyalusing, PA			
Norfolk, NE	Milwaukee, WI			
West Point, NE				
Amarillo, TX				
Pasco, WA				

As mentioned above, researchers developed nine cattle procurement regions. These regions were based on the geographic proximity of packing plants and the procurement area for packing plants.[80] These researchers defined the general procurement area around a 300-mile radius of packing plants based on a finding that some cattle are regularly purchased from between 100 to 300 miles away from a packing plant.[81] Included as a single region are California and Arizona.[82] The JBS/Swift acquisitions include the purchase of the California beef packing plant presently owned by National and the Arizona packing plant presently owned by Smithfield. Thus, these two competing beef packers that are in the same defined region and located approximately 226 miles from each other would be merged into a single entity under the proposed JBS/Swift acquisitions, resulting in a lessening of competition within that region. In addition, though not in the same defined region, the JBS/Swift packing plant located in Cactus, TX, is approximately 185 miles and 103 miles from Dodge City, KS, and Liberal, KS, respectively. Currently JBS/Swift and National are competitors within this cattle procurement area and the effect of the JBS/Swift acquisitions would be to eliminate a beef-packer competitor within a 300-mile radius of any one of those three beef packing plants.

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[75] *See* Tyson Corporate, Our Locations – List, available at http://www.tyson.com/Corporate/AboutTyson/Locations/ListPage.aspx.
[76] *See* Cargill Meat Solutions North American Beef Facilities, available at http://www.cargillmeatsolutions.com/about_us/tk_cms_about_loc_beef.htm.
[77] *See* Meat, Poultry, and Egg Product Inspection Directory, U.S. Department of Agriculture Food Safety Inspection Service, December 7, 2007, available at http://www.fsis.usda.gov/regulations_&_policies/Meat_Poultry_Egg_Inspection_Directory/index.asp.
[78] *See* National Beef: Company Information, available at http://www.nationalbeef.com/.
[79] *See* Meat, Poultry, and Egg Product Inspection Directory, U.S. Department of Agriculture Food Safety Inspection Service, December 7, 2007, available at http://www.fsis.usda.gov/regulations_&_policies/Meat_Poultry_Egg_Inspection_Directory/index.asp.
[80] Examining Packer Choice of Slaughter Cattle Procurement and Pricing Methods, Oral Capps, Jr., et al., Agricultural and Resource Economics Review, April 1999, at 16, attached hereto as Exhibit 7.
[81] *Id.* at 15.
[82] *Id.* at 16.

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On a national level, the JBS/Swift acquisitions would combine 11 packing plants now owned by 3 beef packers under the single ownership of JBS/Swift. While researchers have found that the wholesale beef market is national in scope, the discussion above suggests that transportation costs function to limit the national purview of the slaughter-ready cattle market. According to a recent study by John R. Schroeter, "The wholesale beef market . . . is essentially national in scope and insulated, to some extent, from the vagaries of the terms and volume of trade in a single regional fed cattle market."[83]

D. The Pre-existing Market Power that would be Enhanced by the JBS/Swift Acquisitions is Manifest in the Beef Packer' Ability to Limit Producer Access to the Market.

As previously discussed, producers of fed steers and heifers are subject to "market access risk," which refers to "the availability of a timely and appropriate market outlet."[84] This risk is particularly significant because fed cattle are perishable commodities that must be sold within a fairly narrow time frame, otherwise they will decrease in value.[85] Under the current level of beef packer concentration, there is already evidence that feeders are subjected to market power and are foregoing revenues to avoid market access risk. The LMMS found that "[t]ransaction prices associated with forward contract transactions are the lowest among all the procurement methods [including cash market procurement methods],"[86] and proffered that the results of the study may suggest that "farmers who choose forward contracts are willing to give up some revenue in order to secure market access . . ."[87]

The JBS/Swift acquisitions would exacerbate market access risk for steer and heifer producers by effectively shrinking the number of market outlet gatekeepers for the estimated 92.1 percent of market outlet capacity from six firms to only four firms, as was previously discussed above.

E. As Gatekeepers of the Market Outlets, the Concentrated Beef Packing Industry Wields Considerable Market Power Exercised through Captive Supply Arrangements, Novel Purchasing Strategies, and Anticompetitive Behavior.

While the beef manufacturing industry has been limiting the number of its market outlet gatekeepers through horizontal consolidation, thus exacerbating market access risk for cattle producers, the beef manufacturing industry has been simultaneously increasing its use of non-traditional contracting and marketing methods, enabling it to more effectively exercise its manifest market power. These non-traditional cattle procurement methods increase the vertical coordination between the live cattle industry and the beef packing industry and include

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[83] Captive Supplies and Cash Market Prices for Fed Cattle: A Dynamic Rational Expectations Model of Delivery Timing, John R. Schroeter, Department of Economics, Iowa State University, Working Paper # 07002, January 2007, attached as Exhibit 12.
[84] GIPSA Livestock and Meat Marketing Study, January 2007, Volume 3, at 5-4, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_3.pdf.
[85] *See id*
[86] *Id.*, at 2-36.
[87] *Id.*

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purchasing cattle more than 14 days before slaughter (packer-fed cattle), forward contracts, and exclusive marketing and purchasing agreements. Together, the four largest beef manufacturers employed such forms of "captive supply" contracting methods for a full 44.4 percent of all the cattle they slaughtered in 2002.[88] And use of these captive supply methods has been increasing rapidly, rising 37 percent from 1999 to 2002.[89] As stated above, the LMMS found that approximately 38 percent of cattle were procured by such non-traditional methods during the period October 2002 through March 2005.

Captive supplies have been shown to increase the instability of prices for cattle producers and hold down cattle prices.[90] Over the past 20 years studies have supported the idea that buyer concentration in cattle markets systematically suppressed prices, with price declines found to range from 0.5 percent to 3.4 percent.[91] As average prices for cattle are artificially depressed and become more volatile, due to these captive supply procurement methods, it is cattle producers who pay the price, even when broader demand and supply trends should be increasing returns to producers.[92] Despite this negative outcome, cattle producers continue to opt into captive supply arrangements because those producers have few other attractive marketing choices in an industry that effectively reduces access to market outlets.[93] Furthermore, while such captive supply arrangements may appear attractive to an individual producer at a given point in time, the collective impact of these contracting practices on the market as a whole is harmful to the live cattle industry. As previously discussed, producers acting individually are not in the position to change these dynamics of the market.

The JBS/Swift acquisitions would facilitate the exercise of market power by further concentrating control over market access, thus increasing the propensity for live cattle producers to continually enter captive supply arrangements despite their negative impact on the live cattle industry.

1. The JBS/Swift acquisitions would facilitate ongoing market power abuses to the detriment of U.S. cattle producers.

The beef manufacturing industry recently exacted its market power on the U.S. cattle industry for purposes of influencing national public policy; and, in doing so, imposed unnecessary costs and burdens on U.S. cattle producers, which costs and burdens U.S. producers could not avoid without eliminating or severely limiting their marketing options. In March 2003, beef-related food manufacturer IBP, Inc., notified U.S. cattle producers that it would require producers to, *inter alia*, "Provide IBP, inc. access to your [producers'] records so that we [IBP]

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[88] *See* RTI International, "Spot and Alternative Marketing Arrangements in the Livestock and Meat Industries: Interim Report," Report Prepared for the Grain Inspection, Packers, and Stockyard Administration, U.S. Department of Agriculture, July 2005 at 3-15.
[89] *See id.* at 3-17.
[90] *See* John M. Connor, "The Changing Structure of Global Food markets: Dimensions, Effects, and Policy Implications," Staff Paper #3-02, Department of Agricultural Economics, Purdue University, February 2003, at 7-8, attached as Exhibit 13.
[91] *See id.*
[92] *See id.*, at 8.
[93] *See id*

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can perform random producer audits . . ." and "Provide third-party verified documentation of where the livestock we [IBP] purchase from you [producers] were born and raised."[94]

This coercive threat to impose costly and burdensome requirements on U.S. cattle producers was initiated by IBP for the express purpose of soliciting producers' help in contacting "Senators or members of Congress," to whom producers were asked to express their concerns regarding IBP's plans to impose such onerous conditions on their industry. This was IBP's political response to Congress' passage of the mandatory country of origin labeling law.[95] This abuse of market power was initiated months *before* the USDA even published its October 30, 2003 proposed rule to implement the country of origin labeling law.

Such abuses of market power would be facilitated by the JBS/Swift acquisitions as U.S. cattle producers' market outlets would become even more limited, particularly in certain geographic areas, and producers would not be able to avoid the arbitrary dictates of any one of the remaining beef packers.

2. The JBS-Brazil Merger would facilitate the imposition of arbitrary product specification, leading to unavoidable cattle price discounts.

In addition to the application of price premiums and discounts for contract or grid-priced cattle that are based on standardized USDA yield and quality grades, Tyson and Smithfield have each established different price premiums and discounts for additional factors, such as muscle scoring. For example, Smithfield discounts certain muscle scores between $5.00 per cwt. and $10.00 per cwt, and Tyson uses muscle scores to apply varying discounts under a different system.[96] These discounts and premiums are purported to reflect consumer preferences,[97] but whether a $120 discount (i.e., $10 per cwt. applied to a 1,200 lb. animal) is reflective of the actual discount the beef manufacturing industry receives upon the sale of the resulting meat, or if it represents a windfall for the beef manufacturing industry, is undeterminable without additional information. Nevertheless, the ability to impose such discounts, without knowing if they are legitimate, is facilitated by the currently limited marketing outlets, which would become even more limited under the JBS/Swift acquisitions.

There is a host of potential market power abuses, the propensity toward which would be facilitated by an increased concentration of the steer and heifer market, that would either force producers into compliance or cause them to suffer economic losses. For example: a beef manufacturer in a more concentrated market could establish discounts for cattle that were not conceived by the beef manufacturer's preferred genetic lineage, or that were not fed the beef manufacturer's preferred brand of mineral or feed supplement.

Thus, the potential for the beef manufacturing industry to impose wholly arbitrary product specifications, which directly result in lower cattle prices paid to producers, is a significant concern arising from the JBS/Swift acquisitions.

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[94] Letter from Bruce Bass, IBP, Inc., to Producers, March 2003, attached as Exhibit 14.
[95] *Ibid.*
[96] *See* Muscle Scoring Provides Important Production Tips, Nexus Marketing, Ames, Iowa, attached as Exhibit 15.
[97] *See id.*

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3. The JBS-Brazil Merger would increase the potential exercise of pricing strategies that disrupt competitive market fundamentals.

As part of its investigation, the Subcommittee should determine if pricing strategies of the concentrated beef manufacturers, such as that described in the example above, are among the reasons for the pricing anomalies disclosed in the LMMS study. The LMMS study states that in direct trade transactions based on a carcass weight valuation, the average cattle price is 1.3 cents lower than the average price for direct trade transactions with live weight valuation.[98] Even more striking is the difference for grid valuation transactions, where prices average 1.8 cents lower than the average price for direct trade transactions.[99] Assuming an average dressed weight for cattle of 781 pounds,[100] this price differential translates into a loss of $10.15/head for producers selling on a carcass weight basis and a loss of $14.06/head for producers selling on a cash grid basis compared to producers selling on a live weight valuation. It is important to note that these comparisons hold other explanatory variables for price differentials fixed in the model.[101] When this price difference is multiplied times the volume of cattle sold during the period examined by the LMMS study, it adds up to a total loss of $202,631,068 for producers who sold their cattle on the cash market on a carcass weight or grid basis rather than a live weight basis.[102]

The LMMS study reveals that cattle producers selling their animals on a carcass weight basis or a grid basis have lost more than $200 million on these transactions in the period covered by the study. The anomalous price differential for dressed weight and grid basis cattle compared to cattle sold on a live weight basis appears counter-intuitive and contradicts a conclusion that beef manufacturers use purchasing methods that provide an incentive for quality and yield. Instead, it appears that the uncertainty inherent in dressed weight and grid basis transactions, and the transference of that price risk from beef manufacturers to cattle producers through these types of transactions, has only operated to depress prices for live cattle and to deprive cattle producers of a market-based price for their product.

The data suggest that beef manufacturers have been able to manipulate the grid system to engineer a lower overall average return to producers who sell on a grid basis. This practice fails to send the right market signals to producers and feeders, and it creates a counter-intuitive disincentive to sell on a grid basis and to seek premiums for yield and quality characteristics. The LMMS data reveal an unreasonable and unfair depression of cattle prices for those producers who sell on a grid basis that is contrary to competitive market fundamentals.

4. The JBS-Brazil Merger would facilitate a division of the market, effectively eliminating competition for certain subclasses of cattle in certain regions.

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[98] *See* GIPSA Livestock and Meat Marketing Study, Vol. 3 (Jan. 2007) at 2-39.
[99] *See id.*
[100] *See id.*, at 1-21.
[101] *See id.* at 2-39.
[102] This estimate is based on a total of 58 million head of cattle sold reported to RTI from October 2002 through March 2005 and RTI statistics showing that 61.7% of these cattle were sold on the cash or spot market, 17% of which were on a carcass weight basis and 28% of which were on a grid basis. *See Id.* at ES-3 – ES-4, 2-40.

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Tyson Fresh Meats, Inc., ("Tyson") has issued presumably new terms and conditions under which it will purchase cattle for slaughter.[103] Tyson states that it "does not typically accept for processing at its facilities" cattle that exceed 58 inches in height, cattle that exceed 1,500 pounds, or cattle with horns longer than 6 inches in length.[104] The imposition of such restrictions presents a number of competition-related concerns: First, if Tyson is one of only two buyers in the marketing region where such restricted cattle are potentially available (i.e., cattle are approaching but have not yet exceeded any of Tyson's restrictions) and if the other buyer imposed no comparable restrictions, then the other buyer would have an incentive not to bid on such cattle, which, if Tyson did not purchase, would be available for sale at a discount as soon as Tyson's restrictions were exceeded. In fact, Tyson would have an incentive to lowball such potentially available cattle knowing that if the producer did not sell to Tyson within a short period of time, there would be no competition for the cattle after the restrictions were exceeded. Second, for cattle that already exceed Tyson's restrictions, regardless of the demand for beef, the producer would have significantly fewer market outlets for the cattle. Third, this action constitutes an outright denial of access to the marketplace, which is even more egregious than would be a discount for cattle that exceeded Tyson's restrictions, as it automatically eliminates a dominant competitor from the marketplace.

The JBS/Swift acquisitions would potentially exacerbate the division of the marketplace that has already been initiated by Tyson. Should one beef manufacturer declare that it would slaughter only steers, only heifers, only Holsteins, or only hornless cattle, for example, the marketplace could be sufficiently divided by the remaining food manufacturers to severely limit competition for each subclass of cattle, if not eliminate competition altogether.

5. The JBS-Brazil Merger would facilitate strategic entries and exits from the cash market for the purpose and with the effect of lowering cattle prices.

Under the existing, concentrated structure of the beef manufacturing industry, empirical evidence shows that the U.S. cattle market is already susceptible to coordinated and/or simultaneous entries and exits from the market. In February 2006, all four major beef-related food manufacturers – Tyson, Cargill, Swift, and National – withdrew from the cash cattle market in the Southern Plains for an unprecedented period of two weeks. On February 13, 2006, market analysts reported that no cattle had sold in Kansas or Texas in the previous week.[105] No cash trade occurred on the southern plains through Thursday of the next week, marking, as one trade publication noted, "one of the few times in recent memory when the region sold no cattle in a non-holiday week."[106] Market analysts noted that "[n]o sales for the second week in a row would be unprecedented in the modern history of the market."[107] During the week of February 13 through 17, there were no significant trades in Kansas, western Oklahoma, and Texas for the

[103] *See* Standard Terms and Conditions for the Sale of Cattle to Tyson Fresh Meats, Inc. ("TFM"), Effective Date – February 4, 2008, attached as Exhibit 16.
[104] *Id.*
[105] "Packers Finally Seriously Cut Kills," *Cattle Buyers Weekly* (Feb. 13, 2006).
[106] "Classic Standoff Continues Through Thursday," *Cattle Buyers Weekly* (Feb. 20, 2006).
[107] "Classic Standoff Continues Through Thursday," *Cattle Buyers Weekly* (Feb. 20, 2006).

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second week in a row.[108] Market reports indicated that Friday, February 17, 2006, marked two full weeks in which there had been very light to non-existent trading in the cash market, with many feedlots in Kansas, Oklahoma, and Texas reporting no bids at all for the past week.[109] The beef manufacturers made minimal to no purchases on the cash market, relying on captive supplies of cattle to keep their plants running for two weeks and cutting production rather than participating in the cash market. The beef manufacturers reduced slaughter rates rather than enter the cash market. Cattle slaughter for the week of February 13 – 17 was just 526,000 head, down from 585,000 the previous week and 571,000 at the same time a year earlier.[110] According to one analyst, the decision to cut slaughter volume indicated "the determination by beef packers to regain control of their portion of the beef price pipeline."[111] Another trade publication noted that the dramatic drop in slaughter was undertaken in part to "try and get cattle bought cheaper."[112] At the end of the second week of the buyers' abandonment of the cash market, one market news service reported, "The big question was whether one major [packer] would break ranks and offer higher money. That has often occurred in the past, said analysts."[113]

As a result of the beef manufacturers shunning the cash market, cash prices fell for fed cattle, replacement cattle, and in futures markets. Sales took place after feedlots in Kansas and the Texas Panhandle lowered their prices to $89 per hundredweight, down $3 from the $92 per hundredweight price reported in the beginning of February.[114] The same day, February 17, live and feeder cattle futures fell to multi-month lows.[115] Replacement cattle prices also dropped in response to buyer reluctance.[116] In Oklahoma City, prices for feeder cattle dropped as much as $4 per hundredweight.[117]

Whether the beef manufacturers' simultaneous boycott of the cash market was deliberately coordinated or not, it was a highly unusual event that required simultaneous action in order to effectively drive down prices, which it did. As market analysts observed, the major question in markets during the second week of the buyers' strike was whether or not any one of the major beef manufacturers would "break ranks" to purchase at higher prices than the other beef manufacturers. No buyer did so until prices began to fall. In fact, beef manufacturers were willing to cut production rather than break ranks and purchase on the cash market.

Abandonment of the cash market in the Southern Plains by all major beef manufacturers for two weeks in a row resulted in lower prices and had an adverse effect on competition. Cattle producers in the Southern Plains cash markets during those two weeks were unable to sell their product until prices fell to a level that the buyers would finally accept. The simultaneous refusal

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[108] Curt Thacker, "Cash Cattle Quiet 2-20," *Dow Jones Newswires* (Feb. 20, 2006).
[109] Lester Aldrich, "Cash Cattle Standoff 2-17," *Dow Jones Newswires* (Feb. 17, 2006).
[110] Curt Thacker, "Cash Cattle Quiet 2-20," *Dow Jones Newswires* (Feb. 20, 2006).
[111] Jim Cote, "Today's Beef Outlook 2-17," *Dow Jones Newswires* (Feb. 17, 2006).
[112] "Classic Standoff Continues Through Thursday," *Cattle Buyers Weekly* (Feb. 20, 2006).
[113] "Classic Standoff Continues Through Thursday," *Cattle Buyers Weekly* (Feb. 20, 2006).
[114] Curt Thacker, "Cash Cattle Quiet 2-20," *Dow Jones Newswires* (Feb. 20, 2006).
[115] Jim Cote, "Live Cattle ReCap – 2/17/2006," *Dow Jones Newswires* (Feb. 17, 2006).
[116] "The Markets," *AgCenter Cattle Report* (Feb. 18, 2006), available on-line at http://www.agcenter.com/cattlereport.asp.
[117] "The Markets," *AgCenter Cattle Report* (Feb. 18, 2006), available on-line at http://www.agcenter.com/cattlereport.asp.

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to engage in the market did not just have an adverse effect on competition – it effectively precluded competition altogether by closing down an important market for sellers. The simultaneous boycott of cash markets in the Southern Plains was, however, a business decision on the part of the beef manufacturers that did not conform to normal business practices and that resulted in a marked decline in cattle prices. At the time, market analysts interpreted the refusal to participate in the cash market as a strategy to drive down prices, and purchases only resumed once prices began to fall.

The coordinated/simultaneous action in February 2006 was not isolated and was soon followed by a second, coordinated/simultaneous action. During the week that ended October 13, 2006, three of the nation's four largest beef manufacturers – Tyson, Swift, and National - announced simultaneously that they would all reduce cattle slaughter, with some citing, *inter alia*, high cattle prices and tight cattle supplies as the reason for their cutback.[118] During that week, the packers reportedly slaughtered an estimated 10,000 fewer cattle than the previous week, but 16,000 more cattle than they did the year before.[119] Fed cattle prices still fell $2 per hundredweight to $3 per hundredweight and feeder prices fell $3 per hundredweight to $10 per hundredweight.[120]

By Friday of the next week, October 20, 2006, the beef manufacturers reportedly slaughtered 14,000 more cattle than they did the week before and 18,000 more cattle than the year before – indicating they did not cut back slaughter like they said they would.[121] Nevertheless, live cattle prices kept falling, with fed cattle prices down another $1 per hundredweight to $2 per hundredweight and feeder cattle prices were down another $4 per hundredweight to $8 per hundredweight.[122]

The anticompetitive behavior exhibited by the beef-related food manufacturers' coordinated/simultaneous market actions caused severe reductions to U.S. live cattle prices on at least two occasions in 2006. This demonstrates that the exercise of market power is already manifested in the U.S. cattle industry – a situation that would only worsen if there were even fewer buyers in the marketplace. For example, the reduction in cattle prices that followed the coordinated/simultaneous actions of four beef-related food manufacturers in February 2006 and three beef-related food manufacturers in October 2006 could be accomplished by only three beef manufacturers, and only two beef manufacturers, respectively, should the JBS-Brazil Merger be consummated.

The potential for a recurrence of this type of anticompetitive behavior is considerable and constitutes an empirically demonstrated risk that would likely become more frequent, more intense, as well as extended in duration. Therefore, this anticompetitive behavior is evidence that the JBS/Swift acquisitions would reduce competition in the marketplace.

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[118] *See* "National Beef Cuts Hours at Two Kansas Plants (Dodge City, Liberal)," Kansas City Business Journal (October 10, 2006) attached as Exhibit 17; "Update 1 – Tyson Foods to Reduce Beef Production," Reuters (October 10, 2006), attached as Exhibit 18; "Swift to Stay with Reduced Production at U.S. Facilities," Meatpoultry.com (October 10, 2006), attached as Exhibit 19.
[119] *See* "Livestock Market Briefs, Brownfield Ag Network," (October 13, 2006), attached as Exhibit 20.
[120] *See id.*
[121] *See* "Livestock Market Briefs, Brownfield Ag Network," (October 20, 2006), attached as Exhibit 21.
[122] *See id.*

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F. JBS/Swift Has a History of Being a Bad Actor and Should Not Be Permitted to Exploit the U.S. Cattle Industry as It Did the Brazilian Cattle Industry.

On November 28, 2007, Dow Jones Newswires reported that "JBS SA's Friboi Group (JBSS3.BR)" was among a number of Brazilian companies which, after a two-year investigation by the Brazilian Justice Department's antitrust division, were accused of engaging in anti-competitive practices.[123] JBS SA was reportedly charged with "anti-competitive practices for coordinating price agreements among themselves in order to keep cattle prices low when purchasing livestock for slaughter."[124] The report indicated that JBS SA had denied the charges. However, in a subsequent news article, JBS SA reportedly agreed to pay $8.5 million to an antitrust fund as a result of the charges and further agreed to end the practices that were allegedly anti-competitive.[125]

This example demonstrates that it is highly likely that the U.S. live cattle market would be subjected to coordinated interaction by JBS/Swift given that the company was reportedly accused, and was found culpable based on the payment of restitution, of engaging in such anticompetitive behavior in another geographic market, which is comparable to the U.S. market.

G. The JBS/Swift Acquisition Would Significantly Exacerbate the Ongoing Exercise of Market Power Through JBS/Swift's Ownership of the Nation's Largest Cattle Feeding Facility.

If consummated, the JBS/Swift acquisitions would result in the nation's largest beef packer owning Five Rivers, the nation's largest cattle feeding company. Five Rivers currently feed and market approximately 2 million cattle annually and is currently owned by the nation's fifth largest beef packer, Smithfield, under a joint venture.[126] Based on Smithfield's estimated daily capacity of 7,975 cattle (*see* Figure 6), and applying the 260 reporting days established by the USDA Agricultural Marketing Service ("AMS") as the number of annual slaughter days,[127] Smithfield's estimated annual slaughter is 2.1 million. Therefore, Smithfield's ownership of Five Rivers gives it sufficient numbers of fed cattle to meet nearly 100 percent of its annual slaughter capacity. However, it is not likely that Smithfield could coordinate the finishing of cattle to coincide with its daily capacity needs throughout the year from its own feedlots, nor is it likely that Smithfield could economically transport Five Rivers' cattle to its four packing plants, which are far removed from all of Fiver Rivers' feedlot locations. According to Five Rivers'

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[123] "Brazil Justice Department Fines Major Beef Cos In Cartel Case," Kenneth Rapoza, Dow Jones Newswires (November 28, 2007), attached as Exhibit 22.
[124] *Id.*
[125] "Brazil Antitrust Agency Signs Agreements with JBS, Lafarge," Jeb Bount, Bloomberg (November 29, 2007), attached as Exhibit 23.
[126] History of Smithfield Foods, attached as Exhibit 24, available at http://www.smithfieldfoods.com/Understand/History/.
[127] Livestock Mandatory Reporting; Reestablishment and Revision of the Reporting Regulation for Swine, Cattle, Lamb, and Boxed Beef; Proposed Rule, U.S. Department of Agriculture, Agricultural Marketing Service, Federal Register, Vol. 72, No. 152, August 8, 2007, at 44,688-689 (meatpackers are required to report each day for an estimated total of 260 reporting days in a year).

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website, its feedlots are located in Colorado, Idaho, Kansas, Oklahoma, and Texas,[128] locations far removed from Smithfield's packing plants in Pennsylvania, Arizona, Michigan, and Wisconsin.

If this assumption is correct, Smithfield likely operates Five Rivers as an independent feeder, not a vertically integrated component of its packing operations. Thus, Smithfield likely contributes to the current competitiveness of the marketplace by marketing Five Rivers cattle to Tyson, Cargill, or National.

Post-merger, however, JBS/Swift would own both Smithfield and Five Rivers, affording it control over approximately 2 million fed cattle annually, representing approximately 7 percent of the nation's annual steer and heifer slaughter. Whereas Smithfield was not likely capable of slaughtering all or most of the cattle fed at Five Rivers due to the combination of limited daily slaughter, the logistics of timing the finishing of cattle, and the long distances between its packing plants and Five Rivers' feedlot locations, JBS/Swift could likely slaughter all of the cattle fed at Five Rivers due to its significantly increased number of plants and capacity. The effect would be a potential increase in the percentage of packer-owned cattle presently slaughtered on a national basis and a potential reduction in the volume of cattle sold in the cash market – a circumstance that would effectively thin the cash market and potentially drive down prices.

In addition to the structural integration Five Rivers would provide JBS/Swift, JBS/Swift also would have access to information regarding the value of feeder cattle it intends to purchase for feeding long before independent producers would have such information. The information available to JBS/Swift would be knowledge of the type and quantity of future purchasing orders for beef – essentially insider information – that would accord JBS/Swift a distinct advantage when competing against independent cattle producers for feeder cattle.

The Subcommittee should investigate both the current practices of Smithfield with respect to the disposition of cattle fed at Five Rivers and the change in this disposition of cattle that would likely occur should the JBS/Swift acquisitions be consummated.

H. The JBS/Swift Acquisitions Would Likely Violate Both the Spirit and Express Language of the Packers and Stockyards Act.

Congress enacted the Packers and Stockyards Act of 1921 ("PSA") to not only prohibit anticompetitive and monopolistic practices, but also to protect livestock producers from unfair, deceptive, and manipulative practices by the animal food manufacturing industry. Thus, the PSA goes well beyond the traditional antitrust concerns of efficiency and market competition. The PSA's central provision for protecting the U.S. live cattle industry is 7 USC § 192. Section 192 provides:

> It shall be unlawful for any packer or swine contractor 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:

[128] Five Rivers website address is available at http://www.fiveriverscattle.com/Index.aspx.

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(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, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect; or

(c) Sell or otherwise transfer to or for any other packer, swine contractor, or any live poultry dealer, or buy or otherwise receive from or for any other packer, swine contractor, or any live poultry dealer, any article for the purpose or with the effect of apportioning the supply between any such persons, if such apportionment has the tendency or effect of restraining commerce or of creating a monopoly; or

(d) Sell or otherwise transfer to or for any other person, or buy or otherwise receive from or for any other person, any article 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; 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; or

(f) Conspire, combine, agree, or arrange with any other person (1) to apportion territory for carrying on business, or (2) to apportion purchases or sales of any article, or (3) to manipulate or control prices; or

(g) Conspire, combine, agree, or arrange with any other person to do, or aid or abet the doing of, any act made unlawful by subdivisions (a), (b), (c), (d), or (e) of this section.

The concerns raised herein demonstrate that the JBS/Swift acquisitions would increase the probability, if not the certainty, that the practices prohibited by the PSA will occur to the detriment of U.S. cattle producers. In fact, the evidence presented demonstrates that many of the prohibited practices are already occurring unabated within the U.S. live cattle industry. Inasmuch as the term "creating" in subdivisions (c), (d), and (e) above need not occur instantaneously, the JBS/Swift acquisitions would clearly catapult the beef packing industry toward monopolization nationally, and would likely achieves complete monopolization in certain geographic regions.

I. The JBS/Swift Acquisitions Present Additional Concerns that Should Be Investigated by the Subcommittee.

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In addition to the concerns discussed above, the Subcommittee should consider that the JBS/Swift acquisitions would increase the probability that the following anticompetitive practices would become more frequent and would intensify in the U.S. live cattle industry:

1. Bidding not to buy cattle, i.e., offering a low bid with no intent to buy, but rather, with the intent to lower prices for live cattle.

2. Offering preferential agreements with captive suppliers for prices and terms not available to other sellers of comparable cattle in the market.

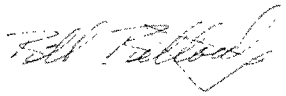
3. Entering into strategic alliances that contain special agreements for preferential access to the market and/or special prices.

4. Exercising undue influence over national commodities markets, potentially eliminating this hedging tool for U.S. cattle producers.

III. CONCLUSION

R-CALF USA appreciates the opportunity to express its concerns regarding the JBS/Swift acquisitions and respectfully requests that the Subcommittee conduct a thorough, probing analysis of the JBS/Swift acquisitions and that it expand its investigation to include a thorough, probing analysis of the current market environment in which these acquisitions are proposed. R-CALF USA is confident that such a comprehensive investigation would reveal the need to forestall indefinitely the JBS/Swift acquisitions as well as to initiate immediate remedial action to halt the anticompetitive practices already prevalent within the U.S. live cattle industry.

Thank you.



Bill Bullard
CEO
R-CALF USA

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Anticompetitive Mergers and Conduct in Agricultural Markets: A Major Failure of Antitrust Enforcement Policy

Statement prepared for the hearing on
"Agricultural Consolidation and Other Related Issues"
held by the
Senate Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights,
May 7, 2008.

By

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Introduction

I am honored to have been asked to offer my views on the state of antitrust enforcement in the markets related to agriculture. In nut shell, the government agencies charged with enforcing antitrust law have repeatedly failed to challenge or to remedy the competitive problems that confront American agriculture. The most conspicuous failure has come in merger enforcement where a series of decisions either not to challenge mergers or settle for weak, even anticompetitive, remedies has resulted in increased concentration on both the input and output side of agriculture. In addition and equally troubling, the enforcement agencies have failed to undertake challenges to well documented, anticompetitive conduct affecting farmers and ranchers. Given this pattern of failure, it is time for Congress to give serious consideration to creating alternative means of enforcing the commands of antitrust law.

Over the last decade, I have been particularly interested in issues involving competition in agricultural markets. In 2000, I published an article in the Wisconsin Law Review: *Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy*, 2000 WIS L. REV. 531. A central thesis of that article was that there are serious problems of market failure in agriculture directly related to the high and increasing levels of concentration in the industries buying from farmers and ranchers. I urged increased antitrust enforcement and also suggested legislative action in addition to antitrust enforcement was essential to restoring competition in agricultural markets. The goal of legislation should be to facilitate the operation of a dynamic market process that is efficient, transparent, open, and fair. Since then, I co-authored with Professors Neil Harl and Roger McEowan an article in defense of the packer ownership ban (*The 2002 Senate Farm Bill: The Ban On Packer Ownership of Livestock*, 7 DRAKE J. AG. L. 267 (2002)). I have also written about the exploitation of farmers by seed companies that have patents or licensed their patents covering some of the genetic material included in seeds (*Post-Sale Restraints via Patent Licensing: A "Seedcentric" Perspective*, 16 FORDHAM INTEL PROP. MEDIA & ENTERTAINMENT L. J. 1053 (2006)).[1]

I also have a background in some aspects of these issues. As a government lawyer some 35 years ago, I reviewed the old meat packing consent decree and in the process came to appreciate the context within which Congress crafted the Packers and Stockyards Act. In 1995, I served in Wisconsin on a committee that reviewed and proposed modifications for the regulations governing contracts for vegetables being purchased for canning. I have also done an extensive examination of the grain marketing industry in connection with a study of the famous Chicago Board of Trade decision which is a landmark antitrust case.[2] In addition, my work on the competitive implications of other kinds of vertical distribution arrangements has provided me with relevant

[1] I have also done a chapter for a book on agricultural policy: *The Prospects and Limits of Anti-Trust and Competitive-Market Strategies* in RENEWING AGRICULTURE-OF-THE MIDDLE, Thomas A. Lyson, G. W. Stevenson and Rick Welsh, Eds., forthcoming 2008 (MIT Press).

[2] *The Content of the Hollow Core of Antitrust: The Chicago Board of Trade Case and the Meaning of the 'Rule of Reason' in Restraint of Trade Analysis*, 15 RESEARCH IN LAW AND ECONOMICS 1 (1992).

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background on some of the key issues being considered today.[3] In September 2001, I was one of six invited academic experts in the U.S. Department of Agriculture's Public Forum on Captive Supplies held in Denver, Colorado.[4] I have also been an invited witness at a number of hearings held by this committee and by the Senate Agriculture, Nutrition, and Forestry focused on the issues of agricultural competition.

Overview

Farmers are poorly served by existing market structures and practices. Farmers and ranchers today confront excessive concentration in most of the industries buying and processing agricultural products including those in meat, grain and dairy. The existence of concentrated markets creates the incentive and the capacity for such firms to engage in conduct aimed at exploiting those participants with limited options and to entrench existing market power against the threat of deconcentrating and effective competition.

Free and open markets are generally the best institutional structure for achieving all the important goals of economic policy: efficiency, dynamic growth, equitable allocation of resources, opportunity for all participants. Where markets are unconcentrated with many buyers and sellers, there is a strong tendency for efficient, workable and fair methods to develop as the inevitable outcome of the interaction of many participants all seeking a neutral and open market place.

But no such inherent tendency exists in markets where there is a substantial difference in size between buyers and sellers and the market is also highly concentrated, i.e., there are few firms altogether on one side. Also, if one side has significant and persistent advantages in information or some other important element related to the transactions between buyer and seller, then too such a market is unlikely to experience much pressure for desirable conditions. There is a grave danger that strategic conduct will shape such markets frustrating the goals of an efficient, open, fair and accessible marketplace. This in turn imposes immediate burdens on the disfavored class of participants and ultimately on consumers and the economy as a whole as less efficient production and market transactions take place.

When markets lack the inherent tendencies to create desirable conditions, the law can play a vital role in defining rules for the participants that reduce their capacity to engage in strategic conduct and restore greater balance among the participants. The statute books contain many such laws including ones regulating credit, insurance, product safety, job safety, franchising of various kinds (e.g., gas stations, fast food, automobile dealerships), energy markets and, of course, securities markets.

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[3] E.g., *The Competitive Dynamics of Distribution Restraints: The Efficiency Hypothesis Versus the Rent Seeking, Strategic Alternatives*, 69 ANTITRUST LAW JOURNAL 569 (2001); *Vertical Restraints in Beer Distribution: A Study of the Business and Legal Justifications for Restricting Competition*, 1986 WISCONSIN L. REV. 1 (with Dahlson); *Legal and Economic Analysis of Vertical Restraints: A Search for Reality or Myth Making*, in ISSUES AFTER A CENTURY OF FEDERAL COMPETITION POLICY, Wills, Culbertson, Caswell, ed., 95 (1987).

[4] The written statements made at that forum are available at the U. S. Department of Agriculture website: www.usda.gov/gipsa/forum/forumprogram.htm

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America's farmers and ranchers are caught in an economic vise. When they seek to buy the various inputs that they need—seed, fertilizer, equipment, herbicides, etc.—they face increasingly concentrated markets and exploitive strategies of producers. When they attempt to sell their products, especially dairy and meat products, they have only a very limited number of buyers who use their buyer power to drive down the prices paid for these products. Despite the recent dramatic increases in the price of grains, those commodity markets are also highly concentrated on the buying side. This bodes ill for the long run ability of farmers and ranchers to receive the full benefit of the market prices that such commodities receive.

The markets for agricultural commodities provide a textbook illustration of how law and regulations can either facilitate or frustrate the accomplishment of the goal of an efficient, transparent, and equitable market context. Antitrust law enforcement over the past decade has failed to deal effectively with either the substantial structural changes or the exploitive and exclusionary conduct manifest on both sides of the production of agricultural products. In addition, the U. S. Department of Agriculture (USDA) has substantial authority to adopt and enforce rules that could ameliorate some of the most serious problems of access, information disclosure, and exploitation. But it has consistently failed to use its authority to facilitate efficient market practices.

The consequence of the combined failure to enforce antitrust law and to fashion relevant market regulations is that farmers and ranchers were and are under-compensated for their production. But at the same time, consumers are paying higher and higher prices for food products because the bottlenecks in the process of moving food from farm to market and on to the consumer have allowed both processors and retailers to exploit both producers and consumers.

Another important general point that informs much of the following discussion is that buyer power needs to be measured with different metrics and its competitive implications understood in terms of the buying side of the market.[5] Contemporary antitrust enforcers have largely failed to appreciate these facts. As a result, the analysis of mergers creating buyer power has been consistently deficient. In addition, the agencies have failed to take necessary action to control anticompetitive conduct by dominant firms in agricultural markets.

In the following discussion I will review the last decade of inactivity in four major agricultural market areas (pork, dairy, commercial crops, and beef) as well as in grocery retailing. The consistent observation is that the enforcement agencies, basically the Antitrust Division of the Department of Justice although the FTC plays an important role with respect to mergers in the grocery store aspect of the market, have failed to perform appropriate analysis of the competitive effects of these mergers and conduct. As a result, markets are worse off today than they were 10 years ago. This has harmed both

[5] I elaborated on this point at the DOJ/FTC *Workshop on Merger Enforcement*, February 17, 2004. My text is available at http://www.usdoj.gov/atr/public/workshops/docs/202606.htm.

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producers and the ultimate consumers. I will end my discussion with some reflections on the directions that public policy ought to take to remedy this situation.

Pork

One of the most instructive areas to examine is the market for hogs. In 2003, Smithfield acquired Farmland's pork processing facilities and in 2007, it acquired Premium Standard Brands (PSB). The PSB merger consolidated the only two major processors serving the Southeastern United States. The next closest major facility is in Kentucky about 400 miles away. My interviews with agricultural economists who had studied the industry told me that producers faced very substantial costs if they wanted to take their mature hogs to that more distant processor because it is costly to haul mature hogs that long a distance. As a result, hogs in the Southeast were often priced as much as 10% below the price paid for comparable hogs in the Midwest even before the merger.

My investigation received strong confirmation from the RTI study of the pork processing industry that GIPSA sponsored.[6] That study which focused on the period 2002 to 2005 found that there was statistically significant buyer power in the market for mature hogs.[7] This is very significant because this finding antedated the acquisition of PSB. This finding can then be compared with market structure in the pork industry. During the period when buyer power was found to exist, national concentration rose from an HHI of 1042 in 2001 to an HHI of 1334 in 2005 (i.e., before taking account of the Smithfield PSB merger).[8]

What is significant here is that standard buyer side analysis would be likely to conclude that increases in concentration in that range would be unlikely to cause an adverse effect on competition. But here in fact we have direct, sophisticated econometric evidence that lower levels of concentration are sufficient to create buyer power.

Despite knowing that the PSB merger would in fact increase buyer power with demonstrable adverse effect on producers, the Antitrust Division failed to act. The Division claimed hog raisers in the Southeast would not be exploited because they could transport their hogs to other processors, but the closest facility that appears to exist is approximately 400 miles away in Kentucky. Shipping mature hogs that distance is costly and would be rational only if the price offered by the monopoly processor were very deeply below the price offered by the distant buyer. In addition, the Division claimed that farmers providing contract services in the Southeast could somehow switch to providing those services to "independent producers who own their own hog operations in the area." But given a monopoly buyer, these "producers" face the same problem of depressed prices that other smaller producers would confront.

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[6] GIPSA LIVESTOCK AND MEAT MARKETING STUDY, VOL. 4: HOG AND PORK INDUSTRIES FINAL REPORT, (2007)

[7] Id. at ES-3.

[8] See, Packers and Stockyards Statistical Report, 2005 Reporting Year, 48 (table 31) (Feb. 2007) available at: http://archive.gipsa.usda.gov/pubs/2005_stat_report.pdf

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Not only was this decision wrong, but it demonstrates a major failure to understand both the dimensions of the markets for mature hogs and to appreciate that buyer power in fact occurs at lower levels of concentration than the Division associates with seller power. The PSB merger was one that not only "may substantially lessen competition or tend to create monopoly", it was one that did substantially lessen competition and tended to create a monopoly in pork processing in the Southeast.

Dairy

In 2001, the Antitrust Division allowed Suiza to acquire Dean. This combination created the largest fluid milk processor in the count with a market share in excess of 30%. The Division approved this merger without formal objection, but its review lasted many months and involved a substantial revision of the proposed deal. Basically, the new Dean agreed to divest a significantly larger number of milk processing facilities than it had originally proposed. In addition, the press release announcing approval implied that the new firm would not enter into a long-term exclusive dealing contract with Dairy Farmers of America (DFA), the largest dairy cooperative. However, Dean and DFA quickly found a way around that commitment. In addition, Dean refused to deal with independent milk producers who had traditionally been direct suppliers. Even these high-volume, high quality producers were forced to submit to DFA.

National Dairy Holdings (NDH) purchased the divested facilities. DFA, however, was a substantial shareholder in NDH and obtained an exclusive supply contract. The third major milk processor is Hood. Through various means, Hood and NDH, with the blessing of the Antitrust Division, have managed to combine their managements. Only vigorous protests from a few cooperatives have kept Hood from completely embracing the DFA exclusive dealing arrangements.

The divestitures should have provided a means to retain competition in both the buying and sale of fluid milk. The limits on exclusive dealing were also important because DFA was using its control over access to the Suize and Dean processing facilities to coerce other cooperatives into merging with it or putting themselves under its control. Most dairy farms produce Grade A milk suitable for use as fluid milk, but in fact the bulk of that milk is used for other purposes such as making cheese or ice cream. However, to share in the premium paid for milk used as fluid milk, a farmer's milk must be delivered to a fluid milk processor some percentage of the time. In practice, however, most farmers belong to cooperatives or other buying groups and it is the group that must make delivery of some percentage of its milk for some period to time in order for all the members of the group to qualify for participation in the higher price milk pool.

DFA through its ownership links to NDH and Hood and its exclusive dealing arrangement with Dean (and other milk processors) has control of access to fluid milk sales in many parts of the country. The result is a serious problem of access for those dairy farmers that do not want to be part of DFA. In addition, it appears that DFA has engaged in various discriminatory and preferential agreements with the result that many

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dairy farmers are getting less for their milk than they received when the buying side was more competitive.

The Antitrust Division has an open investigation of the conduct of the milk industry. But the matter has been pending for years without any action. In summary, then, the combined failure of the Antitrust Division to take firm action against consolidation of processors and to challenge the panoply of anticompetitive practices rife in the industry has resulted in serious losses of income and coercion of farmers.

In addition, as Professor Ron Cotterill of the University of Connecticut has documented, the increased concentration in both processing and retailing have resulted in an increasing price spread between what farmers receive for milk and what consumers pay for.[9] Thus, the failure of antitrust enforcement in dairy has resulted in harm to both producers and consumers.

Commercial Crops—Corn, Grain, Soybeans and Cotton

In 1999, the Antitrust Division allowed Cargill to acquire Continental's grain operations subject to some modest divestiture. The immediate result was to increase concentration in the business of buying grain such as corn, wheat and soybeans. Farmers found themselves with less competition at the farm gate for their crops. As in the case of pork, the levels of concentration that resulted are such that there was a significant increase risk of buyer power. Despite the recent increases in the prices for most grains, the point here is that the industry structure facilitates the intermediaries such as ADM and Cargill to extract much of the gain that ought to come to the farmer.

A related problem is the consolidation of the seed industry. There have been a large number of mergers and acquisitions in the industry over the last decade. The result has been a reduction in competition and an increase in the price of seeds. The most recent combination is the most egregious. The Antitrust Division has allowed Monsanto, the leading owner of patents on genetic modifications for seeds, to acquire Delta Pine & Land (DPL), the dominant producer to cotton seeds. DPL does not itself engage in developing genetic modifications, but it is an obviously major partner for such development. As long as it remained independent, it had a strong incentive to support competing lines of development. This both increased the potential for major improvements in genetically modified seed and ensured that competing technologies could be developed. Competition in technology in turn would result in lower costs to farmers and fewer restrictions.

The previous administration had, to its credit, rejected this merger because of these risks. However, recently, the Antitrust Division approved the merger subject to

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[9] *See*, Ronald W. Cotterill, Adam N. Rabinowitz, Li Tian, *Milk Market Channel Structure: Its Impact on Farmers and Consumers, and the Inadequacies of Antitrust Enforcement as a Foundation for Dairy Policies: Evidence from the Northeast Dairy Industry*, Testimony before the United States Senate Committee on the Judiciary (October 30, 2003) available at: http://www.fmpc.uconn.edu/research/milk/Testimony103003.pdf.

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complex regulatory decree that has the effect of limiting technological competition. The decree effectively authorized two firms to continue to compete with Monsanto while excluding a third major developer. The very complexity of the decree demonstrates the anticompetitive potential that this merger creates. Indeed, the number of objections to the settlement filed with the trial court as part of the Tunny Act review is unprecedented. Among the objectors are 13 state attorney generals.[10]

Interestingly, the Division also required that Monsanto allow its licensees in cotton seed production to stack Monsanto's genetics with genetics from other sources. This reflects recognition that Monsanto has and can use such restraints to foreclose competition. Unfortunately, the government only imposed this limit with respect to cotton seed despite the fact that Monsanto apparently uses the same anticompetitive restraints in all its seed contracts. Thus, despite recognizing the anticompetitive nature of the restraints, the government has failed to act to protect corn, soybean and other farmers from exploitation.

An additional problem with the current methods of marketing seeds containing patented genetics is the use of post-sale restraints on the use of the seed. In the case of cotton and soybeans, the restraints Monsanto imposes prohibit saving and replanting the seed. This forces farmers to buy new seed each year at inflated prices because the seed companies do not face competition from saved seed. The argument for the restraint is that Monsanto is entitled to a license fee for such use. That claim, assuming its validity, does not justify a practice that protects from competition the un-patented components in a seed. The alternative approach, used by seed companies elsewhere in the world, is to collect a fee from farmers who save and replant seed subject to intellectual property rights.[11] Unfortunately, the Antitrust Division although fully aware of the anticompetitive effects of Monsanto's policy has failed to challenge it and in fact seems to have excused it as lawful in a brief of the Supreme Court.[12] Subsequently the government has concluded that patent law does not authorize and immunize at least some post-sale restraints.[13]

Beef

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[10] The Antitrust Division has recently filed a 58 page response attempting to justify its position. The response, competitive impact statement and proposed decree are available at: http://www.usdoj.gov/atr/cases/monsanto.htm

[11] My article *Post-Sale Restraints via Patent Licensing: A "Seedcentric" Perspective*, 16 FORDHAM INTEL PROP. MEDIA & ENTERTAINMENT L. J. 1053 (2006) develops this analysis with respect to both saved seed issues and the use of restraints to facilitate price discrimination against small farmers.

[12] The Solicitor General in response to a request from the Court filed a brief urging denial of certiorari in McFarling v. Monsanto, 543 U.S. 923(2004) (invited the views the Solicitor General); 545 U.S. 1139 (2005) (cert. denied). The brief is available at: http://www.justice.gov/atr/cases/f209200/209268.htm

[13] The basic position of the government was that the post-sale restraints imposed by Monsanto were lawful. The government shifted position when the victims of such restraints were computer manufacturers. See, Quanta Computer, Inc. v. LG Electronics, Inc., __U.S.___, 127 S.Ct. 2087 (2007)(inviting the views of the Solicitor General); __ U.S.___, 128 S.Ct. 28 (2007) (certiorari granted). The government's amicus brief on the merits is available at: http://www.justice.gov/atr/cases/f227600/227630.htm

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The next panel will discuss the competitive effects of the proposed Swift-National-Smithfield merger in detail. The beef packing industry has not seen many anticompetitive acquisitions in the last 25 years. In fact, Smithfield's entry a few years ago with geographically dispersed foothold type acquisitions was a clear plus for competition and may have moved the industry toward some modest deconcentration. In addition, the beef feeding operations that Smithfield also owns are not vertically integrated into its packing houses. Hence, it has had a strong interest in the retention of a viable market for fed cattle. The same would be true of any other owner of those feeding operations if it was not vertically integrated. Of course, such an owner is a potential de novo entrant into the slaughter market in the region near the feeding operation. As long as such a firm stood in the wings, it would put pressure on existing firms to be more competitive. If actual entry occurred, it would stimulate a more competitive market for beef because it would increase the number of competitive buyers in the market. In fact, shortly before deciding to sell out, Smithfield had been in the process of making entry. It halted that plan and thereafter proposed to sell its entire operation to JBS.

I have two observations related to overall antitrust enforcement. First, the existing, pre-merger, level of concentration in the beef packing is substantially greater than in pork processing. In pork we know that buyer power exists. It follows that buyer power already exists in the beef processing market. Moreover, the proposed merger will substantially increase that concentration and create the kind of vertical integration that will make manipulation of the cash market even more possible. Hence, this merger "may substantially lessen competition" in the words of the Clayton Act's prohibition on anticompetitive mergers.

Secondly, in September 2001, a group of experts including myself evaluated the competitive implications of the use of long term contracts by packers to secure cattle rather than the cash market. We disagreed about the competitive implications of this practice overall. But we agreed that no packer should be allowed to use its current cash price at the plant receiving contract cattle as the basis for the contract price. The incentive to manipulate cash prices is obvious, but the more subtle harm is that the buyer for such a plant can not raise the cash price even to get a good pen of cattle because the effect is to raise the price of all cattle coming to that plant that week. Thus the contract suppliers have the benefit of a "most favored nation" system and are assured that they will get the same or better price than the cash price. But this distorts buying practices and harms the cattle feeding business by restricting the flexibility of buyers in the cash market. Moreover, there are a number of alternative bases for pricing contract cattle that would significantly reduce the incentive to manipulate the cash price. Hence forbidding this practice would not undermine whatever efficiencies contract systems might produce.

Despite our expert consensus the USDA has failed to adopt even this simple regulation. Moreover, the Antitrust Division is aware of this practice and other market manipulating practices including collective misstatements about future cash purchase plans and joint withdrawals from buying in the cash market. Yet the Division so far I can tell has not even conducted a through investigation of these anticompetitive practices.

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The beef market illustrates forcefully the failure of the USDA as the agency charged with responsibility, like the SEC or CFTC, to ensure a fair, efficient and open market regulator to carry out its responsibilities. But it also shows that the Antitrust Division aware of the regulatory context that facilitates collusive market manipulation and exploitation of producers has failed to take any action to enforce the antitrust law prohibitions on this conduct.

Grocery Consolidation

Another factor that merits brief reference because it is very important in the overall evolution of buyer power in agricultural markets is the increased concentration in the grocery business. As that business becomes more concentrated the retailers acquire greater buyer power and use that power in ways that cause adverse effects on upstream markets. Indeed, one continually reads as a justification for mergers among food processors that they need to combine in order to have bargaining power with retailers. The other side of that power is an increase in their own buying power. They use that power to drive down the prices they pay even as they try to keep up prices with respect to what retailers pay for their goods.

The FTC is largely responsible for enforcing antitrust law in the grocery business. It has failed to take appropriate account of the creation and entrenchment of buyer power in its reviews of such mergers. Although this may seem only indirectly to affect farmers, the reality is that upstream power is reflected back onto the suppliers least able to transfer the impact further. A major error, therefore, in the analysis of buyer power in merger cases is the failure to look for the places where the exploitation of such power will come to rest. If such a focus had been used, the FTC and Antitrust Division would have observed that there is a more substantial risk of adverse effects on competition from mergers creating buyer power.

The Implications of Consistent Failure to Enforce the Law

The history of the last decade of antitrust enforcement related to agricultural markets is sad. As the foregoing summary shows, the results have been a substantial increase in concentration that has and will result in exploitation of farmers and a failure to challenge any of the anticompetitive practices that these firms employ. There is also an equally disturbing failure on the part of the USDA to use its substantial existing authority to protect and promote fair and open market access. It is not surprising that the latest farm bill may impose more direct legislative commands on these markets.

In the late 1990s, the Antitrust Division created Mr. Ross's position. The hope was that this would provide better engagement with agricultural issues. It is clear after a decade that the position carries no authority to oversee the initiation and filing of cases. At best, Mr. Ross provides a phone number to which complaints can be directed. But he has no authority to do anything about those complaints. He is a dedicated civil servant in a difficult position of having to justify and defend decisions over which he has no control.

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What this tells us is that institutionally the Antitrust Division has not been able to provide the kind of oversight of anticompetitive conduct and mergers in agriculture that Congress expects.

What can be done? First, hearings like this have some utility because they provide to the actual decision makers at the Antitrust Division the signal that there is significant unhappiness with the policy of inaction that they are pursuing. This role can be augmented if the Committee will insist on confidential briefings by the Division about its decisions. Such a strategy will avoid the disputes about confidentiality that arise when it is asked to justify its decisions in public. At the same time, such briefings will make the Committee and its staff much better informed about the merits of the analysis and decisions of the Antitrust Division in agricultural matters. Another alternative would be to have the Government Accountability Office conduct a full review of the key decisions about agricultural mergers in the last 10 year with a focus on the consequences of the actions and inactions of the Antitrust Division.

Second, I would suggest it is time to change the institutional arrangement for enforcing competition law in agriculture. The Grassley-Kohl bill, S 1759, proposes changes in the process that would directly address the institutional failures of both the USDA and the Antitrust Division. Not surprisingly, the Justice Department has made self-serving assertions that it can handle antitrust enforcement without any changes in the current system. As the foregoing review of the last decade of non-enforcement shows, the facts do not support that claim. If enacted, the bill would impose new obligations on the Antitrust Division to develop appropriate enforcement guidelines relevant to agriculture, and it would change the standard for determining the legality of mergers in agriculture to ensure more effective public and private enforcement of the antitrust laws. If that legislation were the law today, the JBS/National/Smithfield merger would never even be under discussion.

If America's farmers and ranchers are to have the benefit of a workably competitive market, there must be a more active and informed oversight of both the practices of buyers and sellers and a much stronger commitment to restoring competitive market structures. In light of the past decade of experience, it is clear that change is required.

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Comments to the Senate Judiciary, Anti-trust Subcommittee

The potential market impacts of the proposed merger of JBS Swift and Company with National Beef Packing Company, Smithfield Food's beef operations and Five Rivers Ranch Cattle Feeding

May 7, 2008

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Overview

Issues of concentration, market power, and vertical coordination are not new issues for the beef industry. They have been a part of the industry for well over 100 years. Congressional involvement in the beef industry also has a long history. The Sherman Act of 1890, the Packer and Stockyards Act of 1921, and "The Consent Degree" of 1922 were all in response to concerns over mergers between packers, stockyards, and the railroads.

The dominant beef packing firms of the early 1900's all essentially disappeared by the end of the century. However, they were replaced with new dominant firms that brought new innovation to the beef industry and that followed the cattle out of the eastern corn belt to the western corn belt and the high plains.

A brief look at the major packers of the last 30 years shows a continued process of mergers, acquisitions, buy outs and sell offs. For example, the nations current largest beef packer, Tyson acquired IBP, the then largest beef packer in 2001. IBP had grown from one original plant in Denison, Iowa in 1960 through a process of acquisitions and new plant construction. The current number two largest beef packer, Cargil, who owns Excel beef first acquired MBPXL, formerly Missouri Beef, in 1979. They then acquired Spencer Beef in 1986. The present third largest packer, JBS Swift, acquired Swift and Co. in 2007. Swift and Co was formed in 2002 when ConAgra Beef was sold to a group of investors in Texas and Colorado. ConAgra Beef was formed after acquiring Monfort of Colorado and Swift in 1987. The present day number five beef packer, Smithfield Beef, was formed when Smithfield purchased Moyer Packing and Packerland, two separate companies, in 2001.

There has also been a changing history of cattle feeding within these companies. Tyson/IBP has never for the most part owned cattle feeding facilities. However, they do have a

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number of marketing agreements with specific cattle feeding operations. Cargil, originally a grain only company, acquired Caprock cattle feeding in 1974 prior to owning any packing plants. Cargil continues to own and feed cattle. Monfort was originally a cattle feeder who then constructed a beef packing plant to kill their own cattle. When ConAgra purchased Monfort they also purchased the feedlots. However, when ConAgra sold off its beef operations to Swift, the feedlots were not part of that deal. ConAgra continued to operate the feedlots until 2004 when they were sold to Smithfield Beef, the same company above who acquired Moyer Packing and Packerland in 2001. Continental Grain got into the cattle feeding business in 1975 with the purchase of its first major feedlot. Continental Grain expanded its feeding capacity over the next 25 years with acquisitions of a number of large feedlots. In 2000, Continental Grain formed ContiBeef, LLC out of its feedlots. In 2005, ContiBeef and Smithfield Beef merged their feeding operations into one company, Five Rivers. The proposed merger of JBS Swift, with National Beef, Smithfield Beef and Five Rivers cattle feeding will reunite the original Monfort feedlots with the original Monfort packing plant in Greeley, Colorado.

I provide this brief overview and history for a few reasons. First, to call attention to the fact that there has been and continues to be a changing ownership structure to the beef packing and feeding sectors. I suspect that with each of these prior mergers, buy outs, sell offs, and acquisitions there were industry groups that supported them and industry groups that were opposed to them. Those opposed probably claimed that many of them would be the end of the beef industry. In fact, the beef industry continues to move forward and market efficiency and economic returns continue to reshape the industry and the dominant firms. Secondly, I think it is noteworthy that major agribusiness firms have entered and have exited the cattle feeding and beef packing industry. One would not expect a major agribusiness firm to get out of an industry if

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they were earning an excessive profit, as is often alleged beef packers are by those who oppose these type of mergers. Rather, I would think these continued ownership changes are a result of firms trying to stay competitive in an increasingly competitive global market place. I am certain that there would have been few beef industry experts in 2000 that would have predicted that IBP, the dominant beef packing firm for the previous 20 years, would have been purchased by the dominant chicken firm, Tyson, in 2001. I would be equally positive that those who saw ConAgra enter the cattle feeding and beef packing business in 1987 would have predicted that in less than 20 years they would be completely out of both of those sectors. These are examples of just how competitive this industry is and how at times the returns are not great enough for those in the industry to continue or to stave off a takeover bid from another competitor. Lastly, I would point out that owning both major cattle feeding enterprises and beef packing companies has not led to that firm being the dominant force in the market place.

With that background and short history lesson provided, I will now set forth what I view as the potential benefits and the potential setbacks to the current proposed merger of JBS Swift with National Beef, Smithfield Beef and Five Rivers feeding. I do so with the caveat that in ten to 20 years someone may ask who is JBS Swift and why were we concerned about them in 2008.

Potential Benefits

Certainly a potential benefit to the beef industry is the infusion of new capital and new ideas into the industry. The last couple of years have been very difficult economic years for the cattle feeding and beef packing sectors. I won't elaborate on all the reasons for these difficult economic times, but our own past trade bans on Canadian cattle do to concern over BSE and continued trade sanctions on some of our exports due to concerns over BSE has cost the packers on both the cattle supply side and on the beef demand side of the market. Equity has been drained

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out of the packing industry and without this infusion of new capital into the industry it is possible that at least one of the packing plants within the proposed merger of plants would be shut down or perhaps even more challenging to the industry would be if one of these companies shut down.

The infusion of new ideas may even prove more beneficial than the infusion of new capital. JBS Swift is a dominant firm in world beef trade. They have been trading with countries in the past that have not been major US markets. Perhaps their credibility in these markets could lead to increase US beef exports and therefore improved beef and cattle prices. The upstart, Iowa Beef Packers, took the packing industry by surprise in the 1970's with the introduction of boxed beef, rather than hanging carcasses. Perhaps, JBS Swift will revolutionize the way American beef packers do business in the international market place.

The producer owned cooperative, U.S. Premium Beef (USPB) has a majority ownership in National Beef. That cooperative provides its members some very attractive pricing grids on which to sell fed cattle. Presently, all those cattle must be harvested at one of the three National Beef plants. With this proposed purchase, it is my understanding that USPB will acquire shares in the new JBS Swift company and that members of USPB would then be able to ship cattle to any of the JBS Swift/National/Smithfield packing plants that harvest steers and heifers. This could greatly expand the desirability of owning or leasing USPB shares and selling fed cattle through this cooperative. Cattle producers in the more isolated feeding areas of the West and the North East would then have potential access to this marketing cooperative.

As one considers the market power dynamics of the new beef packing industry if this merger were approved, it might well be that there is actually increased competition. Considering the present five biggest firms, it might be argued that there have been two dominant firms the last few years, one weaker large firm and two medium sized firms, one of which may itself be in

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some financial difficulty. The resulting firm structure could be three large firms, all competing very aggressively for a limited supply of fed cattle. Given that the present beef packing industry has excess capacity relative to the size of the fed cattle population, these three large firms may compete very aggressively for fed cattle and the resulting price paid for fed cattle may be very close to a perfectly competitive market price.

I visited with an independent feedlot operator in one of the market areas where there is really only one packer. He was basically supportive of this merger. His thoughts were it would be better to have one strong packer that he could sell to then it would be to have one weak packer or no packer to purchase his cattle. This argument goes both to the argument of an infusion of capital into the industry and the argument that a large packer will not necessarily exercise more market power than a smaller, weaker packer. I will again restate, margins are very competitive in the beef packing and cattle feeding sectors. Packers recognize that to remain competitive they need an adequate supply of cattle. It is therefore, not in their long term interest to consistently buy fed cattle below the competitive market price, if in doing so they put their cattle suppliers out of business. It may in fact be the case that a weaker packer, struggling to compete with the larger, perhaps more efficient packer, would be more inclined to try and buy cattle cheaper for short term gains.

Potential Setbacks

I see two potential setbacks to the cattle industry if JBS Swift is given the approval to acquire National Beef, Smithfield Beef and Five Rivers cattle feeding. The first is a loss in the number of competitive bids in a market area and the second is the increase in captive supply, or at least the increase in packer ownership of cattle.

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National Beef has two plants located in Southwestern Kansas. Those plants have acquired cattle on a regular basis from cattle feeders in Colorado, Kansas, Nebraska, Oklahoma and Texas. JBS Swift has packing plants in Colorado, Nebraska and Texas that also obtain cattle from feeders in Colorado, Kansas, Nebraska, Oklahoma and Texas. Rather than being two separate head buyers for these plants, there would only be one head buyer for JBS Swift. Feedlots in these areas may have had four bids on a regular basis from Excel, National, JBS Swift and Tyson. They will now only have 3 independent bids. So long as excess capacity remains in the industry, this may not be any problem as was previously noted. Even plants within the same company do compete on the margin to obtain enough cattle to operate their plant efficiently. However, if cattle supply more closely matched packing capacity, then economic theory would suggest that a loss of an independent buyer in the market place would likely result in a lower market price for fed cattle.

National Beef presently has a plant in southern California and Smithfield Beef has a plant in Arizona. Each of these plants presently offer independent bids to cattle producers in those market areas. With the proposed purchase of National Beef and Smithfield Beef, those two plants would be under one ownership. Going from two independent buyers to one buyer in a market place certainly as the potential to lower the price paid for cattle.

In all other market areas, I do not see that the proposed purchase will alter the number of independent buyers. It is merely a change of name of who those buyers are and not a change in the number of independent buyers.

Perhaps the largest potential setback to the cattle industry from this proposed agreement is the increase in the packer ownership of cattle. With the purchase of Five Rivers feedlots, JBS-Swift would have a one time feedlot capacity of 813,000 head and total annual cattle fed would

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likely be in excess of 1.6 million head. Compared to an annual cattle slaughter of 34 million head, that does not seem like it would have much of a market impact. It is less than 5% of the expected annual slaughter. However, in looking at the location of the feedlots and the packing plants, it is likely that about 40% of the plant capacity in Greeley, Colorado could be supplied from Five Rivers and that over 25% of the plant capacity in Liberal, Kansas and Cactus, Texas could be supplied by Five River feedlots. This level of packer ownership of cattle could take those plants off the effective market for fed cattle in some weeks. However, those cattle are also taken off the market and not available to other plants within JBS Swift nor are they available to other packers.

There has been considerable debate about the impact of captive supplies of cattle by packers, of which ownership is one form, on the market price for cattle in the cash market. In general, past studies have found small negative impacts on fed cattle prices from increased captive supplies. There has been legislation debated by this Senate to ban beef packers from owning or controlling cattle for more than 14 days prior to slaughter. I am on record as opposing that legislation. See the following paper for a detailed analysis:

Feuz, D., G. Grimes, M.L. Hayenga, S.R. Koontz,J.D. Lawrence, W.D. Purcell, T.C. Schroeder, C.E. Ward. 2002 "Comments on Economic Impacts of Proposed Legislation to Prohibit Beef and Pork Packer Ownership, Feeding, or Control of Livestock" White Paper. Authors Listed Alphabetically. http://www.aaec.vt.edu/rilp/publications.html January 14, 2002

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Concluding Remarks

As I have previously stated, the cattle feeding and beef packing sectors are very competitive in that they operate on very narrow profit margins. The competition is global and across protein species. To limit the ability of packers and feeders to enter into relationships that they believe will make them more efficient and more competitive in the global market place, I believe is counter productive to the long term survival of the US beef industry.

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Statement of Senator Chuck Grassley, Judiciary Antitrust Subcommittee Hearing, May 7, 2008

Chairman Kohl and Senator Hatch, thank you both for scheduling this important hearing. As you know, I requested this hearing because of widespread concerns about increased concentration in the agriculture industry, as well as concerns raised about the proposed acquisition of National Beef Packing Co., Smithfield Beef Group and Five Rivers Ranch Cattlefeeding by JBS Acquisitions. It's important that the Judiciary Committee review positive and constructive solutions to agriculture competition concerns, as well as potentially problematic mergers such as the JBS transaction.

For well over a decade, I've had serious concerns about increased consolidation in agriculture and its impact on rural America. I share the concerns of

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many family farmers and independent producers that the agriculture industry has consolidated to the point where many of these smaller market participants do not have equal access to fair and competitive markets. I share the concerns of many in the agriculture industry that large agribusinesses are in a better position to engage in anti-competitive and predatory business practices.

In this Congress, Senator Kohl and I introduced S. 1759, the Agriculture Competition Enhancement Act – or ACE Act – in response to concerns about excessive concentration in the agriculture sector. I was disappointed that we weren't able to include some version of the ACE Act in the Farm Bill. But, I hope that we'll be able to discuss the legislation today and hear the witnesses' views on it. I'd like to see this bill move in the Judiciary Committee,

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because I truly believe that it will help address concerns about agriculture mergers.

The JBS merger is a part of this growing "bigger is better" trend in agriculture. I wrote to the Justice Department's Antitrust Division to urge a careful review of this transaction, and to consider thoroughly the projected impact on the beef industry. JBS is the world's largest beef packer and the third largest beef processor in the United States. National Beef Packing and Smithfield Beef Group are the fourth and fifth largest beef processors in the nation. If this transaction were to be approved, JBS would control approximately 32% of the beef processing market share, killing far more animals than Cargill Meat Solutions or Tyson Foods.

I'm concerned that the proposed JBS merger could severely reduce the already limited number of

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buyers for the commodities of small, independent beef producers. The transaction could leave producers minimal selling options throughout large geographic regions. It would allow JBS to control the largest share of the beef market, and potentially decrease product choice and increase product prices for the American consumer. I spend a lot of time focused on the independent producers, but with rising costs of food world-wide, I'm particularly interested in hearing the potential affects on shoppers in the grocery aisle.

I'm not the only one that has issues with this proposed merger. Small independent producers, family farmers and other agricultural groups share my concerns about the proposed JBS transaction and increasing agribusiness consolidation. Expanded packer ownership, exclusive contracting and captive supply are adversely impacting their ability to

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compete in the marketplace. They share my concerns about reduced market opportunities, possible anti-competitive and predatory business practices, and fewer choices and higher costs for American consumers.

So I'm very pleased that we'll be able to have representatives from JBS and National Beef tell us what they believe will be the benefits to this transaction. I'm also pleased that we have industry folks and agriculture antitrust experts here to also give us their views, both on the transaction as sell as what they see going on in the agriculture industry. Again, I very much appreciate Chairman Kohl agreeing to hold this hearing on agriculture concentration.

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Statement of Steven D. Hunt
Chief Executive Officer
U. S. Premium Beef, Ltd.
Before the Senate Judiciary Committee,
Subcommittee on Antitrust, Competition Policy and Consumer Rights

May 7, 2008

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you and discuss JBS's proposed acquisition of National Beef Packing Co. (National Beef) from U.S. Premium Beef (USPB). I am the CEO of USPB and Chairman of National Beef, but perhaps most importantly, I have my roots in cattle production. My family has been active in cattle production for five generations. I speak to you today on behalf of USPB owners and producers, which on March 14 voted overwhelmingly in favor of proceeding with the JBS transaction. They believe that the livelihood of not only every USPB producer owner, but all cattle producers is dependant upon the health and growth of the beef industry and this is why we support JBS's vision.

USPB is a one of kind cattle producer owned beef processing company, formed to uniquely link cattle producers with consumers through ownership in processing. As a result, we have been able to design a supply of cattle specifically bred and managed to meet consumer preferences, which results in premiums back to the producer and our processing company, National Beef.

USPB was formed in 1997. During our short existence we have evolved from a minority owner of National Beef to the majority owner. In addition to processing customer cattle purchased throughout the U.S., we have processed over 6.2 million head of our members' cattle and paid out over $117 million in cash premiums to our producer members, and paid an additional $87 million in cash dividends as a result of our ownership in processing. In other words, our producer owners have become beef processors through U.S. Premium Beef and have been able to realize the financial rewards from the ranch to the consumer's plate.

We have been successful by guaranteeing value based pricing–paying premiums for high quality grading cattle. Additionally, we also distribute

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carcass data on every single animal at no cost to producers so they can better understand what they are producing and thus focus their efforts on designing high quality cattle. Simply put, our company gives producers the economic incentive to deliver more valuable, consumer preferred beef.

Since our formation, we have been working to diversify our business through geographical expansion, acquisition of other protein businesses and pursuit of businesses in markets outside the United States. This has been essential in managing the risk our owners realize through their investment in USPB. This is a strategy that our producers pursue on the farm and that other businesses employ to successfully manage risk and to compete with very strong, diversified companies during challenging points of the industry cycles.

A prime example of the need to diversify is what has plagued the beef industry since the discovery of a single case of BSE in Washington in 2003, which resulted in the loss of lucrative export markets. While beef has experienced reduced profitability during this time, other proteins, such as pork have benefited in part from replacing beef in the export markets.

Since the loss of the export market, the U.S. beef industry has experienced a "perfect storm" of events that have created the worst processing margins in recent history. These events include a reduction in the supply of fed cattle as a result of severe drought and the extraordinary increase in the cost of inputs, particularly feed grains such as corn. Instead of the anticipated growth of the cattle herd as predicted several years ago, we now have fewer market cattle available with the latest projections calling for further declines during the rest of this decade. This has been especially problematic for the beef processing and cattle feeding industries as the substantial investment in assets have become under utilized thus decreasing efficiency and increasing costs.

These losses and prospects of a declining herd size have left the beef industry in a position where few are willing to invest. In 2006, Hicks Muse announced it was selling its meat processing company, Swift. Smithfield Foods has also made the decision to exit beef processing. Whereas prior to 2003, our company was routinely approached by willing investors and partners, today we witness very few, if any, parties interested in investing in the U.S. beef processing industry, except one.

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JBS S.A., a family owned business based in Sao Paolo, Brazil with U.S. headquarters in Greeley, CO, is willing to invest over $3 billion dollars in the U.S. meat processing industry because they believe that by putting our companies together, we can create more value and increase efficiencies, not only necessary to sustain our industry, but return it to a growth industry.

More importantly, JBS has the same vision for industry growth and success as we do. The proof is in the pudding; since acquiring Swift last year, JBS has expanded production and purchased more cattle. They also have looked for ways to expand demand for U.S. beef, by pushing into new international markets using their unique perspective to introduce U.S. beef to new customers. Moreover, our due diligence made clear that JBS has made concerted efforts to improve the efficiency of the Swift assets they acquired from Hicks Muse. I am confident that we can help each other become even more efficient while we seek to grow the business together.

For USPB, this partnership with JBS is a natural decision that enables our producer owners to broaden our investment into a well diversified, multi-protein world leader in value added products, while at the same time maintaining our founding principles of value based pricing and dissemination of carcass data.

JBS values what we have accomplished at USPB/National Beef and wants to build upon our value added strategy to help bring more value to producers so they can expand production. After the completion of our proposed transaction with JBS, more producers will have the ability to market through our unique producer-owned company by delivering cattle at more plant locations thus reducing freight costs and improving efficiencies for producers and our processing company. Our confidence in JBS's dedication to expanding demand for U.S. beef through this strategy is exemplified by our agreement to become JBS shareholders.

For those who have doubts about this transaction, I have one question: If not JBS, then who is willing to step up and reinvest in the US beef industry with the resources and vision necessary to put the industry back on its feet?

The farmers and rancher owners of USPB have a right and obligation to pursue sound business strategies employed by our competitors, recommended by our universities and applauded by Congress. Those include value-added strategies through vertical integration from the bottom

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up, business product diversification to lay off risk and foreign investment to participate in the growing consumer global marketplace.

As you know, the Department of Justice is reviewing the proposed transaction. I am confident its review will be thorough and that when complete will lead the DOJ to recognize the benefits of the transaction. The beef processing industry is highly competitive, with Cargill, Tyson, JBS and a number of other processors remaining to compete fiercely for cattle and to sell beef to our sophisticated customer base. The transaction will only enhance this competition, by allowing the combined company to become more efficient and providing a strong platform for growth in the future.

I would like my full statement submitted for the record.

Thank you for this opportunity to provide testimony today. I will be happy to respond to questions.

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news from

HERB KOHL

United States Senator
Democrat of Wisconsin

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FOR IMMEDIATE RELEASE: **May 7, 2008**
Contact: Lynn Becker or Rohit Mahajan (202) 224-5653

KOHL STATEMENT FOR JBS SWIFT ACQUISITIONS HEARING

WASHINGTON, DC – Today, Senator Herb Kohl (D-WI), Chairman of the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, opened the panel's hearing "Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions" with the following remarks.

Today we meet to examine the rising tide of consolidation in agriculture. Recent years have witnessed an enormous transformation in the agriculture industry. The disparity in market power between family farmers and the large agri-business firms all too often leaves the individual farmer and rancher with little choice regarding who will buy their products and under what terms. This hearing we will focus on just the latest example of that trend -- JBS Swift's plans to acquire two other meatpacking firms, a transaction that would reduce the number of major competitors in this industry from five to three.

In 1890, our nation's fundamental antitrust law – the Sherman Act – was passed in large part as a response to the consolidation in the meatpacking industry. We now appear to have gone full circle, as the JBS Swift acquisitions will leave the meatpacking industry even more concentrated than it was a century ago. If approved, the JBS Swift acquisitions will increase the market share of the top four firms to 91%. JBS Swift will also acquire Five Rivers, the nation's largest feedlot marketing two million cattle annually. This threatens to give JBS Swift a very strong lever over the nation's cattle supply, while leaving independent ranchers with little bargaining power.

By reducing the number of major buyers for ranchers' cattle from five to three – and in some regions even two -- this deal will give the remaining beef processors enormous buying power. With little choice to whom to sell their cattle, ranchers will increasing be left in a "take it or leave it" position.

And we should be equally concerned with effects on millions of beef consumers across the country in this era of rising food prices. Will only three major national sellers of beef be enough to ensure a competitive market for supermarkets, small grocery stores, and restaurants? Or will consumers need to go on a diet while the giant meatpacking firms grow fatter and fatter?

So I urge the Justice Department to undertake a close and serious examination of the effects of the JBS Swift acquisitions on both ranchers and consumers. Unfortunately, it appears that the Justice Department's antitrust enforcement efforts – both in the agricultural sector and generally – have been much too weak and passive in recent years. In the opinion of many experts, the Justice Department has often failed to take effective action as merger after merger in the pork, milk, and seed markets have sharply increased concentration and reduced competition. Antitrust investigations in the dairy industry have languished with no resolution. While the Justice Department sits largely on the sidelines, agriculture concentration increases and food prices rise.

Weak antitrust enforcement, of course, has not been limited to agriculture. Previously unthinkable mergers among direct competitors in many other highly concentrated industries affecting millions of consumers have been approved by the Justice Department, often over the reported objections of career staff. The most recent example was the Department's approval of the XM/Sirius merger, a merger to monopoly in the satellite radio industry.

This is not the time for the government to take a cramped or limited view of antitrust enforcement. In this era of rising prices, and ever increasing consolidation, the need for vigorous enforcement of our antitrust laws has never been greater, in agriculture and in all other key sectors of the economy. Millions of consumers are depending on aggressive antitrust enforcement. Now is not the time for our antitrust enforcers to be asleep at the switch.

# # #

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Department of Justice

STATEMENT

OF

DOUGLAS ROSS
SPECIAL COUNSEL FOR AGRICULTURE
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND
CONSUMER RIGHTS
COMMITTEE ON JUDICIARY
UNITES STATES SENATE

ENTITLED

"AGRICULTURAL CONSOLIDATION AND OTHER RELATED ISSUES"

PRESENTED ON

MAY 7, 2008

STATEMENT OF
DOUGLAS ROSS
SPECIAL COUNSEL FOR AGRICULTURE
U.S. DEPARTMENT OF JUSTICE
BEFORE THE
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND
CONSUMER RIGHTS
SENATE JUDICIARY COMMITTEE
MAY 7, 2008

Good afternoon, Mr. Chairman and members of the Subcommittee. I appreciate the opportunity to discuss antitrust enforcement in the agricultural marketplace, and in particular, the role of antitrust enforcement in ensuring that agricultural markets are competitive, both on the selling side and on the buying side. While the Antitrust Division cannot comment on the specifics of any transaction that it is currently investigating, we fully understand the Committee's interest in knowing how the Division analyzes mergers in agriculture industries generally. My testimony today will review the standards that the Division applies in evaluating mergers and acquisitions, and I will discuss recent cases in the agriculture sector that have proven to be illustrative of how these standards are applied to particular sets of facts.

The agricultural marketplace is undergoing significant change. Farmers are adjusting to challenges and opportunities in international markets, to major technological changes in the products they buy and sell, and to new forms of business relationships between producers and processors.

In the midst of these changes, farmers in particular have expressed concern about the level of competitiveness in agricultural markets. Farmers are very aware of the importance of competitive markets to sustain their livelihoods, and their ability to help put higher quality food products on America's tables at lower prices and to maintain

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incentives for innovation in producing agricultural products. Competition at all levels in the production process makes this possible.

The Antitrust Division takes these concerns very seriously and has been very active in enforcing the antitrust laws in the agricultural sector. Enforcement of the antitrust laws can benefit farmers, as purchasers of goods and services that allow them to grow crops and raise livestock, and also as sellers of crops and livestock that feed people, not only in our country but also throughout the world. Antitrust Division officials have also undertaken a special outreach effort in agriculture, meeting with producers and producer groups here in Washington and around the country to listen to their concerns and to improve everyone's understanding of the role that antitrust enforcement plays.

The Role of Antitrust Enforcement in Agriculture Markets

The antitrust laws apply in the same way in every industry, with a very few exceptions where their application is limited by specific statute. One exception important for agriculture is the Capper-Volstead Act, which permits agricultural producers to market their products jointly through cooperatives. In addition, certain industries are also regulated by government agencies under statutes that go beyond the antitrust laws to establish additional, industry-specific rules for appropriate behavior in the marketplace. For example, the livestock, meat-packing, and poultry industries are regulated by USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA) under the Packers and Stockyards Act.

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The Antitrust Division investigates and brings enforcement actions against three basic kinds of antitrust violations. First, we bring criminal prosecutions against hard-core forms of collusion, such as price-fixing and market allocation, that violate section 1 of the Sherman Act; we also bring civil enforcement actions under section 1 against joint ventures and other forms of collaboration among competitors when they unreasonably suppress competition. Second, we bring enforcement actions under section 2 of the Sherman Act against monopolization or attempted monopolization, the use of predatory or exclusionary conduct to acquire or hold onto a monopoly. Third, we bring enforcement actions under section 7 of the Clayton Act to prevent mergers from substantially lessening competition in a market.

As members of this Committee understand, the responsibility entrusted to us as enforcers of the antitrust laws is not to engineer the best competitive structure for the marketplace. The antitrust laws are based on the notion that competitive market forces should play the primary role in determining the structure and functioning of our economy. Our job is to stop the specific kinds of private-sector activity that interfere with those market forces in violation of the antitrust laws.

We are law enforcers, not regulators. Our authority rests ultimately on our ability to bring enforcement actions in court, and when we bring an action, it is the court that decides whether the antitrust laws are being violated in the particular instance.

While the antitrust laws play an important role in helping keep markets competitive, they will not address all of the complex issues facing American agriculture in this time of change. There is a broad range of agriculture policy issues for the government to focus on, and antitrust enforcement is only one part of that.

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For us at the Antitrust Division, of course, it is the important part, because it is our part. The Division is committed to stopping anticompetitive mergers or conduct from harming the agricultural marketplace, whether it is buyers or sellers who are harmed in the first instance.

My focus today is on the analysis that the Division employs in reviewing mergers, and the vital role that merger enforcement has in protecting competition in agricultural markets. The Division's goal is to promote competition as a means of ensuring that consumers get the benefit of competitive prices, innovation, and efficiency.

Merger Enforcement Standards

In our conversations with farm groups, we have found that farmers are especially concerned about the potential impact of mergers and acquisitions. Farmers are concerned that mergers will limit the number of sellers of seed, chemicals, machinery, and other equipment from whom they can buy and will limit the number of customers for crops and livestock to whom they can sell. For this reason, I think it may be helpful to start with a discussion of the Antitrust Division's merger enforcement program

The Division reviews mergers under Section 7 of the Clayton Act, which prohibits the acquisition of stock or assets if "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." This enables us to arrest anticompetitive mergers in their incipiency, to forestall harm that would otherwise ensue but be difficult to undo after the parties have consummated a merger. Thus, merger enforcement standards are forward-looking and, while the Antitrust Division

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often considers historic performance in an industry, the primary focus is to determine the likely competitive effects of a proposed merger in the future.

The Antitrust Division shares merger enforcement authority with the Federal Trade Commission (FTC), with the exception of certain industries in which the FTC's jurisdiction is limited by statute. The agencies jointly have developed Horizontal Merger Guidelines that describe the inquiry they follow in analyzing mergers. "The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time." Merger Guidelines § 0.1.

We ordinarily seek to define the relevant markets in which the parties to a merger compete, and then determine whether the merger would be likely to lessen competition substantially in any of those markets. Customers and businesses often use the word market in a variety of ways. In the antitrust merger context, relevant market definition is a technical exercise involving analysis of customer substitution in response to price increases. In performing relevant market definition analysis, the Antitrust Division and the FTC consider both the post-merger market concentration and the increase in concentration resulting from the merger. However, just because a market is concentrated does not necessarily mean mergers in that market can be shown to violate Section 7. In all cases, appropriate consideration has also been given to other factors—such as the likelihood of entry by new competitors—that could affect whether the merger is likely to create or enhance market power or to facilitate any exercise of market power.

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In most instances, the concern raised by a merger is the potential ability of the merging companies to raise above the competitive level the price of the products or services they sell. Of course, it is also possible that a merger will have the potential to substantially lessen competition with respect to the price that the merging companies pay to purchase products or services. This is a matter of particular concern to farmers, who often sell their products to large agribusinesses.

Let me emphasize that the Antitrust Division closely looks at such concerns in merger enforcement. The Merger Guidelines specifically provide that the same analytical framework used to analyze the "seller-side" is also applied to the "buyer-side":

> Market power also encompasses the ability of a single buyer (a "monopsonist"), a coordinating group of buyers, or a single buyer, not a monopsonist, to depress the price paid for a product to a level that is below the competitive price and thereby depress output. The exercise of market power by buyers ("monopsony power") has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines.

Merger Guidelines § 0.1. Thus, the Antitrust Division has reviewed mergers to determine not only whether they posed a competitive threat to persons buying goods or services from the merged entity, but also whether they posed a competitive threat to persons selling goods or services to the merged entity.

One example of the exercise of monopsony power is a situation in which a purchaser with market power reduces the quantity it purchases in order to force down the per unit price it pays. As with an exercise of monopoly power, if the result of an exercise of monopsony power is that output falls below the competitive level, then overall

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economic welfare is thereby reduced. In other words, consumers are harmed by the exercise of monopsony power in the same way they are harmed by monopoly power.

A merger may lower the true economic cost of purchasing. An example might be where a merger enables the firm to commit to larger orders and thereby permits its supplier to save on its costs by scheduling longer and less costly production runs. These cost savings typically will benefit both the merged firm and its suppliers, and to the extent they lower the buyer's marginal cost of production, will tend to be passed along to some extent to final consumers. The case where a merger lowers input prices for no reason other than that the merged firm can now exercise monopsony power is entirely different. If a buyer obtains market power through merger, and thereby is able to depress prices for the inputs it purchases below competitive levels, then producers of those inputs will have depressed incentives to produce, which will result in too few resources utilized to produce the inputs compared to what would be available in a competitive market. Because output decreases in the end, this is likely to harm both suppliers and consumers because suppliers will get a lower price while consumers get a higher price.

While we often speak of consumers as the targeted beneficiary of antitrust enforcement, suppliers also benefit by having healthy incentives to provide the best products and services they can, with the expectation that they will be able to do so free from anticompetitive interference. And, the overall U.S. economy benefits, as the products and services desired by consumers are produced more efficiently, in greater quantities, and at competitive market prices. A focus on promoting competition goes hand in hand with our taking enforcement action in a monopsony case when the facts warrant.

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While most of the merger challenges brought by the Antitrust Division have involved companies that compete with one another ("horizontal competitors"), the agencies also consider whether mergers involving companies at different levels in the production and marketing process ("vertical relationships") may have anticompetitive consequences. Challenges to vertical mergers are less frequent because these mergers often allow the merged companies to compete more efficiently in the marketplace, by reducing costs or streamlining production. However, there are circumstances in which a vertical merger may substantially lessen competition, such as by foreclosing competitive access to one of the markets involved in a way that raises barriers to entry or otherwise threatens competitive prices. This was the case in our recent challenge to the Monsanto/Delta and Pine Land merger, as I will explain in a moment. In such instances, the Division will pursue the appropriate enforcement action just as with horizontal mergers.

Merger Enforcement Activity

The Antitrust Division has brought a number of enforcement actions in recent years to prevent anticompetitive mergers from being consummated in agricultural markets. Where possible, the Division has insisted that the merger be modified to remove any causes for antitrust concern or, when the merging parties do not agree to the necessary conditions, we have sought to block the merger in its entirety. In other cases, the Division recognizes that protecting consumer welfare sometimes requires not challenging transactions where, despite initial impressions, the evidence does not

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demonstrate harm to competition. The Division has closed such investigations without taking action where warranted by the evidence collected in a comprehensive investigation. I would now like to highlight some of our more recent enforcement actions.

Monsanto/Delta and Pine Land

One of the most interesting cases this past year involved the acquisition of Delta and Pine Land Co. (DPL) by Monsanto. DPL is the largest U.S. producer of cottonseed. It introduced Monsanto's herbicide and insecticide genetic traits into seeds and, more recently, began working with other trait developers to create and commercialize traits to compete with Monsanto. Monsanto was vertically integrated: It was both a significant seed producer as well as the dominant developer of genetic traits for cotton.

After a thorough investigation of this merger, in May 2007 the Division filed a lawsuit along with a consent decree that required Monsanto and DPL to divest a significant seed company, multiple cottonseed lines, and other valuable assets, in order to proceed with the merger. As originally proposed, the merger likely would have harmed farmers in cotton growing regions in the Mid-South and Southeastern U.S. by reducing competition in the sale of cottonseed that has been genetically modified to include desirable traits like insect resistance or herbicide resistance. DPL had worked with other biotech companies to develop cottonseed with traits that would compete with seed containing Monsanto's traits. The merger would have eliminated DPL as a partner for trait developers other than Monsanto, and thus would have delayed or even prevented competitive products from reaching the market.

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The appropriate remedy went well beyond divesting Monsanto's seed business. To remedy the vertical concerns, Monsanto was required also to divest significant additional DPL and Monsanto assets, to license Monsanto traits on terms as favorable as DPL had pre-merger, and to include in the licenses the ability to stack non-Monsanto traits with Monsanto traits. Monsanto was also required to divest to Syngenta a group of seed lines carrying Syngenta traits that had been developed by DPL, and that DPL planned to begin marketing as early as 2009. The principal divestiture package was sold to a major trait developer for $310 million shortly after the complaint was filed.

This action was similar to our 1998 challenge to Monsanto's proposed acquisition of DeKalb Genetics Corporation, involving corn seed biotechnology innovation, in which Monsanto met our concerns by agreeing to spin off its claims to a new technology for introducing new traits such as insect resistance into corn seed, and to license its Holden subsidiary's corn germplasm to over 150 seed companies that before the transaction had bought it from Monsanto, so that those companies would be free to use it to create their own corn hybrids if they chose.

DFA/Southern Belle

The Division filed a civil antitrust lawsuit in April 2003 to compel Dairy Farmers of America Corp. (DFA) to divest its 50 percent interest in Southern Belle Dairy. This merger between two dairy processors was not subject to the Hart-Scott-Rodino premerger notification requirements because its dollar value fell below the statutory threshold for reporting, and the Division did not learn about it until after it had been completed. The complaint charged that the partial acquisition reduced competition for school milk contracts in 100 school districts in Kentucky and Tennessee because it gave DFA

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significant partial ownership interests in two dairies that competed against each other for such contracts. As a result, the acquisition reduced the number of independent bidders for school milk contracts from two to one in 45 school districts in eastern Kentucky, and from three bidders to two in 55 school districts in eastern Kentucky and Tennessee. The federal district court initially dismissed the case, granting summary judgment for DFA. The Department successfully appealed the dismissal to the U.S. Court of Appeals for the Sixth Circuit. After a victory in the court of appeals, the Division announced a settlement in October 2006—negotiated on the eve of a district court trial—that required DFA to divest its interest in Southern Belle Dairy Co., bringing the Division's lawsuit to a successful close.

Syngenta/Advanta

In August 2004, the Division challenged Syngenta's acquisition of Advanta and required Syngenta to divest Advanta's worldwide sugar beet seed business in order to proceed with the acquisition. Syngenta, based in Switzerland, and Advanta, a Dutch company, were two of only three significant developers of sugar beet seeds suitable for growing in the United States. Both companies devoted considerable research and development resources to seed innovation. If the original transaction had been allowed to proceed, American farmers would have lost one of the major innovators for sugar beet seeds. As a result of the divestiture, farmers were able to continue to benefit from the competition that results in lower priced seeds and continued innovation, to produce higher yields and better disease resistance.

Suiza Foods/Dean Foods

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In December 2002, the Division challenged Suiza Foods' proposed acquisition of Dean Foods. In Suiza/Dean, we required Suiza Foods to change its originally proposed acquisition of Dean Foods in two significant ways. First, we required Suiza to divest 11 milk processing plants in 8 states (Alabama, Florida, Indiana, Kentucky, Ohio, South Carolina, Virginia, and Utah) to preserve competition in markets for milk sold at school and at other retail outlets. Second, we required Suiza to modify its supply contract with DFA, which would also own a half interest in National Dairy Holdings, L.P., the new firm to which the processing plants were being divested. This remedy was necessary to ensure that dairies owned by the merged firm in the areas affected would be free to buy their milk from sources other than DFA.

Cargill/Continental

The Division's 1999 challenge to Cargill's proposed acquisition of Continental's grain business is an example of a monopsony case in that farmers (as sellers) would have been the direct victims of the loss of competition that was expected to result from the merger as originally proposed. In Cargill/Continental, the Division protected competition in the purchase of grain and soybeans from farmers in a number of local and regional markets, as well as competition in the futures markets, by requiring Cargill and Continental to divest a number of grain and soybean storage facilities in the Midwest, the West, and the Texas Gulf. The merging parties were not only buyers of grain and soybeans in various local and regional domestic markets, but also sellers of grain and soybeans in the United States and abroad.

While the Division looked at the potential effects on competition in both the "upstream" and "downstream" directions, the challenge was based entirely on concerns

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about effects in the "upstream" market, where Cargill and Continental were buying from farmers. The Division carefully looked at each upstream market that could be affected, and traced the potential effect all the way from the local area in which the farmer grew and sold the grain or soybeans to a local elevator and the place at which Cargill or Continental made its final purchase—in some instances, a distance of over 1,400 miles from the farms in Minnesota to the port elevators in Seattle. The relief in the consent decree was carefully fashioned to address the potential competitive problems in each affected local market.

Finally, in conjunction with our merger enforcement program, we also enforce the pre-merger notification and waiting period requirements of the Hart-Scott-Rodino Act. Our most recent HSR enforcement action is in the meatpacking area, filed in February of 2003 against Smithfield Foods for twice making stock acquisitions of its competitor IBP without notifying the antitrust enforcement authorities and observing the required waiting period to enable an appropriate antitrust review. While the HSR Act exempts from its premerger filing requirements certain stock acquisitions that are "solely for the purpose of investment," the Division's complaint alleged that Smithfield's acquisitions were not exempt because Smithfield was also considering and taking steps toward a Smithfield-IBP combination. In November 2004, Smithfield agreed to pay $2 million for this violation.

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Conclusion

As the above summary of our merger enforcement activities in the agriculture sector reflects, the Antitrust Division regularly has both monopoly and monopsony concerns on our radar screen. When those concerns are present we investigate them fully and, when the facts warrant, we take appropriate enforcement action. The Merger Guidelines set forth the analytical framework for all our merger enforcement, and make clear that a competitive analysis of upstream market effects is to be a mirror image of a competitive analysis of downstream market effects. In both cases, we are looking at whether the merger is likely to create or increase market power, or to facilitate the exercise of market power, in any market; the Merger Guidelines define market power as the ability of a seller or coordinating group of sellers to profitably maintain prices above competitive levels for a significant period of time, or the ability of a buyer or coordinating group of buyers to depress prices below competitive levels and thereby depress output. In addition, price fixing and other forms of collusion are just as unlawful when the immediate victims are sellers rather than buyers.

We listen carefully to the concerns of agricultural producers and producer groups as to how a proposed merger or a course of conduct might affect them, and we are equally concerned if the effect is anticompetitively low prices for products sold (e.g., to farmers) as if it is anticompetitively high prices for products purchased (e.g., by farmers).

I would be happy to answer questions from the Committee.

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WRITTEN TESTIMONY OF
THE ORGANIZATION FOR COMPETITIVE MARKETS
presented to the
UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
May 7, 2008

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

1. Introduction

Thank you Chairman Kohl, and members of the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights, for allowing the Organization for Competitive Markets to submit this testimony for the record. OCM is a multidisciplinary nonprofit organization that focuses exclusively on antitrust and competition problems and solutions in agriculture. Our members consist of farmers, ranchers, academics, policy makers and agricultural businessmen.

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

2. JBS/Swift acquisition

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

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

a. Supply is the number of cattle available in a given week, that are for market.
b. Demand is the number of spaces available in the packing plants for those cattle to fill during that same period.
c. Consumer demand, cattle available next month, feed costs, and other factors are important – but secondary and derivative - to price.

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

A large percentage of slaughter-ready cattle are now committed –via captive supplies - for sale prior to delivery at the market. These oral and written contract commitments are always calculated from market prices determined from the crucial negotiated cattle. Thus, the market

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price, derived from negotiated cattle, directly impacts the contract cattle. The live cattle market price is largely set in the Great Plains feeding region (Kansas, Oklahoma, Colorado, Nebraska and Texas) (See map attached). The price set in the feeding region directly impacts prices for slaughter-ready cattle, and these prices are almost immediately transferred to feeder cattle in all states.

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

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

3. Plant Locations

These are the locations of the five biggest beef packers.

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

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

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

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

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

4. Anti-Competitive Effects

This acquisition is likely to decrease competition for four reasons:

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a. *Buyer Number Reduction*: The number of top-tier national buyers will be reduced from five to three. In the Great Plains region, the number of buyers will be reduced from four to three. A modified auction-style market is the model of bidding.
b. *Captive Supplies*: Partial vertical integration harms current competition and will drive a substantial lessening of competition post-merger. Also, Smithfield's Five Rivers Cattle Feeding company will assist the post-merger firm in depressing price because it will take more than one JBS plant equivalent out of the cash market.
c. *Perishability*: Slaughter cattle must be sold during a two week window. They cannot be stored in a warehouse. Thus, sellers must more often sell at the price packers offer, and have lessened negotiating leverage.
d. *Disparity in power and information*: The few head packer buyers have large market power individually and sophisticated information. The thousands of producers individually have no market power and comparatively little information.

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

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

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

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

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

Farmers and Ranchers in most continental U.S. states will directly feel the effects. Feeder cattle from the West, the South, the Midwest, and the Central U.S. are shipped to the Great Plains to be

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fed out in feedlots. Even if those lighter-weight cattle are sold and shipped elsewhere, the price impacts are the same. Specifically, calves and yearlings are priced in direct relationship to the fed cattle price expected when they are fed out to slaughter weight. If slaughter-ready cattle prices decline, feeder cattle prices decline also.

4. How Cattle Are Sold

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

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

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

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

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

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

When packers have a large number of captive supplies, they need few negotiated cattle. They can force the price lower. The feeders have to either accept the price, or wait one more week. The cattle must be sold within two weeks because they are perishable. If the cattle are kept more than two weeks, they will draw substantial discounts for being overweight or overfat.

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When the price is forced lower, the marketing agreement cattle also receive less money. That is because marketing agreements are mathematically tied to the reported price derived from negotiated cattle.

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

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

5. Feeder Cattle

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

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

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

6. Five Rivers Cattle Feeding Company

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

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

7. Holstein and Cull Cow Markets

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

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

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

8. No Efficiency Benefits or Consumer Benefit

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

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

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

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

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

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

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

10. Other Recent Mergers and DOJ Underperformance

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

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

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

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

The DOJ's handling of the Monsanto-DPL transaction serves as a good case study into the DOJ's failure to prevent significant concentration across the agricultural sector. Monsanto's acquisition of DPL gave the combined firm a 50% market share nationally in cottonseed and up to 75% of that market in certain key regions and also cut off substantial joint development efforts

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between DPL and Monsanto competitors, specifically DuPont and Syngenta. This was only the immediate effect, however. The longer term competitive effect is that the enormous new firm has concentrated the cottonseed and cotton trait markets to the point where it has a chokehold on both, competitors essentially are foreclosed from these markets. This will harm innovation and farmer choice in cotton traits and seed for a long time to come.

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

9. **Conclusion**

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

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

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

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The Honorable Thomas Barnett
Assistant Attorney General
U.S. Department of Justice, Antitrust Division
950 Pennsylvania Avenue, NW
Washington, DC 20530

Re: JBS Swift acquisition of National Beef and Smithfield Beef

Dear Mr. Barnett:

JBS Swift has announced plans to buy National Beef and Smithfield Beef. This is an unprecedented five to three merger that will harm price, choice, innovation and competition in the beef industry. The undersigned signatory organizations ask that your division scrutinize the merger, issue a second request, and strongly consider blocking the deal.

In making this request, we note that many other farm and beef groups, including the Farm Bureau and the National Cattlemen's Beef Association, seek this scrutiny. Given the frequently divergent views of these groups on competition issues, this unanimity of opinion is itself evidence that this merger may well "substantially lessen competition."

The primary focus of our concern is with the buying market for cattle. We also note that reducing the number of major beef processors from 5 to 3 is likely to have adverse effects on consumers as well.

A large percentage of cattle are now committed for sale prior to delivery at the market, such commitments are always contingent on market prices. The live cattle market price is largely set in Kansas, Nebraska and Texas. Most other U.S. markets do not have implications for non-market transactional prices and in fact largely mirror the prices from the Great Plains. Because vertical integration by ownership and contract is strong across the country, there is a diminished volume of cash market purchases that set the base prices for all transactions. Vertical integration includes all cattle committed to packers more than 14 days in advance of slaughter. Vertical integration includes packer owned cattle, contracted cattle, and "relationship" cattle.

"Contracted cattle" include formula contracts, forward contracts and relationship cattle. Formula contracts are written or oral arrangements whereby packers have a commitment from producers to deliver at a price set in a mathematical relationship to the reported price of the week. That reported price is from Kansas, Texas or Nebraska, as the case may be. Forward contracts are priced from the futures market - packers acquire rights to cattle by offering a contract with prices set in relation to the nearby futures contract, but with additional negotiated elements.

"Relationship cattle" are those in which the packer typically takes the cattle based upon a formula understanding over a long period of time. Hence, these cattle are effectively committed to a packer because no other packers bid.

Captive supplies "concentrate" the traditional problems of horizontal concentration at the present, or post-acquisition level. The remaining buyer market power can be exerted through a

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company decision to increase the number of captive supply arrangements offered, with mathematically precise impacts on price. That math has been shown in the Picket vs. Tyson litigation, in several academic publications, in the offices of packer buyers, and in the February 2007 USDA Research Triangle Institute report.

The USDA price reporting data does not adequately track these true market dynamics. Packers need not, and do not, report oral arrangements as captive supplies. But the actual market effect is that fewer cattle are traded on the open market, there is lower trading volume, price volatility increases because the open market cattle prices are buffeted by packer decision making on price, shift shut-downs, and mere market rumors.

In the Pickett v. Tyson case, which went to verdict in Montgomery, Alabama in 2004, it was revealed that Tyson bought less than 35 percent of its cattle on the open market in 2002. We believe the open market, competitive bid percentage of cattle industry wide is less than 35% today.

Nationwide, the five major packers have the "checkbooks" that are available to buy cattle. Each company has a similar daily cattle buying method. Field buyers tour the feedlots to gain information on the cattle volume available for sale that week, and to gain information on other price relevant data. All field buyers participate in a conference call with the company's head buyer three to four times per day. The head buyer makes all decisions about slaughter cattle acquisitions on a daily basis. Multiple plants do not matter. One person makes the decisions for the whole company.

Other plants buy cattle, and some have enough size to be periodically meaningful, but they are not market makers. (Greater Omaha, Nebraska Beef, and Premium Protein in Nebraska, for example.) This combination will eliminate two of those national buyers and will increase vertical integration because Swift will now control Smithfield's substantial feeding operations that are proximate to its slaughter houses. This will drive prices down for all feeders of cattle.

The greatest geographic competitive concern comes in the overlapping procurement areas of JBS and National in Colorado, Kansas, and Oklahoma. Today, only the biggest feedlots have three buyers. Most feedlots are lucky to have one buyer. The number of "active buyers" is the key. One active buyer will be eliminated in this region. The Kansas, Nebraska, Texas reported price will go down. It will not go up and it will not stay the same.

It is not economical for feeders to ship live cattle more than 250 miles. Feedlot producers report that this distance is not exceeded because one market weight animal is required to pay for the trucking 250 miles to a plant. A larger cost is unrealistic. Hence the elimination of a major competing buyer in the region will directly affect the prices paid on all sales in the region and will have a ripple effect as those lower prices get factored into formulas and market prices in other regions.

No efficiencies or benefits will arise from this acquisition. Each of the enterprises is substantially larger than necessary for efficient operation and National is already a leading exporter of beef even though it ranks fourth in volume. New entry requires extraordinary

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amounts of cash and liquidity to compete beyond a niche level. Indeed, the current configuration of the Smithfield beef operation makes it a uniquely positioned potential entrant into direct competition in the Texas, Kansas, Nebraska region (especially in light of its substantial feeding operations in the region) and as a result it may well exercise a "wings" effect on competition in that region as well as being a future actual competitor whether under its current ownership or some other owner. Beef packing is a mature industry in which competition must be preserved.

Please give credence to these buyer power concerns, scrutinize the acquisition and issue a second request. Thank you.

Signatory Organizations:

- National Campaign for Sustainable Agriculture
- Organization for Competitive Markets
- Western Organization of Resource Councils
- Ladies of Charity of Chemung County NY
- Church Women United of Chemung County NY
- Church Women United of New York State
- Chemung County Council of Churches,
- NY Court St Joseph #139, Catholic Daughters of the
- Americas,
- Corning/Elmira NY Past Regents' Club of the Diocese of Rochester NY
- St John the Baptist Fraternity,
- Secular Franciscan Order, Elmira NY
- Horseheads Grange #1118, Horseheads NY
- Pomona Grange #1, Chemung County NY
- Powder River Basin Resource Council
- American Corn Growers Association
- Illinois Stewardship Alliance
- Farm Fresh Rhode Island
- Missouri Rural Crisis Center
- North Carolina Contract Poultry Growers Association
- Alabama Contract Poultry Growers Association
- Appalachian Crafts
- Michigan Farmers Union
- Delta Land and Community
- Iowa Farmers Union
- Tilth Producers of Washington
- Independent Cattlemen of Wyoming (ICOW)
- Food and Water Watch
- R-CALF USA
- Montana Farmers Union
- Dakota Resource Council
- Perkins County Livestock Improvement Assn.
- Campaign for Contract Ag Reform
- Presbyterian Church U.S.A. Washington, D.C.
- South Dakota Stockgrowers Assn.
- McKenzie County Energy & Taxation Association (MCETA)
- Center for Rural Affairs
- Kansas Cattlemen's Association
- Institute for Agriculture & Trade Policy
- Pennsylvania Farmers Union
- National Contract Poultry Growers
- Cornucopia Institute
- American Agriculture Movement
- Sustainable Agriculture Coalition
- National Family Farm Coalition
- Dakota Rural Action
- Ohio Farmers Union
- Indiana Farmers Union

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Organization for
Competitive Markets

August 7, 2007

Donna N. Kooperstein
Chief, Transportation, Energy & Agriculture Section
Antitrust Division
United States Department of Justice
325 Seventh Street, NW, Suite 500
Washington, DC 20530
Via fax (202-307-2784) and U.S. Mail

RE: United States v. Monsanto Company, et al., Case No. 1:07-cv-00992 (D.D.C., filed May 31, 2007) (Urbina, J.)

Dear Ms. Kooperstein:

The Organization for Competitive Markets ("OCM") is an independent, nonpartisan, and nonprofit group comprised of farmers, ranchers, academics, attorneys, and policymakers dedicated to preserving and protecting competitive markets in agriculture. The OCM submits these comments pursuant to the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16, to register its objections to the Department of Justice's ("DOJ") proposed final judgment ("PFJ") regarding the acquisition by Monsanto Company ("Monsanto") of Delta and Pine Land Company ("Delta and Pine"), the largest cotton seed company in the United States. With agricultural consolidation and concentration occurring at an unprecedented rate, OCM is disappointed that the DOJ has once again failed to preserve competition and protect American farmers and consumers.

Monsanto's acquisition of Delta and Pine promises to substantially damage transgenic seed trait competition in cotton. Farmers throughout this country are being harmed by Monsanto's aggressive tactics aimed at denying them competitive alternatives. As the DOJ acknowledged in its complaint, Monsanto is the largest producer and supplier of cotton transgenic seed traits in the United States. Monsanto controls over 96% of the market for herbicide-tolerant cotton traits and approximately 99% of the market for insect-resistant cotton traits. Monsanto has used its monopoly power to impose significant price increases on cotton farmers, including a 229% increase in Monsanto's Roundup Ready® herbicide-tolerant trait over the past four years. The technology fees Monsanto charges farmers for its traits accounts for more than 50%, and sometimes even as much as 70%, of the cost of a bag of seed. These statistics illustrate the extent to which greater competition is needed in the cotton transgenic seed trait market where farmers are struggling under the weight of Monsanto's dominance.

Together with its separate joint development partners, Delta and Pine offers the best hope of breaking Monsanto's monopoly in cotton transgenic seed traits. As the DOJ indicated in its complaint, Delta and Pine is an attractive joint development partner because of its extensive germplasm library, personnel and facilities, and superior track record of breeding success. Also, Delta and Pine's high market shares make it an indispensable vehicle for competing trait developers to distribute their competing cotton biotech traits to farmers.

By acquiring Delta and Pine, Monsanto will be positioned to undermine these joint development efforts, close the distribution channel for competing traits, and thereby solidify its monopoly position. The DOJ's own complaint and PFJ clearly acknowledge the very significant anticompetitive effect of Monsanto's acquisition of Delta and Pine on the future development of

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competing cotton traits. Yet the DOJ's proposed remedy to cure these anticompetitive effects - divestiture of Stoneville plus providing Stoneville nonexclusive access to 20 lines of germplasm and certain Monsanto cotton germplasm lines - is woefully inadequate and does not restore competition.

First, Stoneville simply lacks the required infrastructure and expertise to challenge Delta and Pine. Second, the "divestiture" to Stoneville of 20 lines of Delta and Pine germplasm does little to enhance Stoneville's capabilities. Putting aside that it is not even a true divestiture, these 20 lines are either in development and not commercially viable or account for only about 1% of the cotton acres planted in the Southeast and MidSouth. Plus, ongoing germplasm line improvements mean that old lines quickly become obsolete. Even if Stoneville is eventually capable of bringing competing biotech traits to market, the DOJ acknowledges that it will take 8-15 years for them to be commercially viable. By then, it will simply be too late and Monsanto's hegemony in transgenic seed traits will have been cemented permanently. Third, because Monsanto will have more than a 50% post-acquisition share of the highly concentrated cotton seed market, competing trait developers may well lack the incentive to continue their efforts due to a lack of non-Delta and Pine outlets through which to license their traits.

Monsanto's acquisition of Delta and Pine also promises to have harmful spillover applications to other agricultural crops vital to our national economy. With Delta and Pine under Monsanto's control, competing trait developers will be foreclosed from market opportunities that would provide them with necessary revenue to justify the significant research and development costs associated with the development of competing traits in cotton and other crops. Encouraging and promoting alternative, competing transgenic seed traits is especially critical in key crops like corn and soy, where Monsanto already controls more than 95% of the market for herbicide-tolerant corn traits, more than 80% of the market for insect-resistant corn traits, and over 98% of the market for herbicide-tolerant soybean traits. Unless competition is preserved, Monsanto will soon be able to eliminate competition in the trait markets, to the detriment of farmers and consumers everywhere.

Promoting and preserving competition and choice in transgenic seed traits is critical to ensuring the success of the vitally important agriculture sector of the national economy. If the PFJ is approved, the opposite will occur -- Monsanto's acquisition of Delta & Pine will lead to diminished competition, fewer choices, and higher prices for farmers and consumers.

Respectfully,

Keith Mudd,
President

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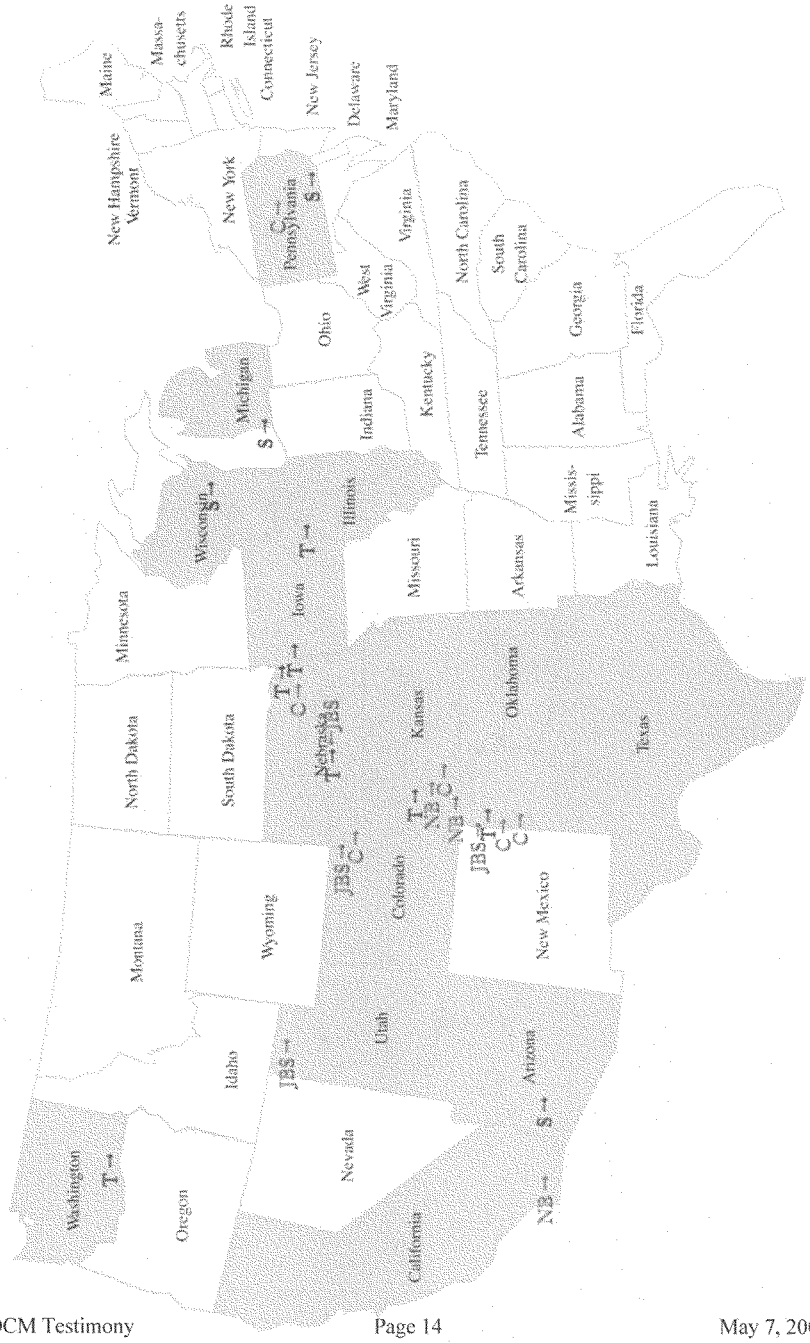

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United States Senate

WASHINGTON, DC 20510

The Honorable Michael B. Mukasey
Attorney General
U.S. Department of Justice
1150 Pennsylvania Avenue NW Room 1145
Washington, DC 20530

Dear Attorney General Mukasey,

We are writing today to express our concern with a proposed acquisition in the cattle industry that will come before the Department of Justice for review and approval. The Brazilian beef company JBS last week announced plans to acquire two U.S. beef processors, thereby becoming the largest domestic processor and further limiting market access for independent beef producers through consolidation. We are deeply concerned about the antitrust implications of the acquisition, as well as its impact on competitive market access for small and independent beef producers.

As you are aware, last year JBS established a foothold in the U.S. by acquiring the Swift Company. This made JBS the third-largest beef processor in the U.S. and the largest beef processor on the globe. This new acquisition would add the fourth and fifth largest U.S. cattle processors to its existing assets by adding National Beef Packing Co., and Smithfield's beef division.

The activities of three buyers of the third, fourth, and fifth largest beef processors colluding would be devastating to the cattle market. The day before this acquisition takes place, if three buyers from Swift, National, and Smithfield were to discuss their plans to buy cattle, they would be violating the antitrust laws against collusion providing grounds for prosecution. On the day after such acquisitions, the same three buyers could meet without breaking the law, but the consequences to the cattle market would be the same.

This acquisition will result in the number of domestic beef processors declining from five to three. In most parts of the country, beef producers only have ready access to one beef processor and are usually confronted with take it or leave it deals for their captive supply of cattle. It is less common for ranchers to have access to two or even three processors. This acquisition would further constrain ranchers by limiting the number of buyers for their product.

The Department of Justice is charged with guarding the public from mergers and acquisitions that would create monopolistic entities. The proposed acquisition would give JBS Swift control of roughly one third of the domestic market and a monopoly in many areas of the country. We urge you to carefully consider the implications of this merger on the cattle market and the consequences it will have on beef producers who want nothing more than a fair and open marketplace for their product.

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Sincerely,