Fighting for the U.S. Cattle Producer!
R-CALF USA

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Federal Trade Commission
Office of the Secretary, Room H-135 (Annex P)
600 Pennsylvania Avenue NW,
Washington, DC 20580

Sent Via Electronic Mail

Re: HMG Review Project – Comment, Project No. P092900: Comments on the Revisions to the Horizontal Merger Guidelines

Dear Sir or Madam:

The Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America ("R-CALF USA") appreciates this opportunity to submit comments to the Federal Trade Commission and the U.S. Department of Justice (the "Agencies") concerning possible revisions to the Horizontal Merger Guidelines.

R-CALF USA is a non-profit association that represents thousands of U.S. cattle producers in 46 states across the nation. R-CALF USA works to sustain the profitability and viability of the U.S. cattle industry, a vital component of U.S. agriculture. R-CALF USA's membership consists primarily of cow-calf operators, cattle backgrounders, and feedlot owners. Various main street businesses are associate members of R-CALF USA.

In addition to its support of the comments simultaneously filed in this matter by David A. Balto, Attorney at Law, R-CALF USA will provide cattle-industry specific comments and recommendations that further support the need for revisions to the Horizontal Merger Guidelines ("Guidelines").

A. The Guidelines Should Require an Evaluation of the Preexisting Competitiveness of the Marketplace as a Part of the Analytical Process to Determine Whether to Challenge a Merger

The Guidelines contemplate that the baseline for determining the potential competitive effects of a proposed merger is the preexisting market environment and market structure prior to the consummation of a proposed merger. Thus, the inherent presumption created by the Guidelines is that the preexisting marketplace is competitive and the acts and practices carried out by the marketplace participants therein are not in violation of antitrust laws. In today's cattle industry market, however, this presumption cannot be supported.

Experts warned several years ago that concentration levels in the U.S. meatpacking industry were already among the highest of any industry in the United States. Oklahoma State University Economist Clement Ward stated in 2001 that this concentration was "well above levels generally considered to elicit non-competitive behavior and result in adverse economic performance,"[1] and the U.S. Government Accountability Office stated with respect to this concentration in 2002 that "no other manufacturing industry showed as large an increase in concentration since the U.S. Bureau of Census began regularly publishing concentration data in 1947."[2] Notwithstanding these warnings, however, additional mergers have been consummated in the U.S. cattle industry market, presumably pursuant to an evaluation in conformity with the Guidelines.[3]

To address the reality that the cattle industry market has already succumbed to unprecedented concentration and to avoid basing competition-related decisions on the unsupported presumption that the current cattle industry market is void of antitrust concerns, the Guidelines should be revised to specifically require an evaluation of the preexisting competitiveness of the marketplace as a part of the analytical process to determine whether to challenge a horizontal merger. In support of this recommendation, it is noteworthy that the U.S. Department of Agriculture ("USDA") in 1996 was unable to conclude that the U.S. cattle industry is competitive in light of the ongoing structural changes that included concentration in the meatpacking industry and greater use of marketing agreements and forward contracts.[4] Unless a determination is first made regarding the extent to which a marketplace is competitive, the assessment of a merger's potential to lessen competition would be perfunctory at best.

B. The Guidelines Should Require an Independent Evaluation to Assess the Potential Competitive Effects Within Each of the Competing Segments Within the Beef Market and the Identification of the Various Sources of Market Power that May Be Facilitated by a Particular Merger

The structural changes that have occurred recently in the U.S. cattle industry have blurred significantly the distinctions between the competing entities participating in the U.S. beef supply chain (or beef market). For example, the beef market is highly complex and consists of three basic components: raising and feeding live cattle, beef processing and packing, and domestic consumption through retail outlets and the hotel, restaurant, and institution sector.[5] The live cattle segment of the beef market is itself a distinct agricultural industry according to the North

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[1] 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.
[2] Economic Models of Cattle Prices, How USDA Can Act to Improve Models to Explain Cattle Prices, Government Accountability Office (formerly Government Accounting Office), GAO-02-0246, March 2002, at 51.
[3] *See*, e.g., the merger between JBS S.A. and Smithfield Beef Group consummated in 2008.
[4] Economic Models of Cattle Prices, How USDA Can Act to Improve Models to Explain Cattle Prices, Government Accountability Office (formerly Government Accounting Office), GAO-02-0246, March 2002, at 49, 50 ("This report also stated that while the body of evidence from the literature was insufficient to support a finding of noncompetitive behavior, GIPSA also could not conclude that the industry is competitive.").
[5] *See* Global Beef Trade: Effects of Animal Health, Sanitary, Food Safety, and Other Measures on U.S. Exports, U.S. International Trade Commission, USITC Publication No. 4033, September 2008, at 3-1.

American Industry Classification System ("NAICS"),[6] and annually is a $50 billion industry.[7] In contrast, the beef processing and packing segment of the beef market is not an agricultural industry, but rather, is classified by NAICS as a distinct manufacturing industry.[8] In today's cattle industry, the manufacturing sector (i.e., the beef processors and packers) has, through direct purchase and/or various forms of marketing agreements and forward contracts, increased its control over the live cattle sector, thus blurring the distinctions between the various participants competing in the beef market.

Although the three separate and distinct industries that comprise the beef market are interdependent, they also are each in competition with the other to capture their respective, competitive share of each dollar that a consumer spends on beef. However, the blurring of the distinction between the manufacturing and live cattle segments has effectively insulated those manufacturers that have gained control over the live cattle industry from the same level of competition still faced by those in the live cattle segment that continue to compete as an independent, though interrelated, segment of the beef market. As a result, a horizontal merger within the industry would have a disproportionate impact on the live cattle segment that faces a higher level of competition for the competitive allocation of the consumers' beef dollar when compared to those manufacturers that have insulated themselves from such higher-level competition.

In order to reflect a public policy goal of preserving competition for, and the competitiveness of, each of the three beef market components, the Guidelines must be revised to ensure that an independent evaluation is conducted to assess the potential competitive effects within each of the competing segments within the beef market. If this is not done, the agencies may erroneously and unwittingly conclude that a merger with potentially devastating consequences to competition for some of the 757,900 [9] remaining participants in the live cattle industry would have no adverse effect on the competitiveness of the entire beef market. To elucidate this concern, we offer the following scenario:

A horizontal merger between a major beef packer and a major, vertically integrated pork processor would not be expected to harm consumers unless the merger involved sufficient market share to facilitate monopoly pricing. However, should the merger enable the merged firm to significantly increase pork production, and if such an increase in pork production were to

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[6] *See* 2007 NAICS Codes and Titles, U.S. Census Bureau, available at http://www.census.gov/naics/2007/NAICOD07.HTM. (The NAICS codes include: Cattle Feedlots (112112), Cattle Farming and Ranching (1121), Agriculture, Forestry, Fishing and Hunting (11.).

[7] *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 (Though the sale of cattle and calves has historically been the leading sector in U.S. agriculture, generating approx. $50 billion annually, an anomaly occurred in 2008 when the corn sector surpassed the live cattle sector. This anomaly is not expected to recur in 2009.).

[8] *See* 2007 NAICS Codes and Titles, U.S. Census Bureau, available at http://www.census.gov/naics/2007/NAICOD07.HTM. (The NAICS codes for the listed industries are: Animal Food Manufacturing (3111), Food Manufacturing (311) and Manufacturing (31-33.).

[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 (757,900 represents the number of remaining beef cattle operations.).

reduce live cattle prices, then live cattle producers would experience prices lower than what a competitive market would predict [10] – for no reason other than the unilateral decision by the merged firm to increase pork production. Under this scenario, the merged firm likely would sell more pork at perhaps somewhat lower prices, consumers could choose to continue purchasing beef or switch to relatively lower-price pork for their protein needs, and live cattle producers would be forced to withstand lower prices for their cattle.

In the foregoing scenario, the buying power used to reduce cattle prices is not a conventional form of market power and likely would not be discovered by following the current analytical process described in the current Guidelines. Here, the ability to lower cattle prices is gained from having complete control over the output of a competing, substitute meat product. This scenario highlights the need for the Guidelines to require the identification of the various sources (i.e., the nature) of market power that may be facilitated by a horizontal merger.

C. The Guidelines Must Recognize and Incorporate Historical Indicators of Industry Competition and Competitiveness

If the Guidelines are to preserve competition for, and the competitiveness of, each of the three beef market components, then they must recognize the historical indicators that have evinced the presence of competition within the respective industry components, and the potential impact a merger likely would have upon those indicators must be weighed. For example, the bellwether indicator of competitiveness within the live cattle industry was the live cattle cycle. The cattle cycle has historically occurred every 10-12 years.[11] In 2002 USDA acknowledged that "the last cycle was 9 years in duration; the present cycle is in its thirteenth year, with two more liquidations likely."[12] 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."[13] In February 2008 the USDA attributed a similar disruption that occurred 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."[14] This

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[10] Studies show that pork and beef are competing proteins: *See*, e.g., Improved Beef Demand Benefits Nebraska Cattle Producers, Cornhusker Economics, Institute of Agriculture & Natural Resources, Department of Agricultural Economics, University of Nebraska – Lincoln, September 27, 2000 ("Pork and poultry are generally considered substitute sources of protein for beef."). Studies show also that increased volumes of competing proteins will reduce cattle prices: *See*, e.g., Livestock, Dairy and Poultry Outlook, USDA-ERS, LDP-M-120 (June 17, 2004), at 9 ("Given the present strength in the fed cattle market . . . increased supplies of competing meats . . . would push breakevens into the red quickly."), available at http://www.ers.usda.gov/publications/ldp/jun04/LDPM120T.pdf; *see also* Livestock, Dairy, and Poultry Outlook, USDA-ERS, LDP-M-139 (Jan. 19, 2006), at 7 ("Improved grading prospects and larger number of cattle on feed will pressure the market, as will larger supplies of competing meats at relatively lower prices.").

[11] *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.

[12] 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.

[13] 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.

[14] 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.

"dramatically" changed structure includes the consolidation of the industry, where "fewer and larger operations account for an increasing share of total output."[15]

The recently acknowledged disruption of the historical U.S. cattle cycle is a bellwether indicator that competition has lessened in the U.S. live cattle industry; and, as the USDA now concludes for the analogous hog industry cycle disruption, there is a relationship between this phenomenon and a changed industry structure that is marked by increased consolidation.

R-CALF USA would encourage the inclusion of such historical indicators of competition and competitiveness in the Guidelines along with the requirement that an analysis of the likely impact a potential merger would have on those historical indicators be conducted.

D. To Protect the U.S. Cattle Industry from Antitrust Activities, Fundamental Reforms Must be Made to the Guidelines

Unfortunately, the Guidelines are ill-suited to evaluate and analyze the anticompetitive effects of mergers within the U.S. livestock industry. During much of the period in which the Guidelines were in effect, the manufacturing segments of the meat market reached unprecedented levels of concentration and literally hundreds of thousands of livestock production businesses exited the industry. For example, USDA data show that 90 percent of the U.S. hog farming operations in existence in 1980 are gone from the industry today. From 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 operations declined from 667,000 in 1980 to only 67,000 in 2005,[16] and there are even fewer today. During this same period, the four-firm concentration ratio for steer and heifer slaughter increased from 35.7 percent to 81.1 percent, and over 600,000 U.S. cattle operations exited the industry.[17] These data provide no support for the assertion that the Guidelines have helped, in any way, to protect U.S. livestock producers from antitrust activities and anticompetitive practices in the market.

Thus, fundamental reforms to the Guidelines are needed to restore a competitive livestock market for independent livestock producers. And, the first step in the review process for the Guidelines must be to evaluate the unique characteristics of the livestock industry and determine the unique susceptibility of livestock to various forms of adverse market power, particularly monopsony power. The unique characteristics 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.[18]

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[15] 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.
[16] *See* Federal Register, Vol. 72, No. 152, Wednesday, August 8, 2007, at 44,681, col. 2.
[17] *See id*.
[18] 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.

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.[19]

3. Feasibility of transporting cattle long distances decreases as cattle approach slaughter weight. Research has 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.[20]

For cattle markets:

1. 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.[21] Thus, competition for slaughter-ready cattle is inherently fragile.

2. 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 "each 1 percent increase in fed cattle numbers would be expected to decrease fed cattle prices by 2 percent."[22]

3. 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.[23] 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%.[24]

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[19] 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.
[20] Examining Packer Choice of Slaughter Cattle Procurement and Pricing Methods, Oral Capps, Jr., et al., Agricultural and Resource Economics Review, April 1999, at 16.
[21] 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.
[22] 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.
[23] *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.
[24] *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.

4. 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.[25]

5. 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"[26] 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. . ."[27]

6. 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.[28] 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.[29] 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 by 3.18 percent.[30] Based on this research, any additional concentration in the cattle industry, 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.

7. 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.[31] Included among the deficiencies found was the exclusion of a large percentage of cattle transaction data.[32]

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[25] *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).
[26] 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.
[27] *Id.* at 2-36.
[28] Examining Packer Choice of Slaughter Cattle Procurement and Pricing Methods, Oral Capps, Jr., et al., Agricultural and Resource Economics Review, April 1999, at 16.
[29] *Id.*, at 16.
[30] Examining Packer Choice of Slaughter Cattle Procurement and Pricing Methods, Oral Capps, Jr., et al., Agricultural and Resource Economics Review, April 1999, at 21.
[31] 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).
[32] *Id*., at 10.

8. 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.[33] 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."[34] Based on this finding, U.S. live cattle producers would likely be defenseless against any increased monopsony power that would be expected should any additional mergers take place in the excessively concentrated cattle industry.

9. Given the long-run lack of profitability in the U.S. live cattle industry, very small changes in cattle prices would likely accelerate the already shrinking number of independent U.S. cattle producers. 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."[35] 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."[36]

E. Conclusion

R-CALF USA appreciates the opportunity to submit these comments and would look forward to any future opportunity to provide additional information to the Agencies regarding the U.S. cattle industry.

Sincerely,

Bill Bullard
CEO

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[33] 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.
[34] *Ibid*.
[35] Packer Concentration and Packer Supplies, Clement E. Ward, Oklahoma Cooperative Extension Service, AGEC-554, at 554-5.
[36] 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.