



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,<sup>1</sup>

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

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.

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:

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

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 known as the SSNIP test (Small but Significant Non-transitory Increase in Price)<sup>2</sup>. 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

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<sup>2</sup> See Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, Revised April 8, 1997.

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<sup>3</sup>) of mid-sized and smaller packers was greater than the profitability of the four largest meatpackers.<sup>4</sup> 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.<sup>5</sup> 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

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<sup>3</sup> 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”).

<sup>4</sup> *Id.*, at 52, 56.

<sup>5</sup> *Id.*

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. Alarming, 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."<sup>6</sup> 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."<sup>7</sup>

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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<sup>6</sup> 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").

<sup>7</sup> *Id.*

- 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 intends 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:**

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.”<sup>8</sup> The GAO also revealed in 2002 that even as long ago as 1996, GIPSA could not conclude that the beef packing industry was competitive.<sup>9</sup> 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.<sup>10</sup>

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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<sup>8</sup> 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.

<sup>9</sup> *See id.* at 50.

<sup>10</sup> 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.

**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.<sup>11</sup> 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.<sup>12</sup> Since that time the HHI exceeded 2,000 during several years, while the 4-firm concentration ratio remained at about 80 percent.<sup>13</sup> 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<sup>14</sup> – a condition that DOJ merger guidelines suggest would presumptively “likely create or enhance market power or facilitate its exercise.”<sup>15</sup> 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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<sup>11</sup> *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.

<sup>12</sup> Exhibit D, at 44.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, Revised April 8, 1997, at 16.

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.<sup>16</sup> 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.<sup>17</sup> 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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<sup>16</sup> Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, Revised April 8, 1997, at 18.

<sup>17</sup> See Written Testimony at 7 (this calculation is based on the annual slaughter of 27 million steers and heifers).

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.<sup>18</sup> 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.<sup>19</sup> Of these remaining cattle operations with 100 to 499 head of cattle, only 72,855 – less than half – are beef cattle operations.<sup>20</sup> 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<sup>21</sup> – 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:<sup>22</sup>

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<sup>18</sup> For 2007 data see Farms, Land in Farms, and Livestock Operations 2007 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, February 2008, at 15.

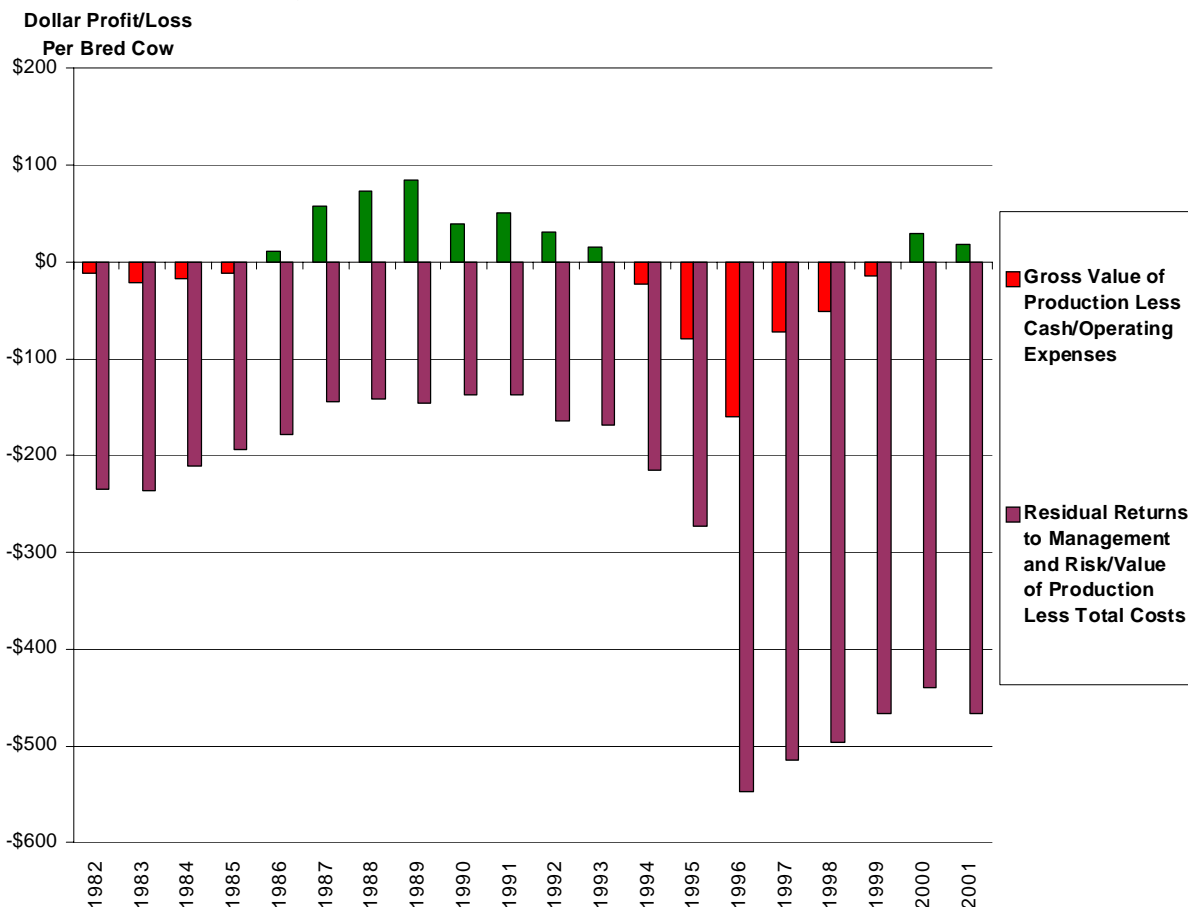
<sup>19</sup> For 2007 data see Farms, Land in Farms, and Livestock Operations 2007 Summary, U.S. Department of Agriculture, National Agricultural Statistics Service, February 2008, at 16.

<sup>20</sup> *Id.*, at 20.

<sup>21</sup> 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](http://www.fas.usda.gov/psd/complete_files/LP-0111000.csv).

<sup>22</sup> 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.

## Average Returns to U.S. Cow/Calf Producers



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:**

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<sup>23</sup>) of mid-sized and smaller packers was greater than the profitability of the four largest meatpackers.<sup>24</sup> 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.<sup>25</sup> 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.<sup>26</sup>

<b>Beef Packer Operating Income as a Percent of Sales (GIPSA/USDA data) by Size</b>				
<b>Time Period</b>	<b>Big Four</b>	<b>5th to 8th</b>	<b>9th to 20th</b>	<b>21st to 40th</b>
2006	-0.2	2.3	2.22	5.42
2005	0.92	1.69	4.47	3.51
<b>Average 1992- 2006</b>	<b>1.46</b>	<b>2.34</b>	<b>3.86</b>	<b>1.77</b>

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.

<sup>23</sup> Exhibit D, at 6.

<sup>24</sup> *Id.*, at 52, 56.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*, at 56.

### **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.<sup>27</sup> 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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<sup>27</sup> 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”).

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,

A handwritten signature in blue ink, appearing to read "Bill Bullard", with a stylized flourish at the end.

Bill Bullard  
CEO, R-CALF USA

Attachments: Exhibits A-F