

Fighting for the U.S. Cattle Producer!



R-CALF

USA

**Presentation to the U.S. Department of Justice, Antitrust
Division, Washington, D.C.**

***Market Failure in the U.S. Cattle Industry: An Overview of the
Effect of Ongoing Antitrust Activities and Anticompetitive
Practices***

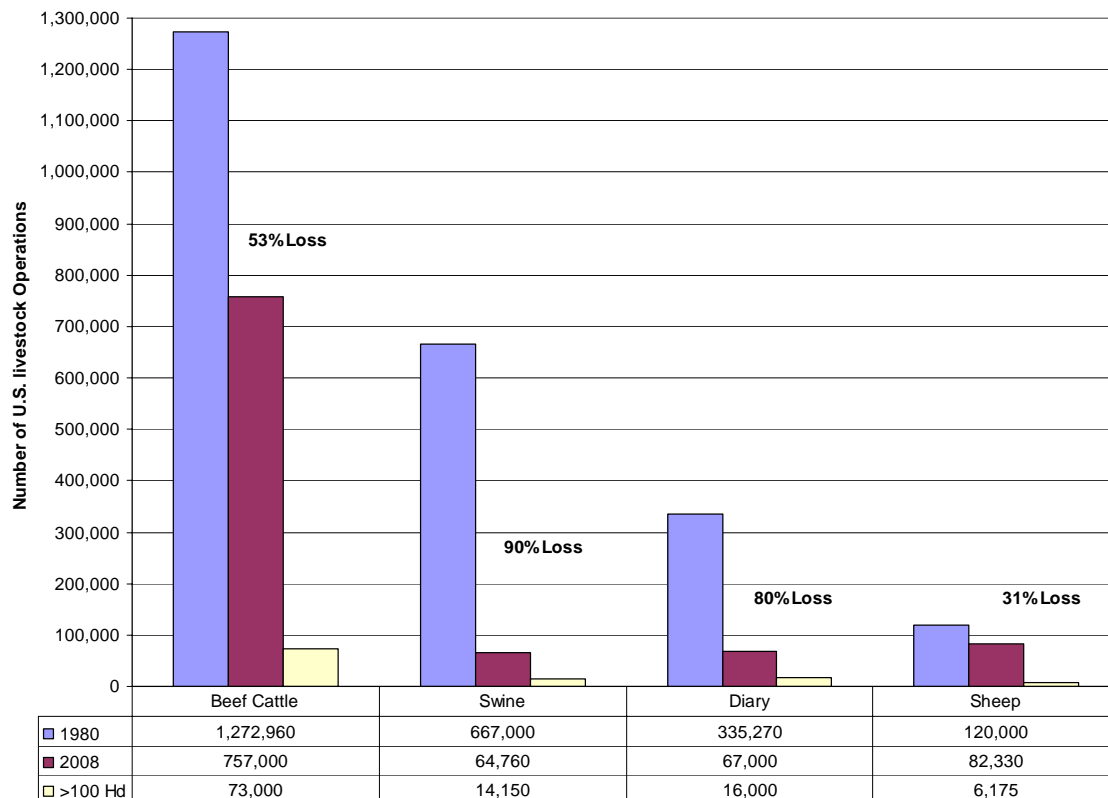
Presented by

Bill Bullard, CEO, R-CALF USA

July 30, 2009

The Entire U.S. Livestock Industry Is in a Severe State of Crisis!

Loss of U.S. Livestock Operations 1980-2008



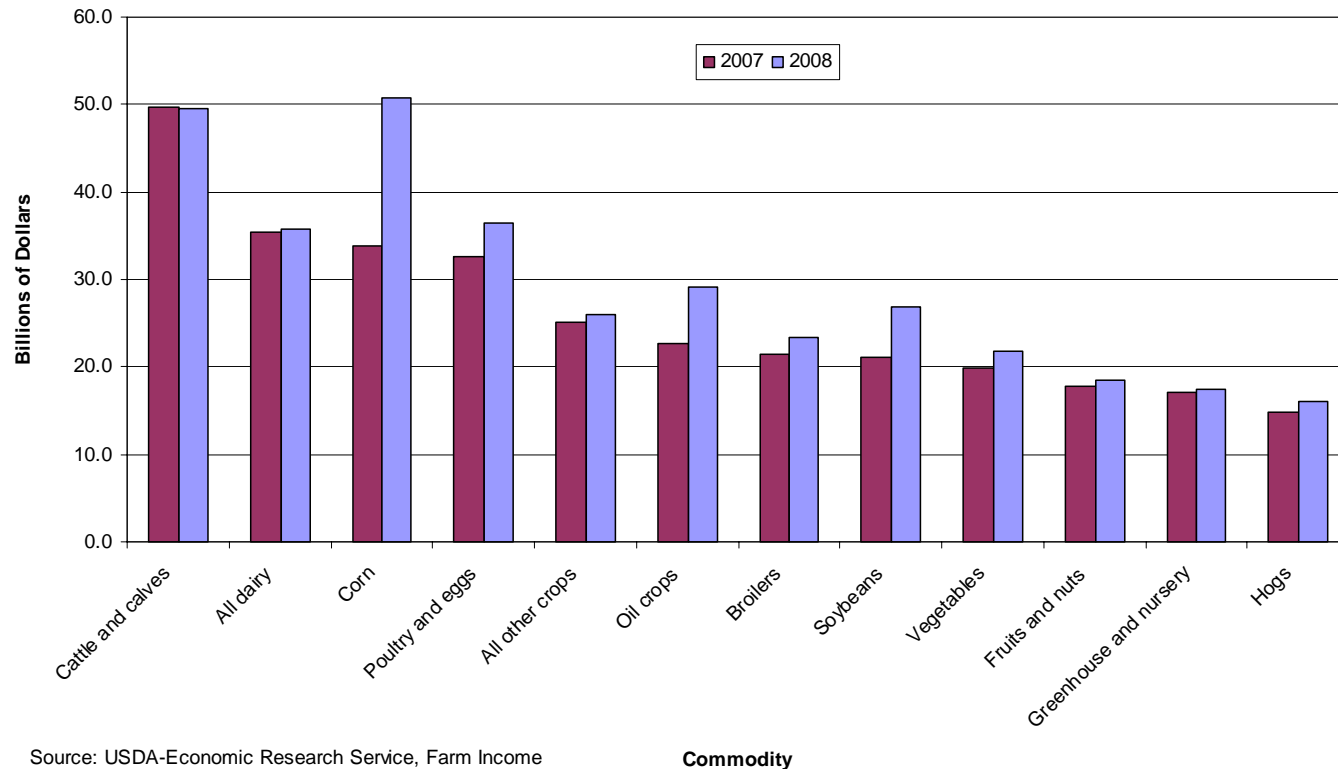
Source: USDA-NASS

Type of Livestock Operations

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Cattle Industry Was Largest Sector of U.S. Agriculture Until 2008

TOP 12 U.S. AGRICULTURE COMMODITIES



Source: USDA-Economic Research Service, Farm Income

Commodity

12 States Each Generate Over \$1 Billion in Cattle and Calf Sales

• Nebraska	\$7.1	• California	\$1.8
• Texas	\$6.9	• S. Dakota	\$1.7
• Kansas	\$6.2	• Missouri	\$1.2
• Colorado	\$3.0	• Idaho	\$1.2
• Iowa	\$2.9	• Minnesota	\$1.1
• Oklahoma	\$2.4	• Montana	\$1.0
		• 2008 Total:	\$36.5

Today's U.S. Cattle Industry

4 Beef Packers Slaughter
Approx. 88 % of All Fed
Cattle in the U.S.

Slaughtered 34.4 Million
Cattle in 2008, Including 1-2
Million Imports

2,170 Feedlots Fed Approx. 90 %
of All Fed Cattle in the U.S. in 2008

80,000 Farmer Feeders in 2008
(Reduced from 85,000 in 2007)
Fed Approx. 10 % of
All Fed Cattle in the U.S

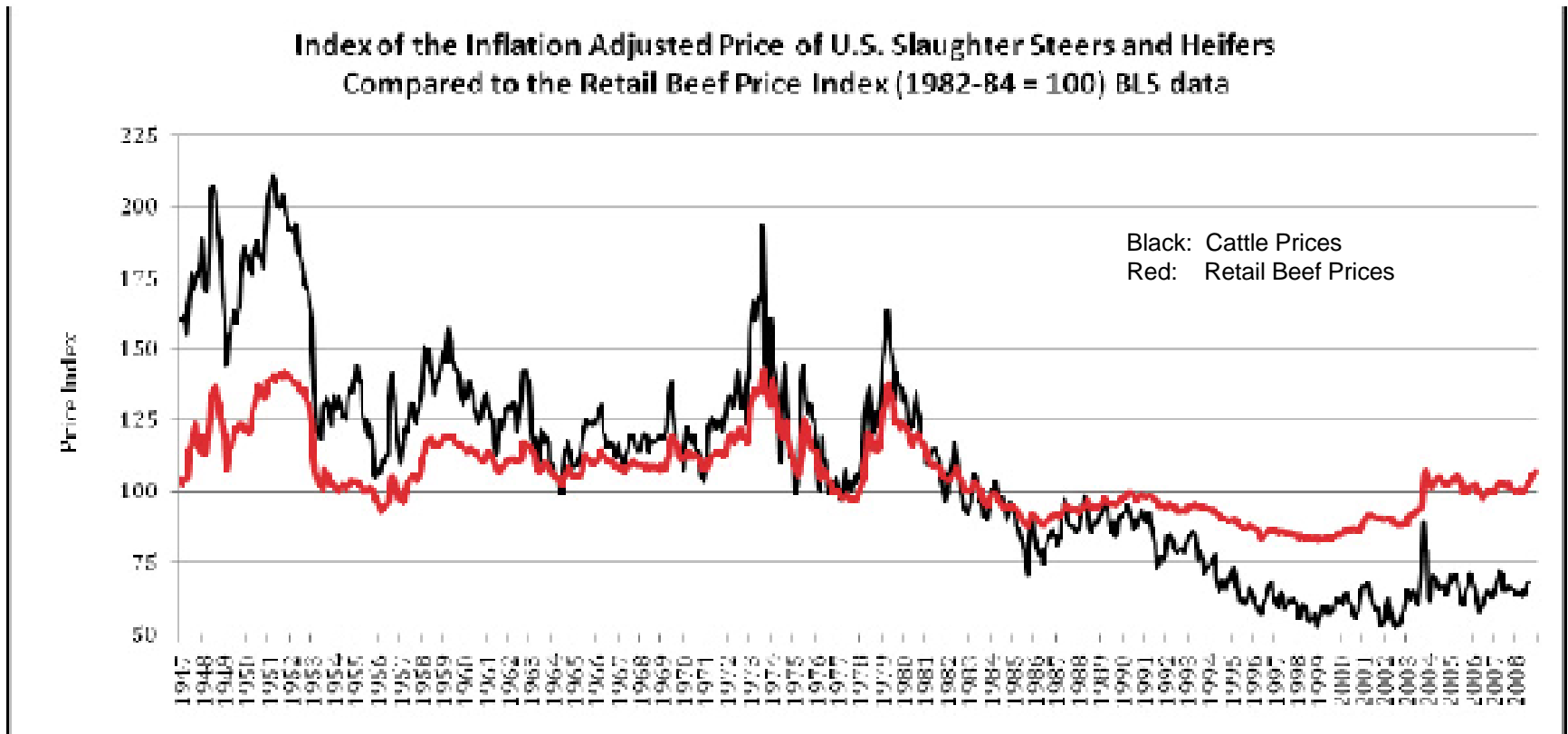
Produced 36 Million
Cattle (calves) in 2008

956,500 Remaining Total Cattle Operations
in 2008, including 757,000 Beef Cattle
Operations

U.S. Cattle Operations have been Exiting the Industry at a Rate of 19,000 Per Year Since 1996

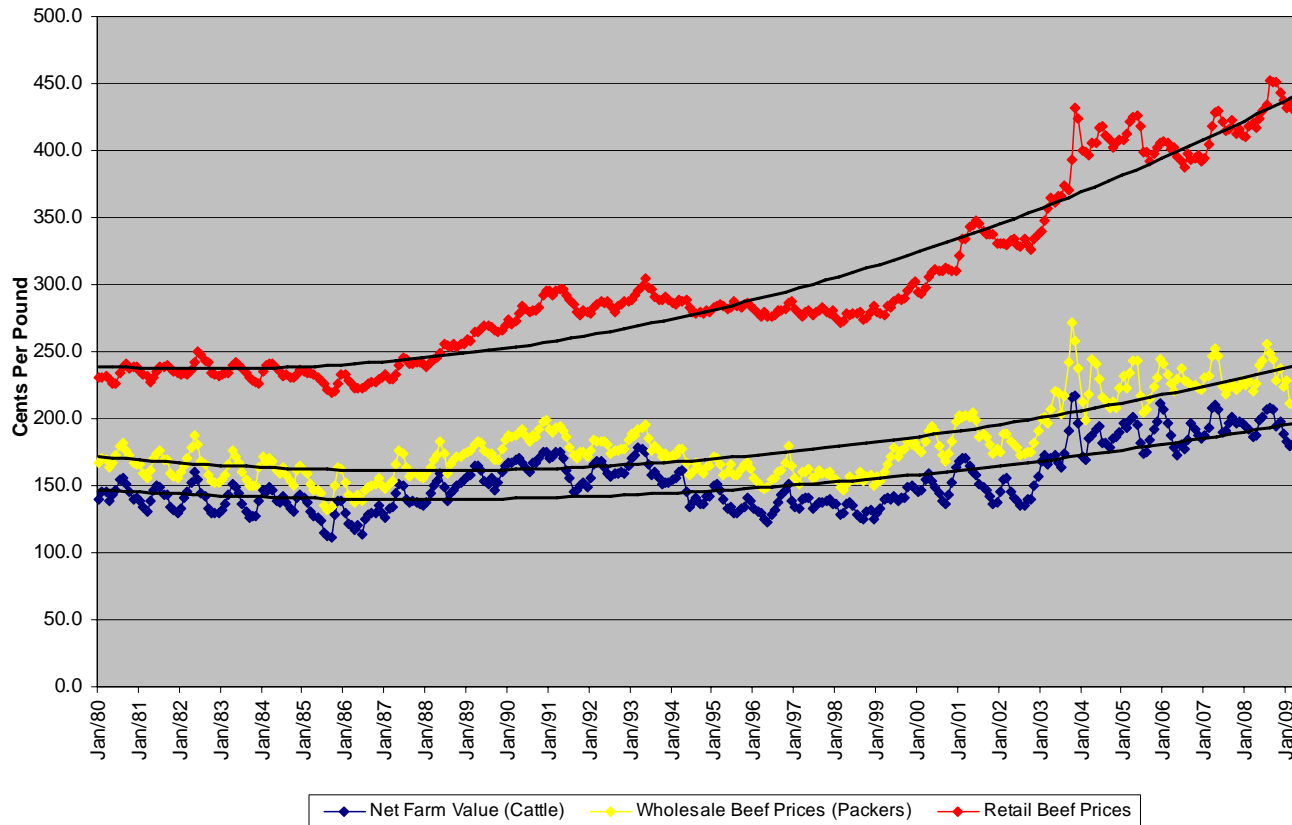
I. Market Phenomena Indicating Market Failure

Market Phenomenon No. 1: Disconnect Between Cattle Prices and Beef Prices



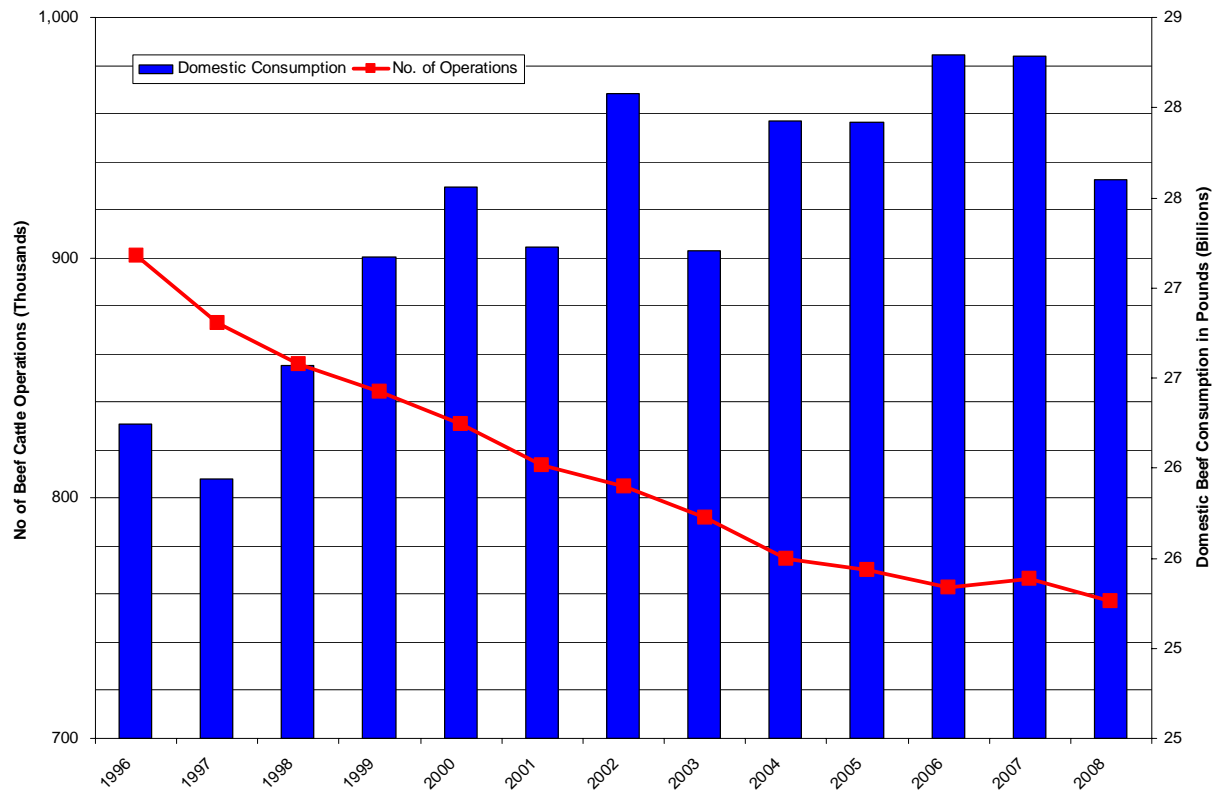
Market Phenomenon No. 2: Increasing Price Spreads Between Ranch Gate and Wholesale, and Ranch Gate and Retail

RETAIL BEEF PRICES vs WHOLESAL BEEF PRICES vs NET FARM VALUE (CATTLE) WITH TREND LINES



Market Phenomenon No. 3: Industry Shrinks as Consumption Increases

No of Beef Cattle Operations vs Domestic Beef Production



Source: USDA FAS, NASS

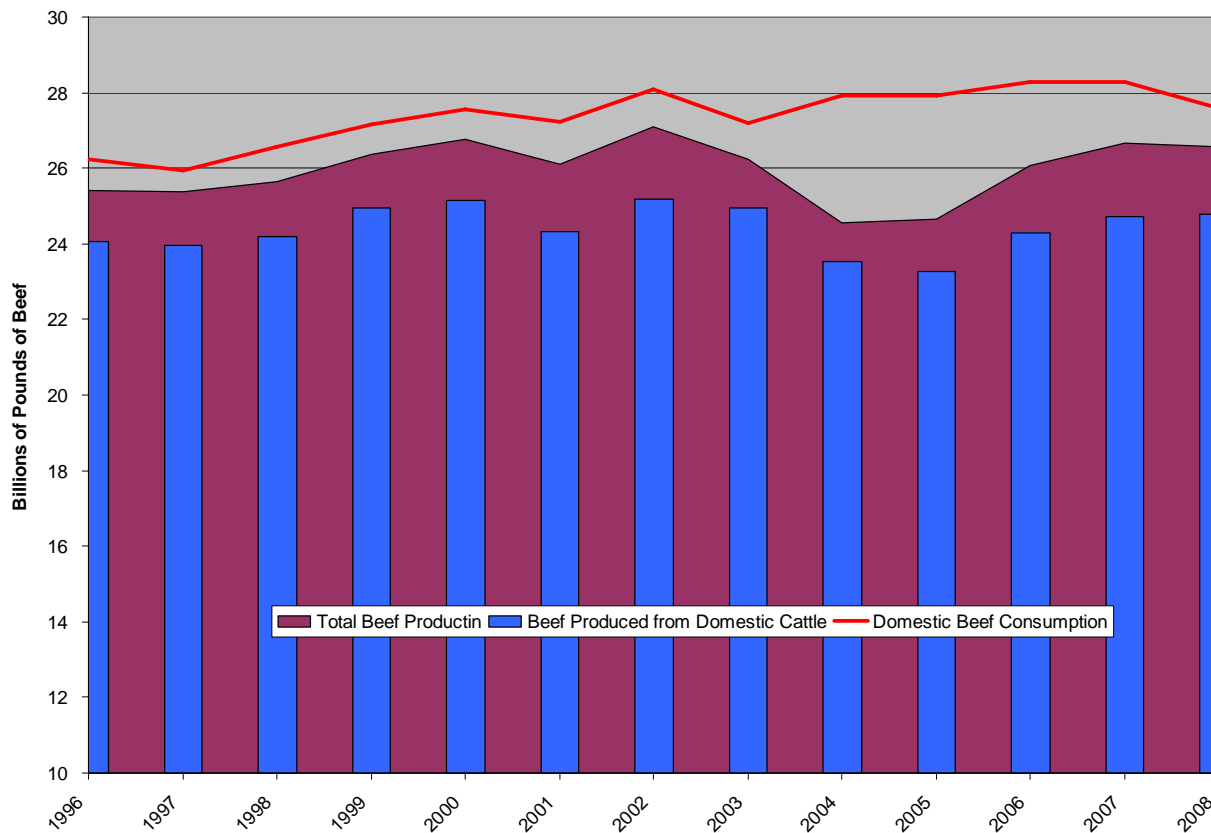
R-CALF USA

Domestic Beef Production v. Total U.S. Beef Production Explained

- USDA currently includes all beef produced at U.S.-based packing plants as domestic beef production.
- However, this is inaccurate because millions of imported cattle are slaughtered in U.S. packing plants each year, including animals imported for immediate slaughter.
- R-CALF USA subtracted the annual production of beef derived from imported cattle from USDA's annual production estimates to arrive at a more accurate estimate of "domestic beef production," i.e., beef produced from animals exclusively born, raised, and slaughtered in the USA. (R-CALF USA multiplied the number of annual cattle imports by the average annual carcass weight to determine the volume of beef produced annually from imported cattle, and then subtracted this amount from USDA's annual production estimates.)

Market Phenomenon No. 4: Domestic Beef Production Lags Behind Domestic Beef Consumption

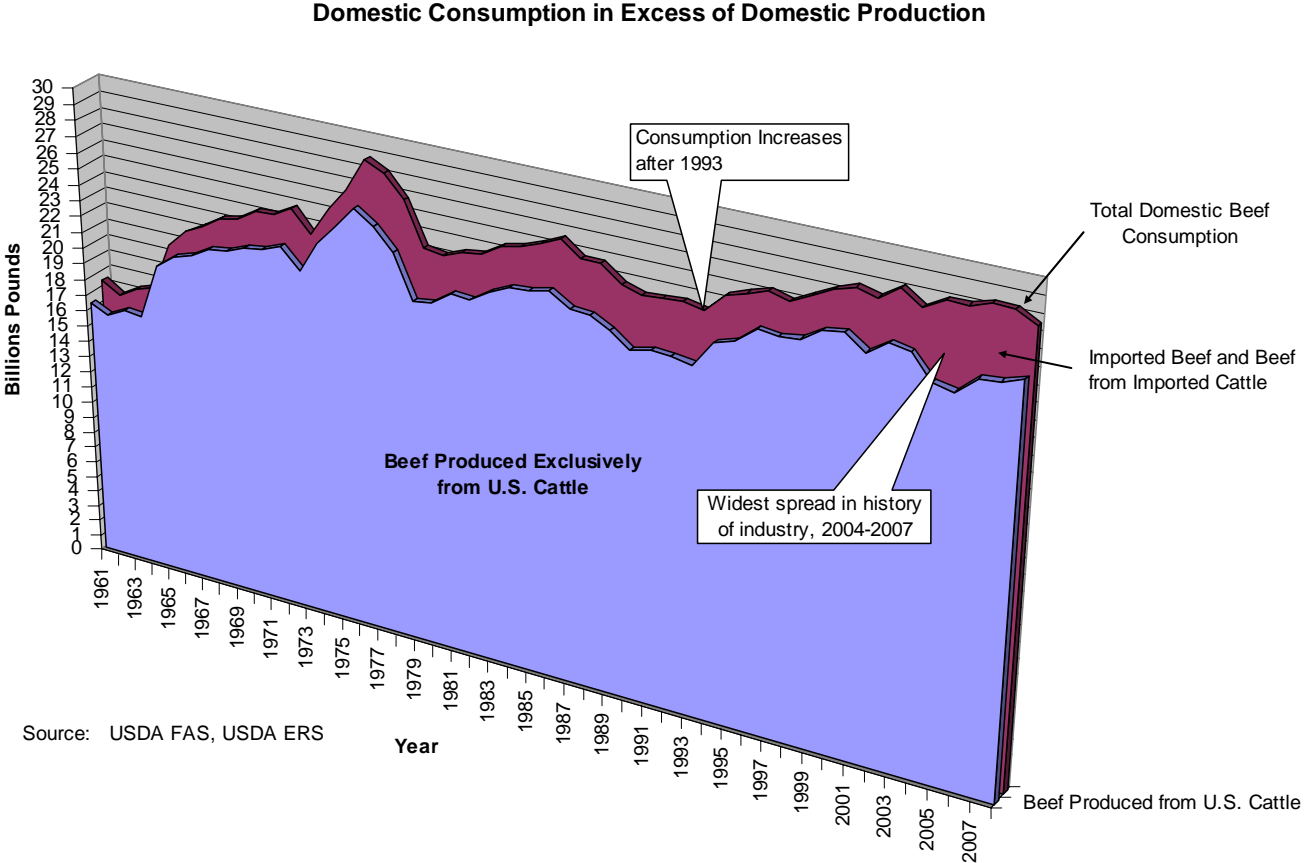
Domestic Production Lags Behind Domestic Consumption



Source: USDA ERS, FAS

R-CALF USA

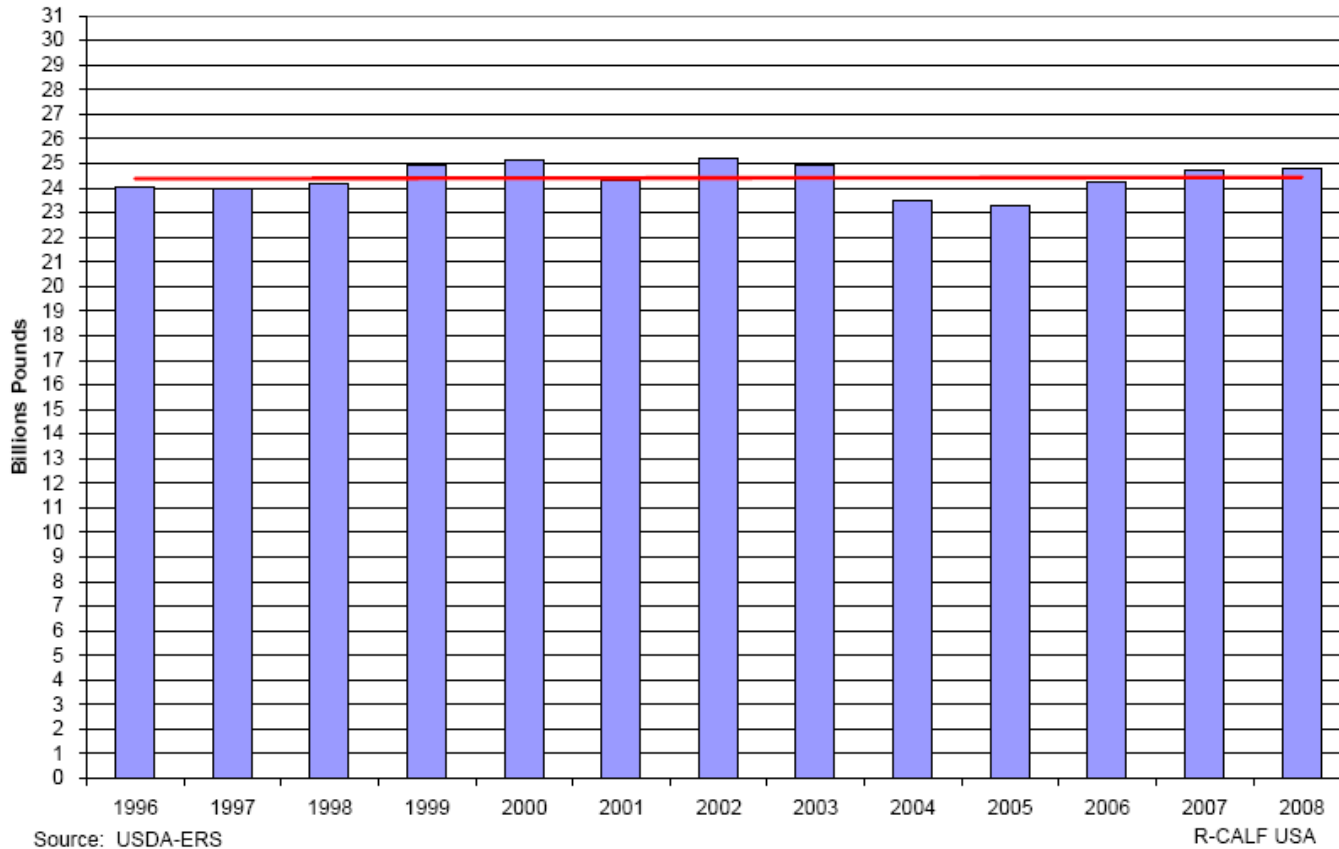
Historic Under-Production of Domestic Beef in Recent Years



Conversion of imported cattle to beef accomplished by multiplying the number of imported cattle by each year's average slaughter carcass weight.

Close-up of Stagnate Domestic Beef Production

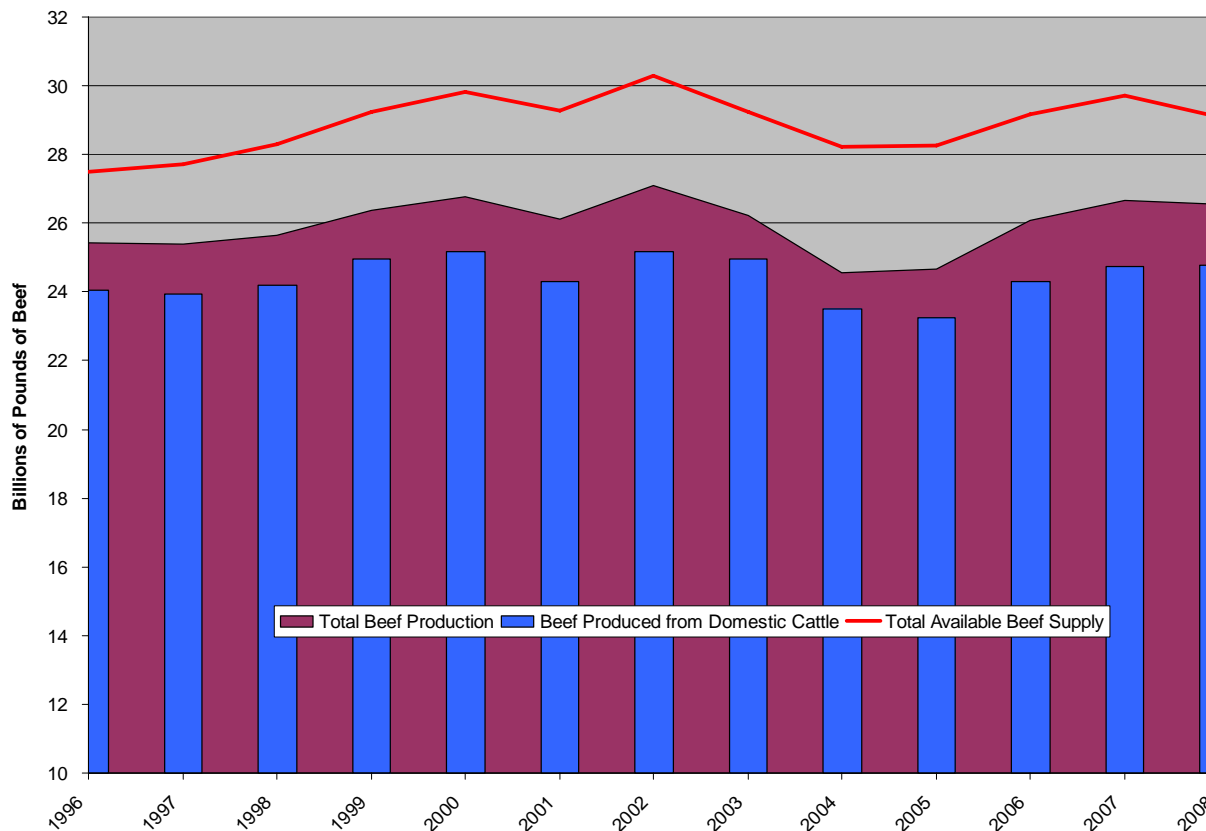
Beef Produced from U.S. Cattle With Trend Line



Note: The volume of beef produced from imported cattle (No. of imported cattle x each year's average carcass weight) is excluded from these data.

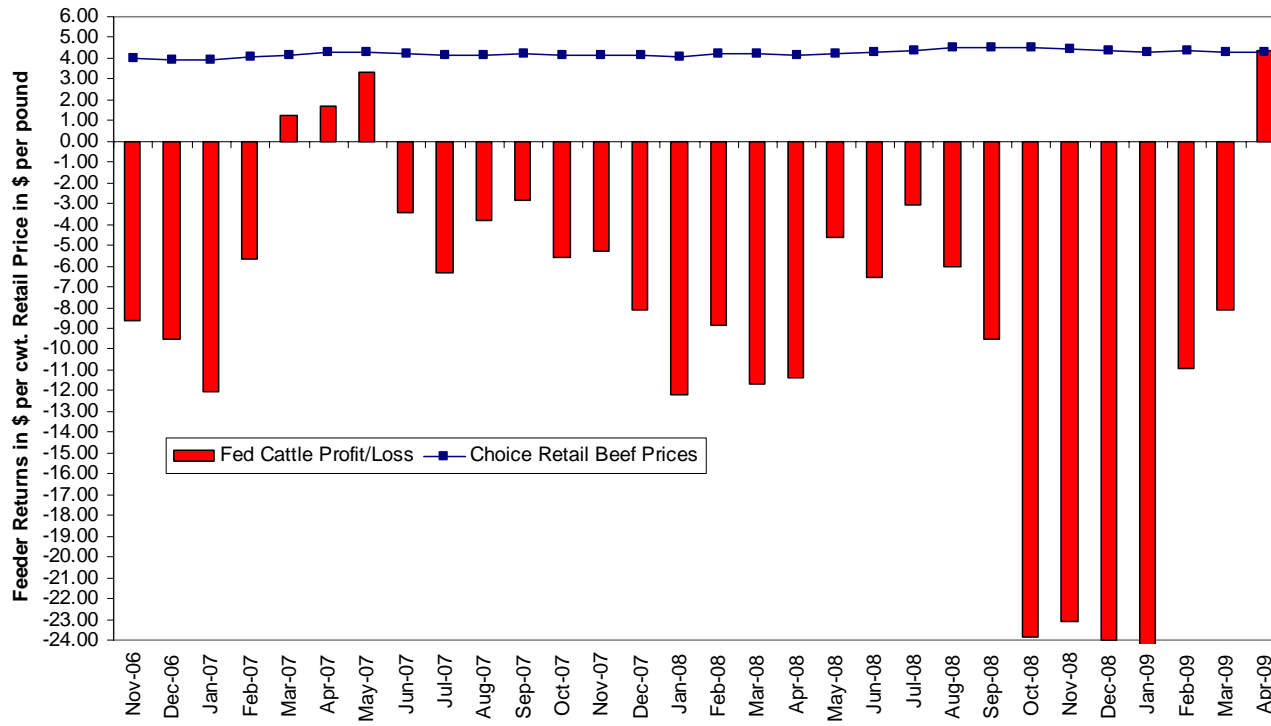
Market Phenomenon No. 5: Domestic Beef Production Losing Share of Total Available Beef Supply

Domestic Production Losing Share of Total Available Beef Supply



Market Phenomenon No. 6: Cattle Feeders Suffer Long-Run Losses While Beef Prices Steadily Climb to Record Levels

Feeder Returns vs Choice Beef Prices

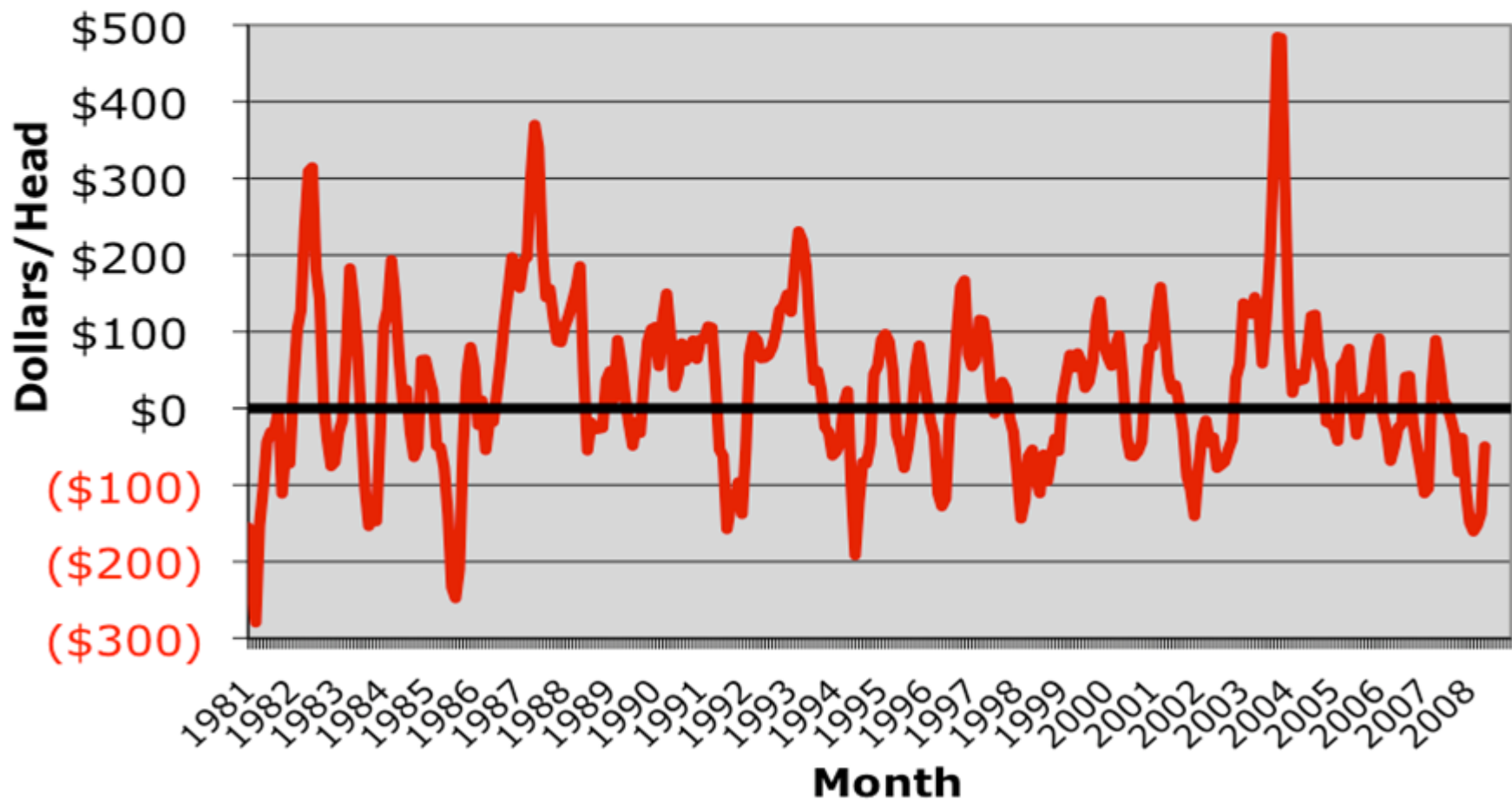


Source: USDA-ERS High Plains Cattle Feeding Simulator and Beef Price Spreads

R-CALF USA

Returns to Feeding #1 Yearling Steers to Choice Grade, Iowa/Minnesota

(in 2007 constant dollars)
Iowa State University Data



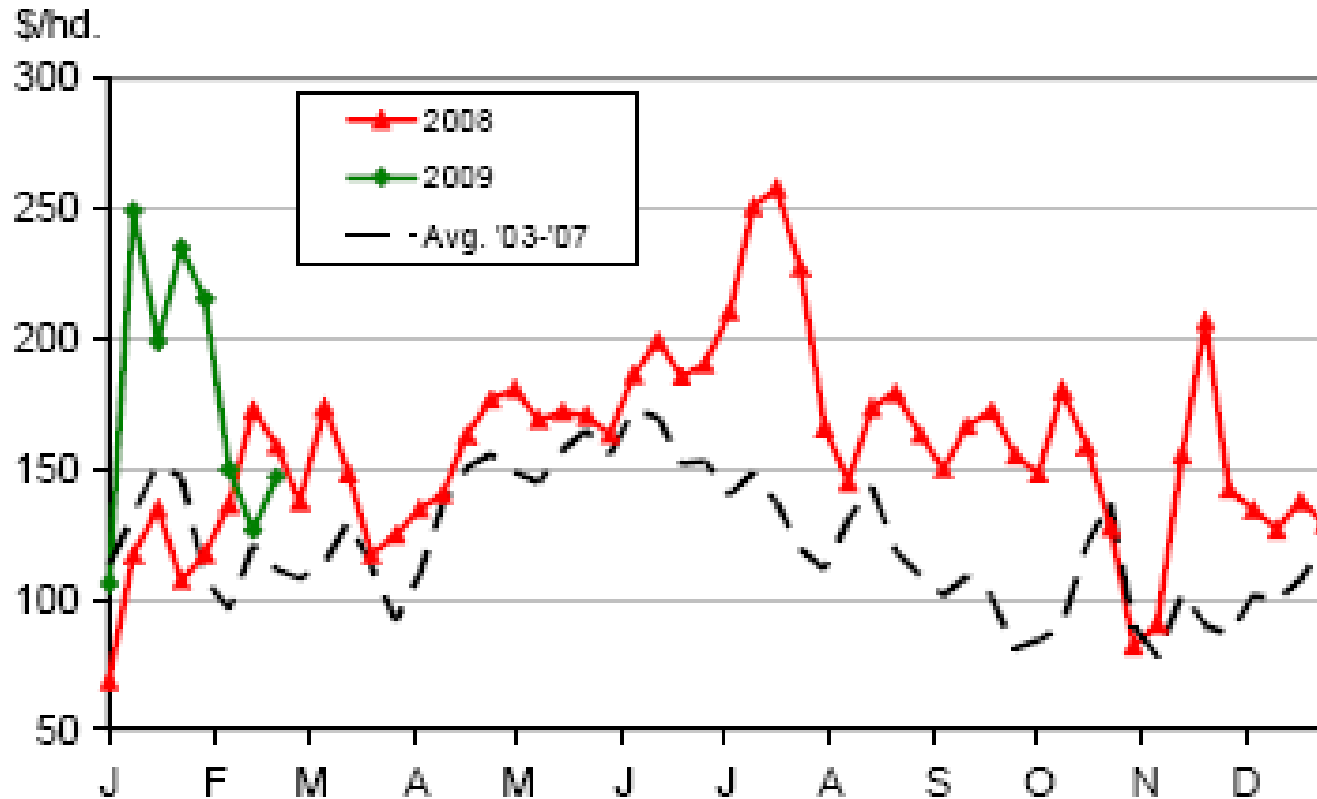
Net Returns to Cattle Feeding, expressed in constant 2008 dollars

Time period	#1 Steer (550 lb to 1150 lb)	#1 Yearling Steer (750 lb to 1150 lb)
1981-1993	48.17	40.20
1994-2008	12.82	13.69
1994-2008 w/o Canadian ban period	-7.73	-3.01

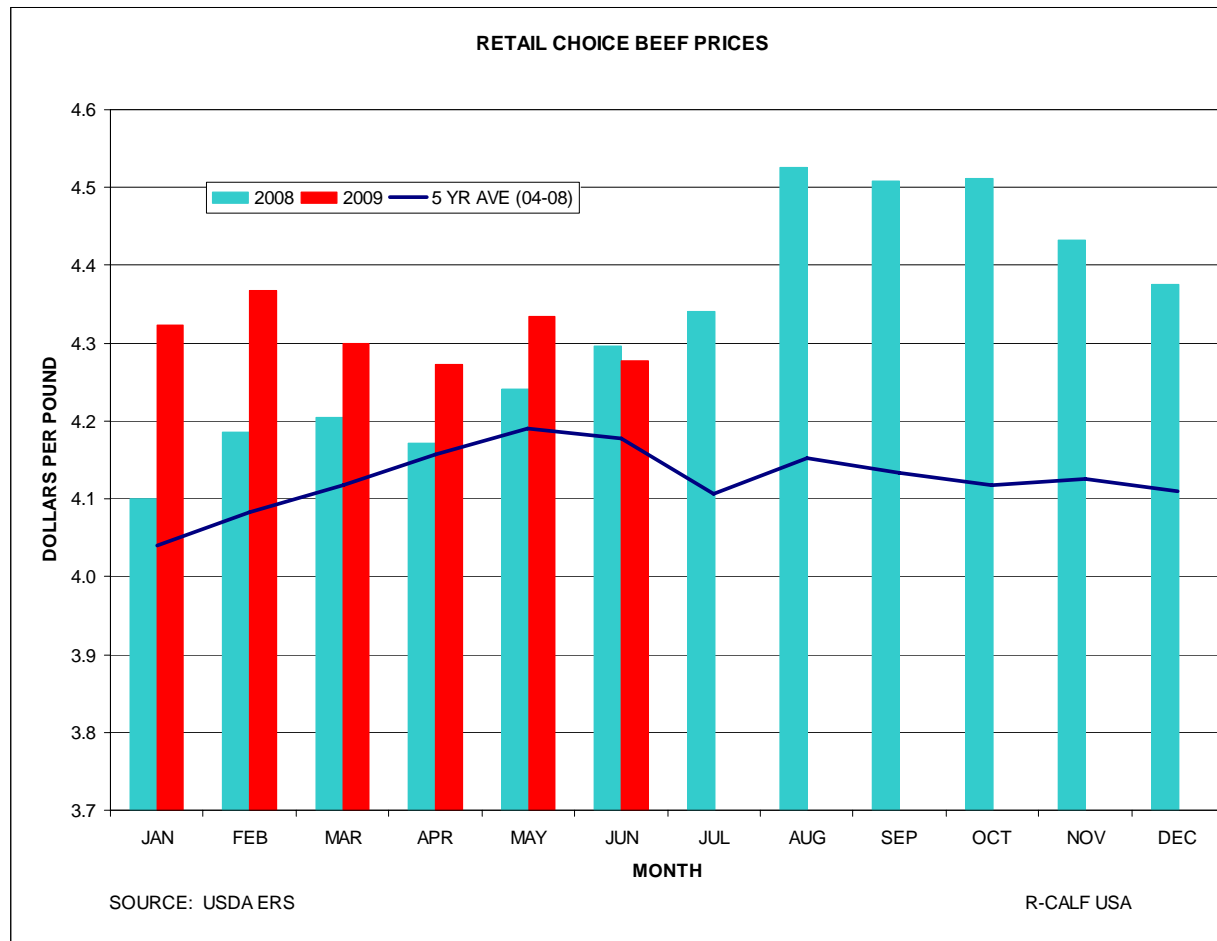
data source <http://www.econ.iastate.edu/faculty/lawrence/EstRet/Index.html>

Market Phenomenon No. 7: Packer Margins Rise as Cattle Feeders Suffer Losses

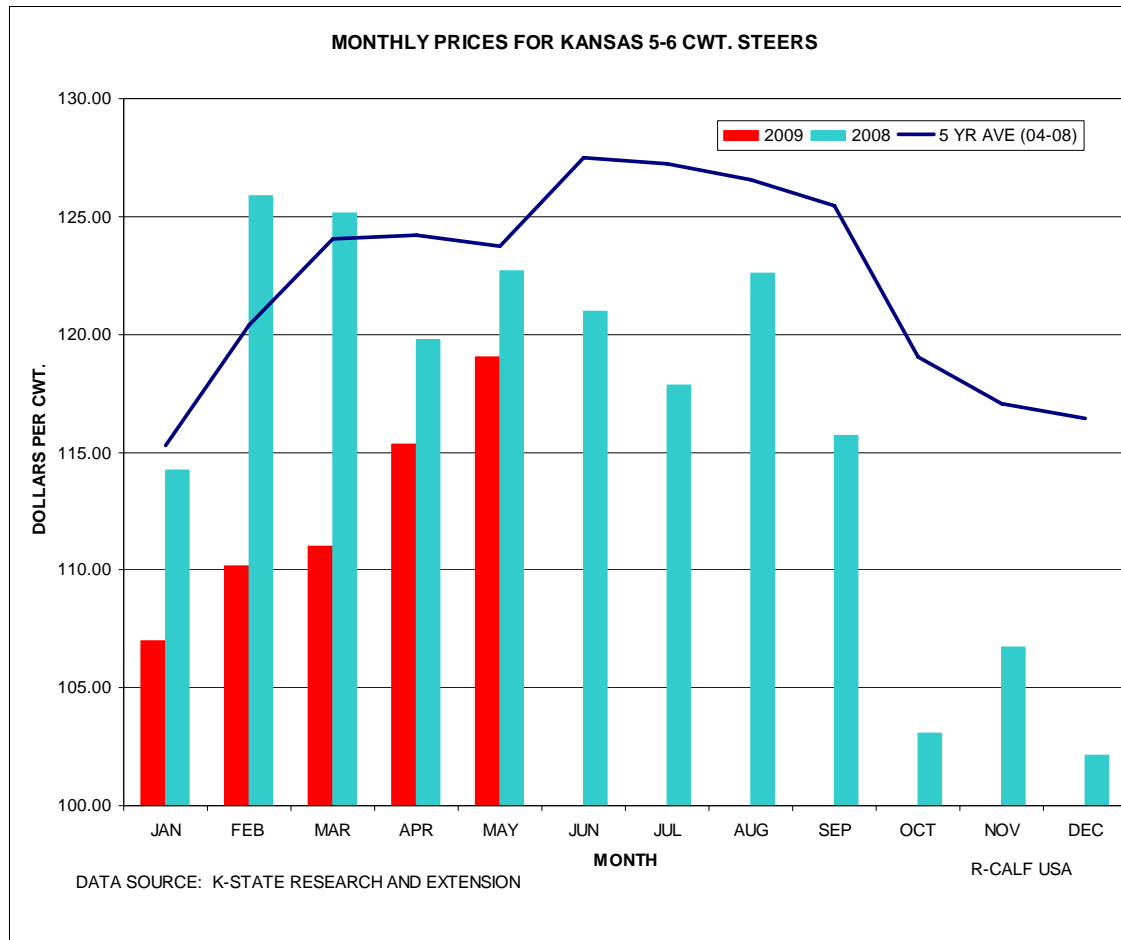
BEEF PACKERS' EST'D GROSS MARGIN



Market Phenomenon No. 8: Consumers Paying Record Beef Prices While . . .

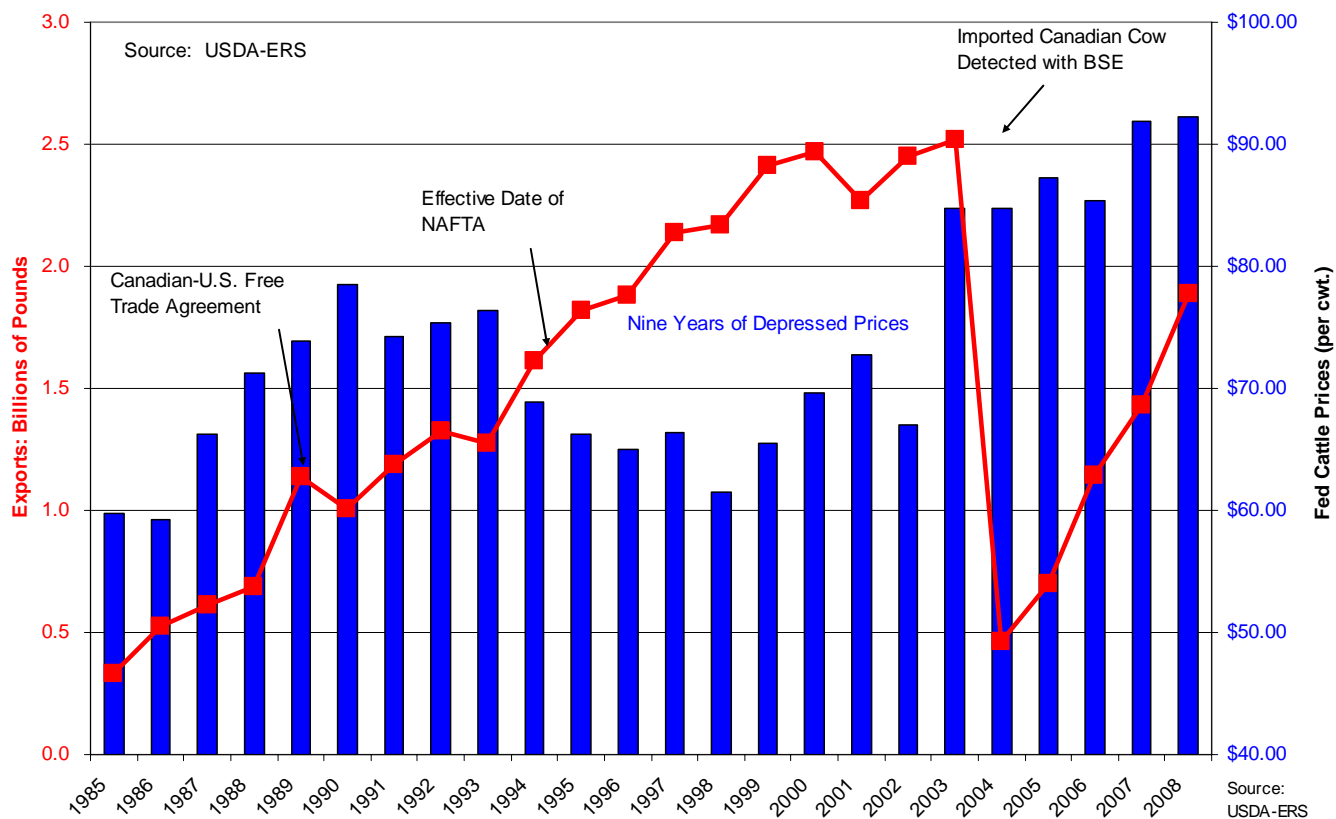


. . . Cow/Calf Producers Receive Depressed Prices



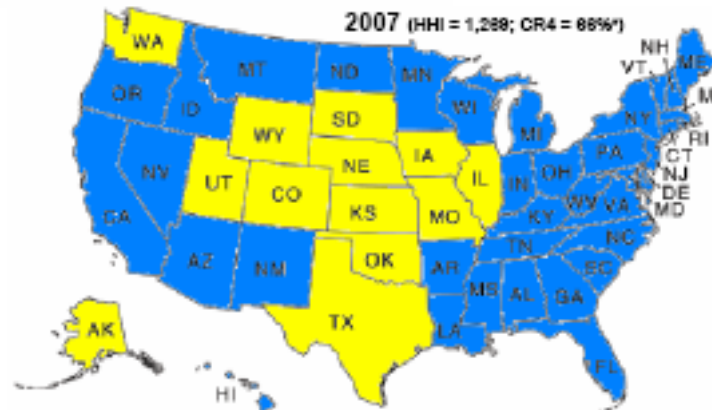
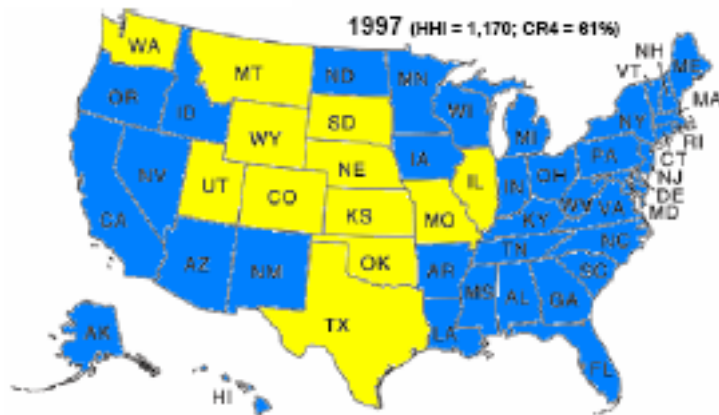
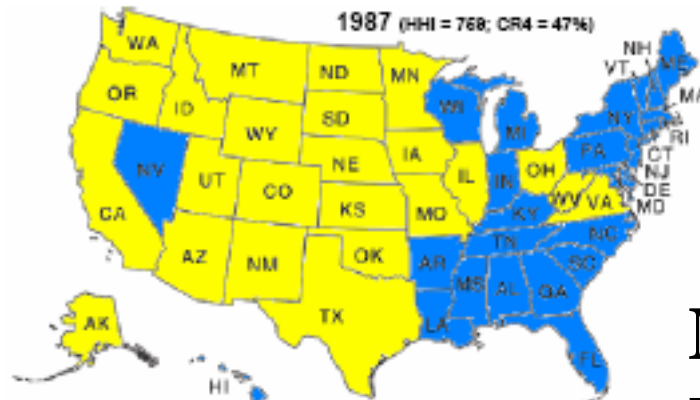
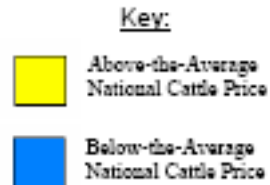
Market Phenomenon No. 9: Increased Exports Do Not Always Equate to Higher Cattle Prices

Relationship Between Export Volumes and Fed Cattle Prices



Effects of Declining Competition on Cattle Prices 1987 - 2007

Prepared by R-CALF USA



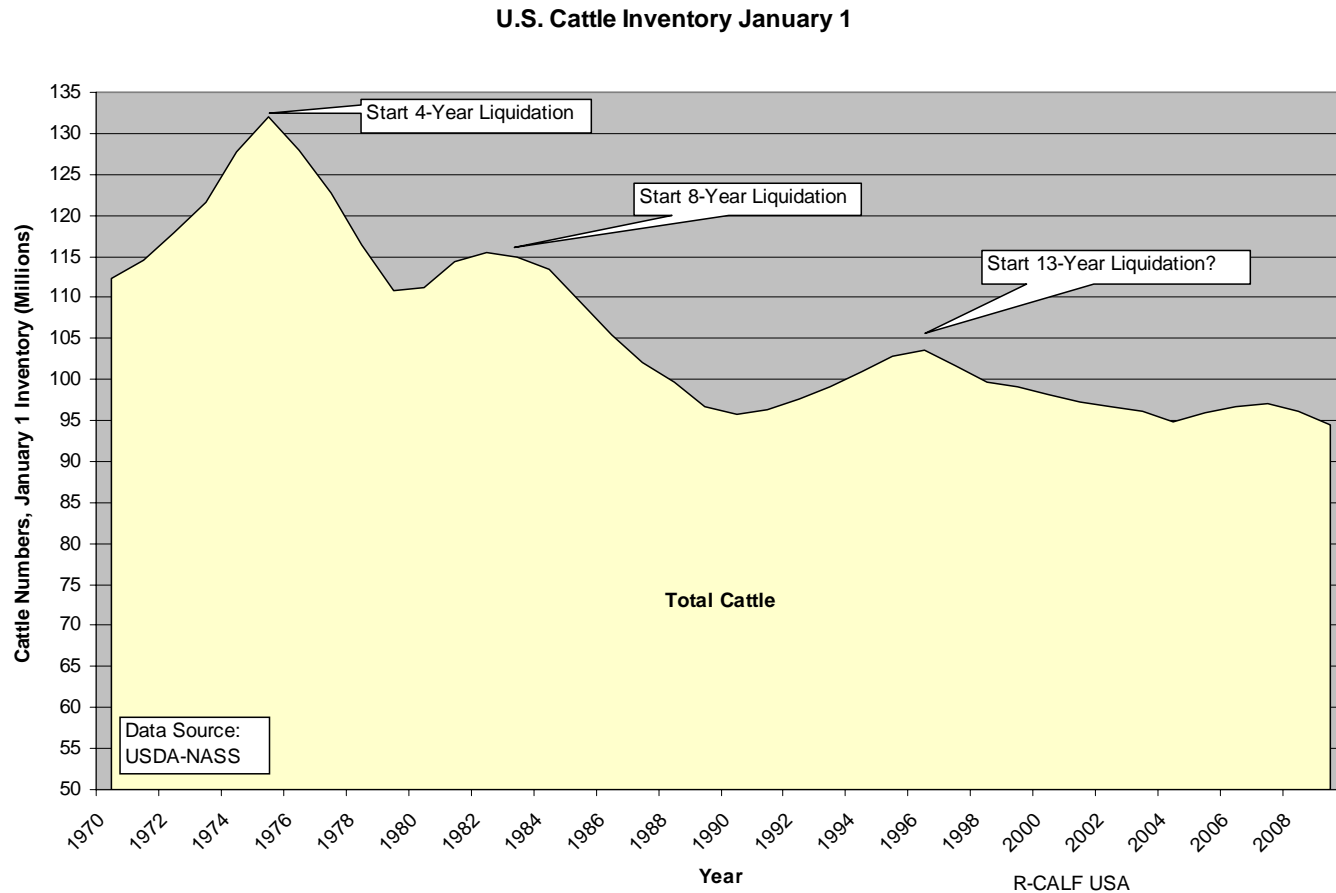
Data Source:

Average Cattle Prices: USDA, NASS, *Meat, Poultry, Production, Disposition and Income, Summary* for 1987, 1997 and 2007.
HHI and CR4: USDA, GIPSA, *Livestock Purchase Concentration, Packers and Slaughter Statistical Report*, 2006 (CR4 is the concentration rate for top 4 firms).

*2006 is the latest data available.

Market Phenomenon No. 10: Fewer States Receive Above-The-Average Cattle Prices

Market Phenomenon No. 11: The U.S. Cattle Cycle Has Been Disrupted

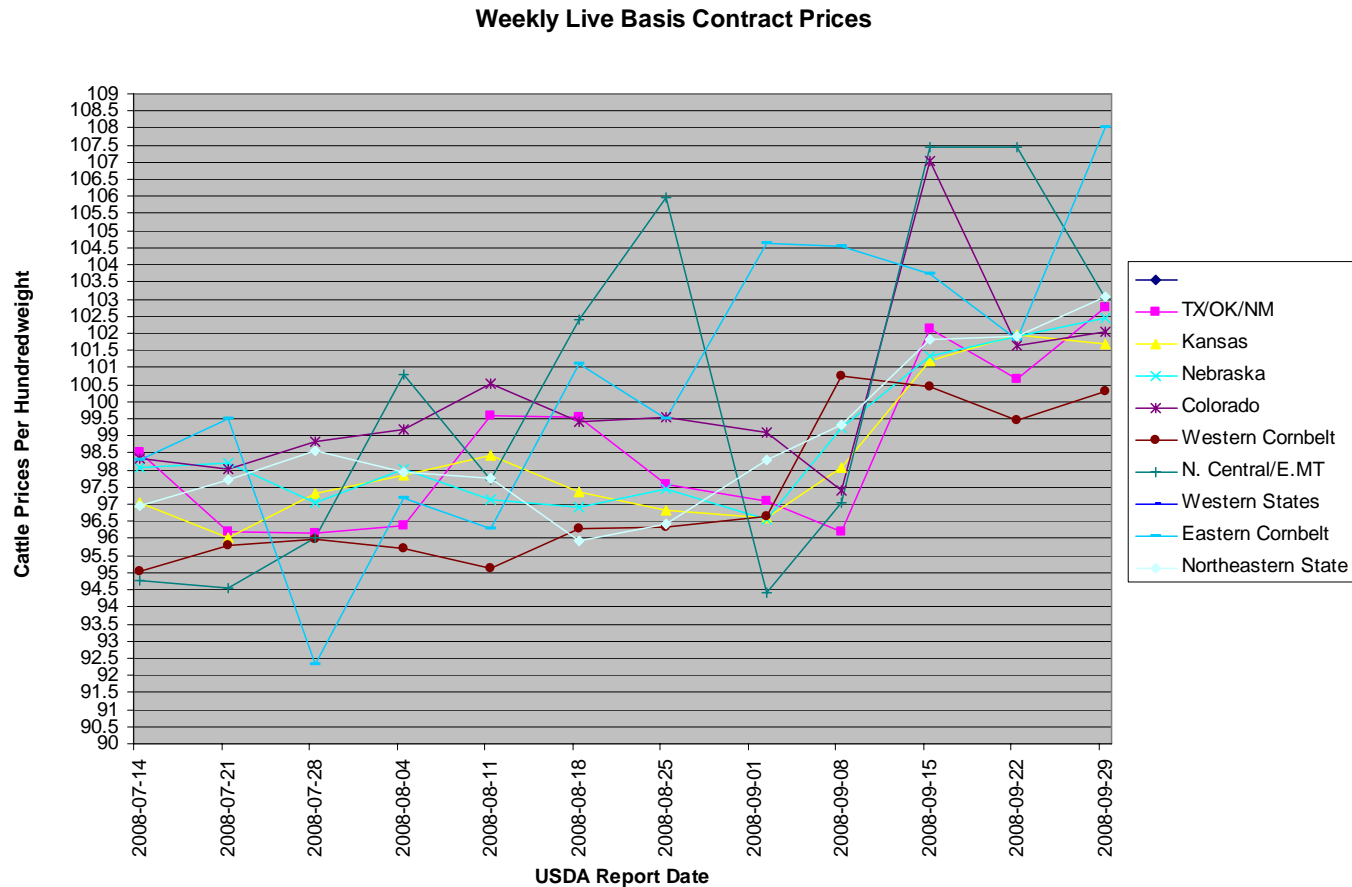


Description of Historical Cattle Cycle

- The U.S. cattle cycle historically occurred every 10-12 years. USDA reported it consists of about 6 to 7 years of expanding cattle numbers, followed by 1 to 2 years in which cattle numbers are consolidated, leading to 3 to 4 years of declining numbers before the next expansion cycle begins again. In 2002 USDA acknowledged that “the present cycle is in its thirteenth year, with two more liquidations likely.” In early 2004 the USDA stated that 2003 marked the eighth year of herd liquidation in the current cattle cycle. 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.”

See R-CALF USA's April 9, 2008 Submission to the Dept. of Justice for a more complete discussion on the disrupted cattle cycle.

Market Phenomenon No. 12: Huge Disparity in Regional Weekly Cattle Prices



Data Source: USDA AMS (See R-CALF USA Sept. 29, 2008 submission to Dept. of Justice.)

II. The Current Structure of the U.S. Cattle Industry Makes It Highly Susceptible to Manipulation

Concentration of U.S. Beef Packing Industry

The U.S. Dept. of Justice estimated in 2008 that the top 4 packers control “over 85% - nearly 24 million” – of all fed cattle purchased.

Slaughter Capacity	Daily	Annual
1. Tyson	33,158 head	8.6 mil
2. Cargill	27,717 head	7.2 mil
3. JBS Swift & Co.	24,111 head	6.3 mil
4. National	13,232 head	3.4 mil
5. American	5,850 head	1.5 mil

Source: Daily slaughter estimates are the average of data compiled by the American Meat Institute, Hendrickson/Heffernan, and the CME Group. Annual estimates were calculated by multiplying daily slaughter times 260 annual slaughter days.

Concentration of U.S. Cattle Feedlots

Measured in one-time capacity

1. Five Rivers (Smithfield & ContiBeef)	811,000 head
2. Cactus Feeders Inc.	510,000 head
3. Cargill (Caprock Cattle Feeders)	330,000 head
4. Friona Industries	275,000 head

Source: Mary and William Heffernan, University of Missouri,
April 2007.

The Beef Industry is Excessively Concentrated

- In 2001, Oklahoma State University Economist Clement Ward found that the concentration levels in the U.S. meatpacking industry were 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.”^[1] At that time, the four largest meatpackers controlled over 80 percent of U.S. steer and heifer slaughter.
- Notwithstanding the fact that this conclusion strongly suggests that no additional concentration should have been allowed, in October 2008 the U.S. Department of Justice allowed the 3rd largest U.S. beef packer – Brazilian-owned JBS, to acquire the nation’s 5th largest beef packer – Smithfield Beef Group, which raised the four-firm concentration ratio to an unprecedented level of approximately 88 percent.

^[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.

The HHI (Herfindahl-Hirschman Index) Reveals that the U.S. Cattle Market Is Highly Concentrated

The HHI is calculated by summing the squares of the percentage of the market held by each competitor. For example, a sector with two firms each controlling half of the market would have an HHI of 5,000).

- Markets with HHI measure in excess of 1,800 points are considered by the Dept. of Justice to be highly concentrated.
- Extrapolating Dept. of Justice data contained in its 2008 enforcement action against the JBS/National merger, the *pre-merger* HHI measurements were:
 - 2,100 points in the High Plains
 - 3,200 points in the Southwest
 - 2,000 points in the market where USDA-graded boxed is sold to wholesale customers

Largest Packers Exceed Optimal Economy of Scale

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

III. The Unique Characteristics of the U.S. Cattle Industry Make it Highly Susceptible to Manipulation

U.S. Cattle Industry is Highly Sensitive to Changes in Supply

- The U.S. International Trade Commission (USITC) has confirmed that the U.S. live cattle industry is highly sensitive to even slight changes in increased live cattle numbers.
- The staff at the ITC found that the farm level elasticity of demand for slaughter-ready cattle is such that:

“[E]ach 1 percent increase in fed cattle numbers would be expected to decrease fed cattle prices by 2 percent.”

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>.

Marketing Practices that Cause Small Impacts on Prices Have a Profound Effect on the Profitability and Viability of U.S. Cattle Producers

- “[E]ven 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.” [\[1\]](#)

[\[1\]](#) *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 2.

Conventional SSNIP Test (5% change in price) is Inappropriate for Evaluating Antitrust Activities in the U.S. Cattle Industry

The net returns (in current dollars) from feeding yearling steers averaged less than only \$14 per head over the 1994-2008 period (see Slide No. 14). For a \$1,000 per head fed steer, the 5 percent test would allow a merger that would decrease price by \$50 per head, which would mean that cattle feeders would be losing \$36 per head compared to the historical average profit of about \$14 per head. A price decrease of only 1.4 percent would completely eliminate the modest profits realized by cattle feeders over the period 1994-2008. Therefore, criteria typically used to define markets and to define an acceptable level of market power are inappropriate to the U.S. fed cattle market.

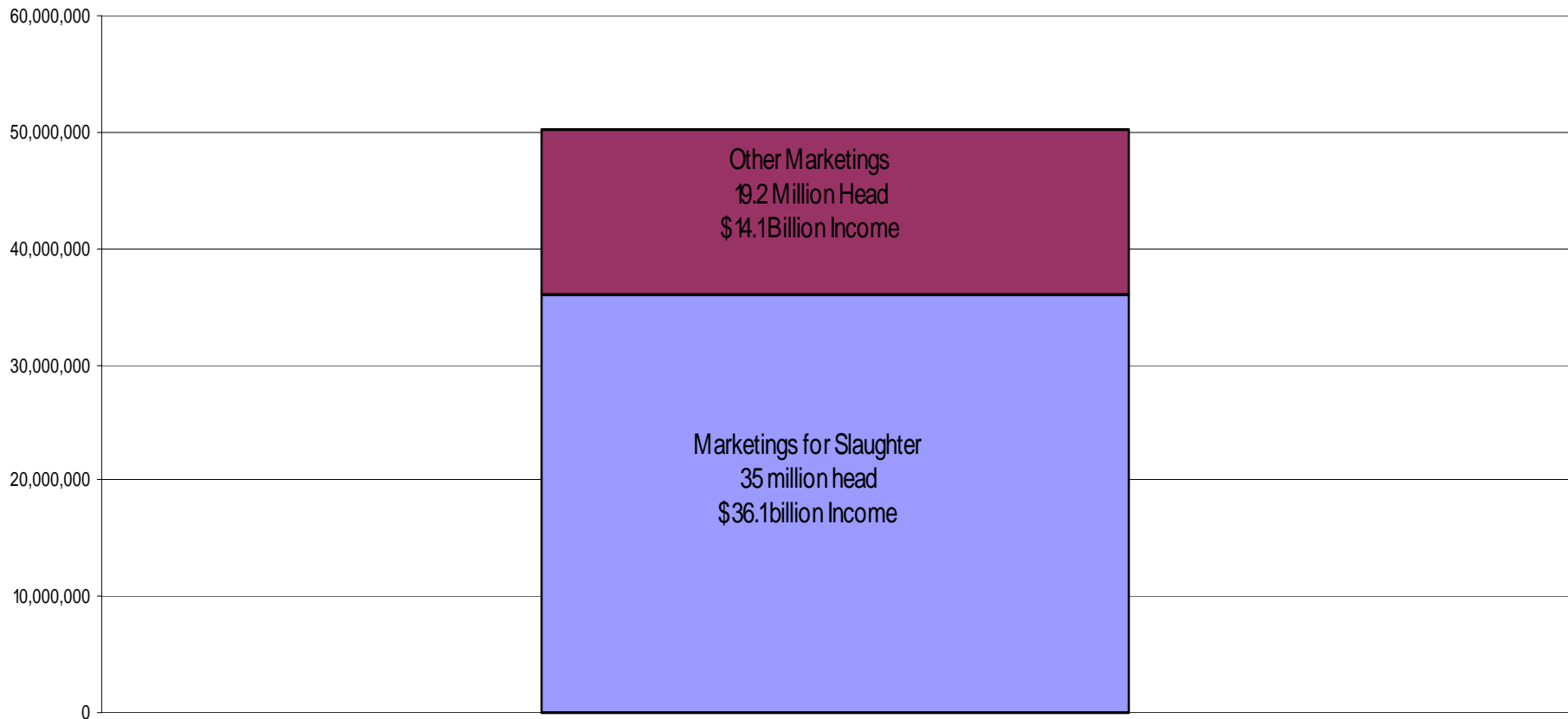
Why Cattle Industry is Highly Susceptible to Manipulation

- Longest biological cycle of any farmed animal – inelastic supply.
- Finished cattle are highly perishable.
- Demand for cattle bounded on weekly basis – Packers set weekly limits by choice and by capacity constraints.
- Transportation costs limit marketing options.
- Packing industry exceeds concentration levels considered to elicit noncompetitive behavior.
- Competition for raw products, e.g., cattle, is inherently less intense than is competition for processed food products.
- Cattle market highly sensitive to even slight changes in supplies.
- Marginal transparency in cattle markets.
- Packers have superior marketing information, particularly those with substantial captive supply arrangements, which include imported cattle.

See R-CALF USA's May 8, 2008 Submission to the Dept. of Justice, at 7-10.

Anticompetitive Practices at the Packer Level Affect More than Just the Fed Cattle Market

Sources of Cattle Industry Income



2007 Sales of Cattle and Calves

IV. Packers Have Demonstrated a Propensity to Engage in Anticompetitive Behavior

Evidence Shows JBS-Brazil Has Tendency to Engage in Anti-Competitive Practices

Dow Jones Newswires reported on November 28, 2007 that JBS SA's Friboi Group (JBSS3.BR) was cited by the Brazilian Justice Department's antitrust division for engaging in the anti-competitive practice of coordinating price agreements with other firms to keep cattle prices low when purchasing livestock for slaughter.

Domestic Packers Have Likewise Engaged in Anticompetitive Behavior

- On Oct. 11, 2007, Smithfield entered into a Consent Decree with USDA and paid a penalty in the amount of \$325,000 after being accused of violating the PSA by, *inter alia*, paying livestock producers on improperly rounded hot carcass weights during the multi-year period Nov. 21, 2001 through Nov. 4, 2004.
- March 4, 2008, National entered into a Consent Decree with USDA and paid a penalty in the amount of \$50,000 after being accused of violating the PSA by failing to disclose freight charge deductions and data errors that affected the price paid for cattle purchased pursuant to quality-based pricing grids.
- June 18, 2007: Swift and Company d/b/a Swift Beef Company (now known as JBS Swift) stands accused by USDA of willfully violating provisions of the Packers and Stockyards Act (“PSA”) by, *inter alia*, failing to pay the full amount due to livestock sellers for hot carcass weights.

V. Captive Supply Use is Rapidly Increasing

Increased Captive Supply Use Causes Competitive Harm to Cattle Producers

- The 2007 GIPSA Livestock and Meat Marketing Study (LMMS) found a causal relationship - 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. (See, Volume 3, at ES-5.)
- *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 in cattle procurement. The analysis showed that for each 1% increase in captive supply cattle, cattle prices decreased 0.155%. (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.)*

Increased Captive Supply Use Causes Competitive Harm to Cattle Producers, Con't.

- Captive supplies increase the instability of prices for cattle producers and hold down cattle prices.^[1] 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.^[2] 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.^[3] 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.^[4] 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. Producers acting individually are not in the position to change these dynamics of the market.
- ^[1] 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 7.
- ^[2] See *id.*
- ^[3] See *id.*, at 8.
- ^[4] See *id.*

Packers Create “Market Access Risk” to Increase Their Captive Supplies

- “Market access risk,” refers to “the availability of a timely and appropriate market outlet.”^[1] 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],”^[2] 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”^[3]

^[1] *GIPSA Livestock and Meat Marketing Study, January 2007, Volume 3, at 5-4.*

^[2] *Id.*, at 2-36.

- ^[3] *Id.*

Increased Captive Supply Use Temporarily Disrupted by BSE

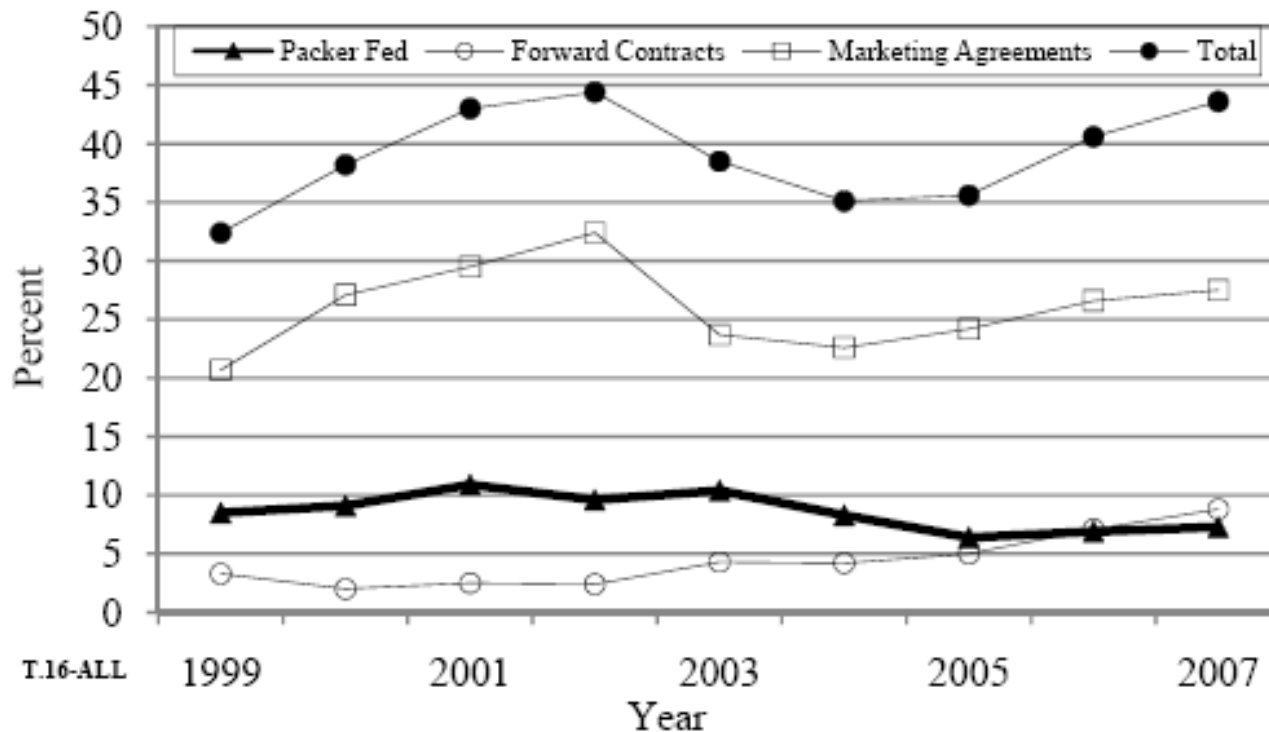


Figure 26. Percentage of Steers and Heifers Procured Through Alternative Types of Committed Procurement Arrangements by the Four (Five) Largest Steer and Heifer Slaughter Firms

Cash Cattle Market Shrank 15 % and Captive Supplies Increased 15 % from 2005 to 2008

TX-OK-NM NUMBERS (Cattle that were fed in these three states)

****Head Counts below reflect slaughter totals for each purchase type from January 1 through June 1 of each year******

	2005	2006	2007	2008	Net Change
Cash	1,097,605 (51.7%)	986,744 (45.9%)	823,810 (38.5%)	804,736 (34.0%)	-17.7%
Formula	811,620 (38.2%)	854,802 (39.8%)	983,029 (45.9%)	1,198,462 (50.7%)	+12.5%
Forward Contract	71,665 (3.4%)	108,816 (5.1%)	53,279 (2.5%)	143,886 (6.1%)	+2.7%
Negotiated Grid	142,091 (6.7%)	197,518 (9.2%)	280,070 (13.1%)	216,875 (9.2%)	+2.5%
TOTAL	2,122,981	2,147,880	2,140,188	2,363,959	

Source: USDA Livestock and Grain Market News/Mandatory Price Reporting/St. Joseph, MO

VI. Evidence Show Packers Are Engaging in Anticompetitive, Unfair, and Deceptive Practices

Examples of Potential Market Power Abuses

- Coercing political support from producers.
- Engaging in coordinated actions resulting in reduced prices for live cattle.
 - Feb. 2006 packers avoided the cash market for two weeks.
 - Oct. 2006 packers announced they would all reduce slaughter
- Imposing disparate discounts for similar quality specifications.
- Imposed pricing strategies that defy competitive market fundamentals.
- Subdividing the cattle market by denying access to the market for certain subclasses of cattle.

See R-CALF USA's April 9, 2008 Submission to Dept. of Justice, at 15-22.

More Examples of Potential Market Power Abuses

- Coercing a waiver of PSA rights from producers in return for market access. (*See R-CALF USA May 20, 2008 Submission to Dept. of Justice*)
- 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.
- Offering preferential agreements with captive suppliers for prices and terms not available to other sellers of comparable cattle in the market.
- Entering into strategic alliances that contain special agreements for preferential access to the market and/or special prices.
- Exercising undue influence over national commodities markets, potentially eliminating this hedging tool for U.S. cattle producers.

(*See R-CALF USA's April 9, 2008 Submission to Dept. of Justice, at 15-22.*)

More Examples of Potential Market Power Abuses

- Anecdotal evidence reveals that packer buyers regularly contact cattle sellers to learn what other packers are offering.
- Anecdotal evidence reveals that packers with multiple plants deny access to a plant offering a higher price.

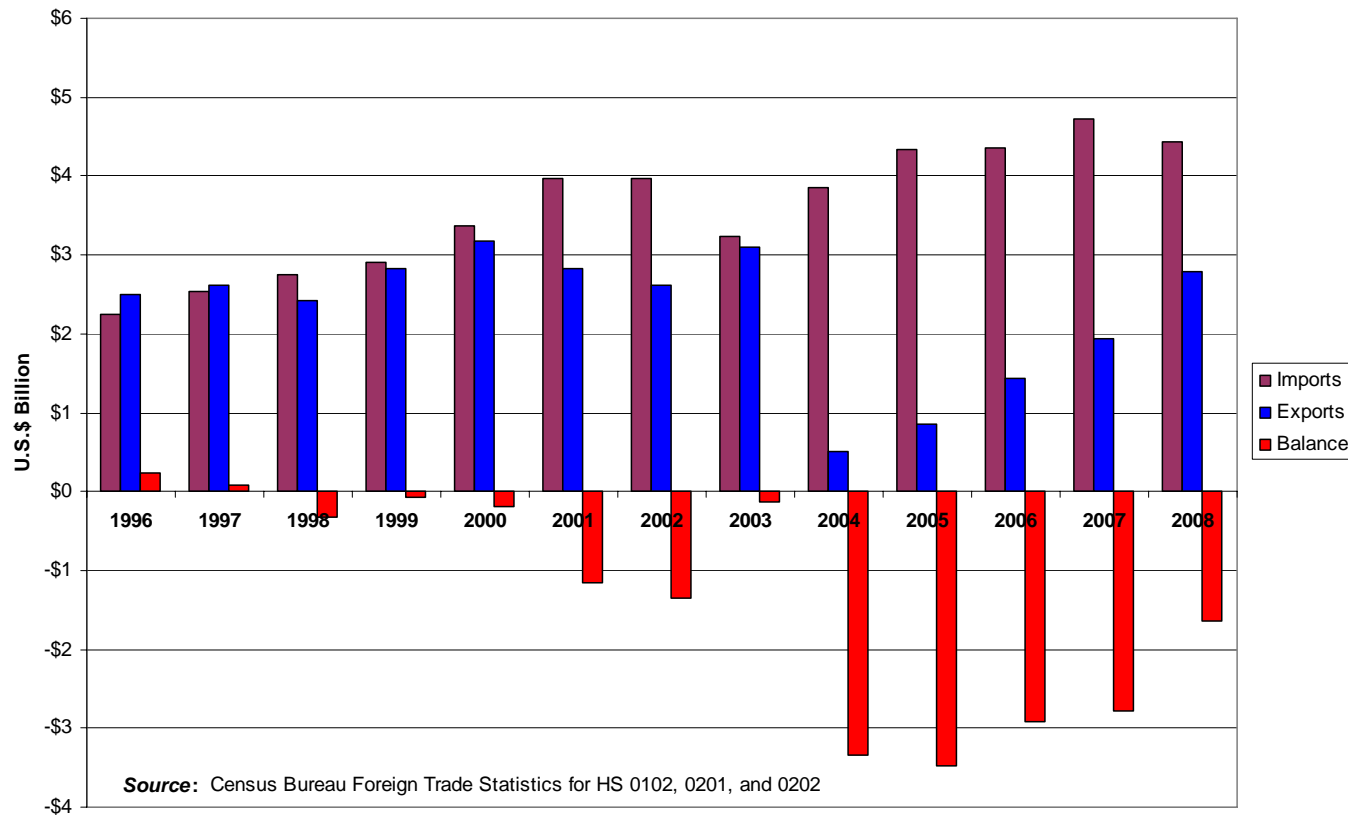
Outcome that Defies Market Fundamentals

On July 11, 2008, the Associated Press issued a news article stating that National Beef had attributed its higher third-quarter profits to, *inter alia*, increased beef demand and lower cattle prices. This is a counter-intuitive outcome for a properly functioning competitive market as higher demand for beef should translate into higher prices for the fed cattle from which the beef was derived.

VII. Impacts From Trade

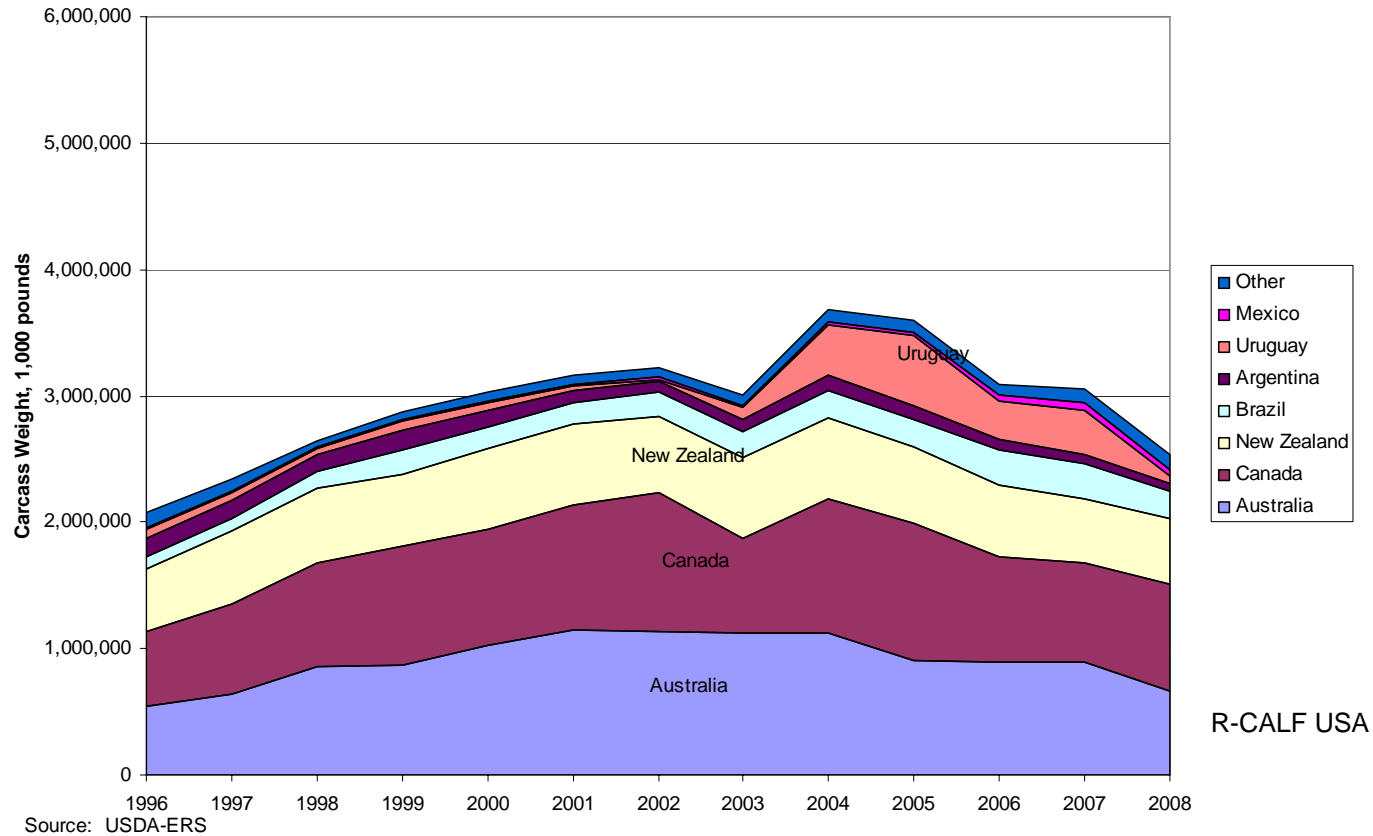
Long Run Value Deficit in Cattle and Beef Trade Exacerbates Broken Market Problems

U.S. Trade in Cattle and Beef



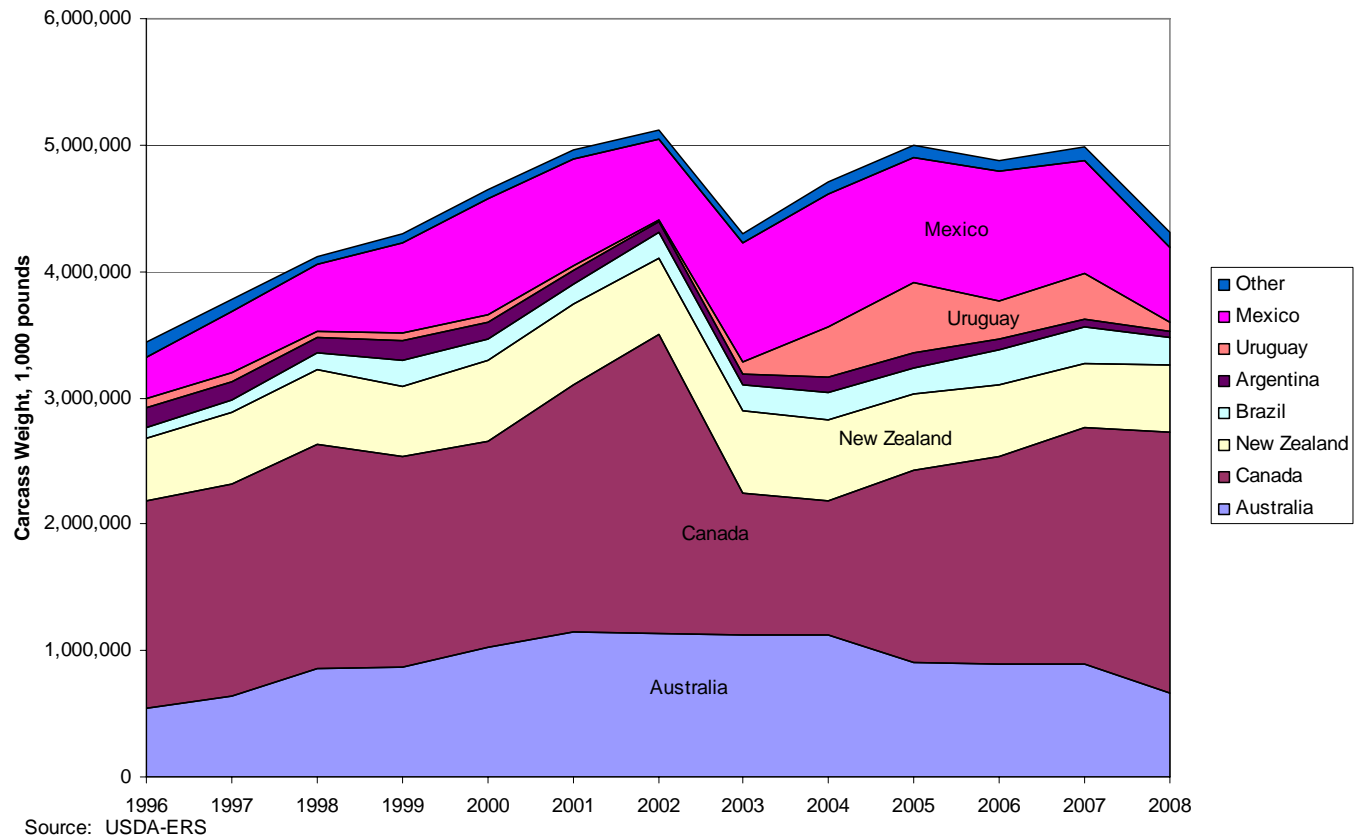
Origins of Imported Beef When Only Imported Beef Product is Included

Origins of Imported Beef Without Including Beef from Imported Cattle



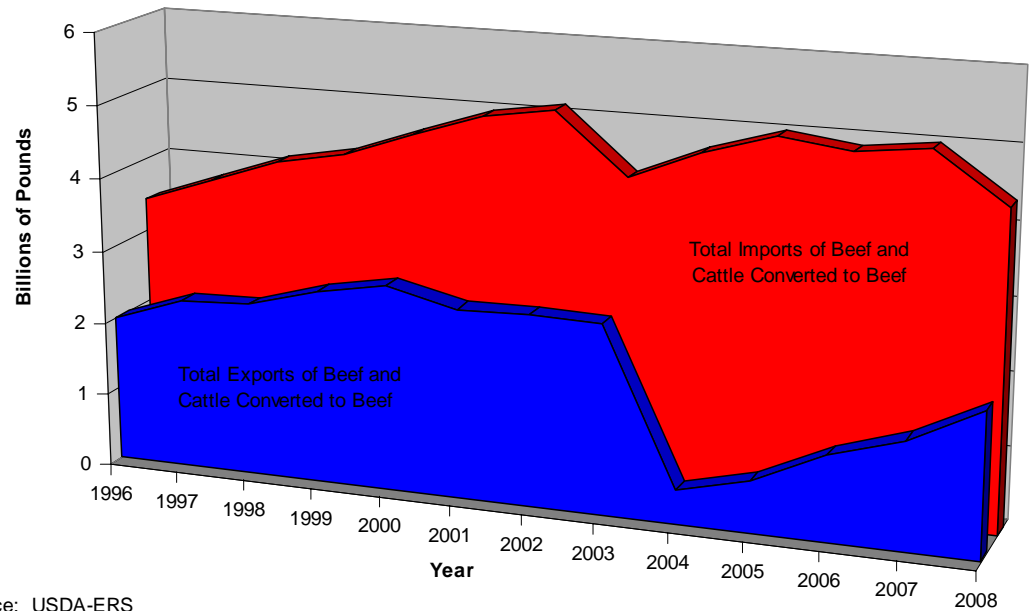
Canada is Largest Beef Source When Imported Cattle are Slaughtered and Mexico Rivals Australia for Second Place

Origins of Imported Beef & Cattle Converted To Beef



Tremendous Volume Deficit in Cattle and Beef Trade Forces Domestic Cattle Prices Lower

U.S. Global Trade Deficit in Cattle and Beef

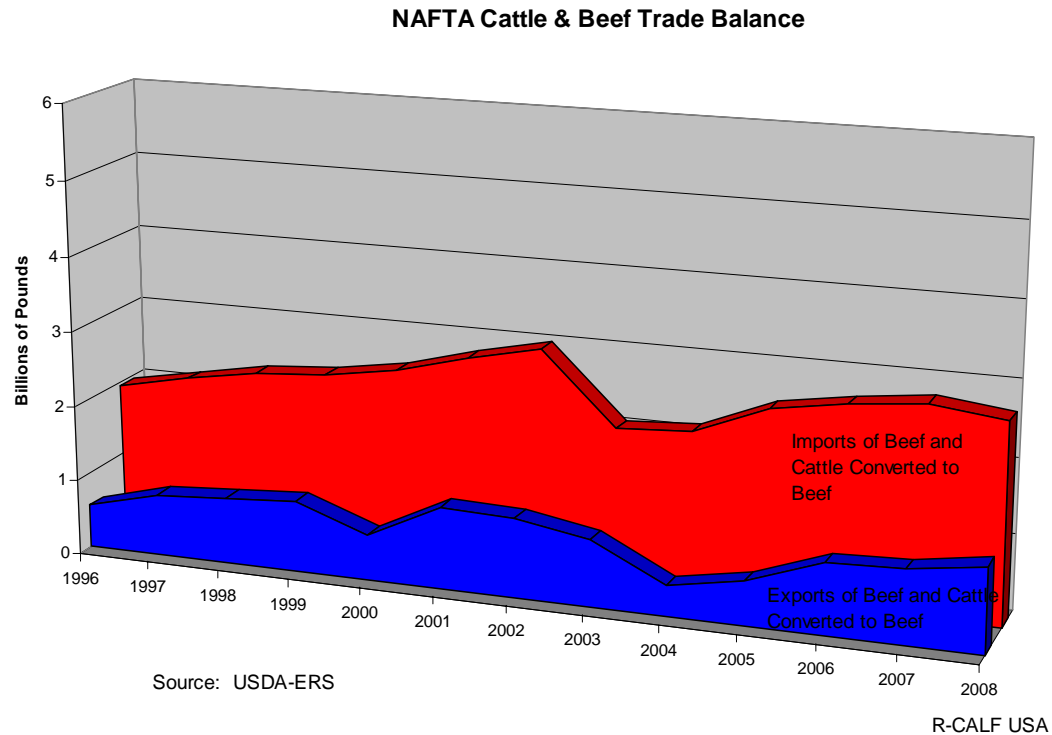


Source: USDA-ERS

R-CALF USA

Conversion of imported cattle to beef accomplished by multiplying the number of imported cattle by each year's average slaughter carcass weight.

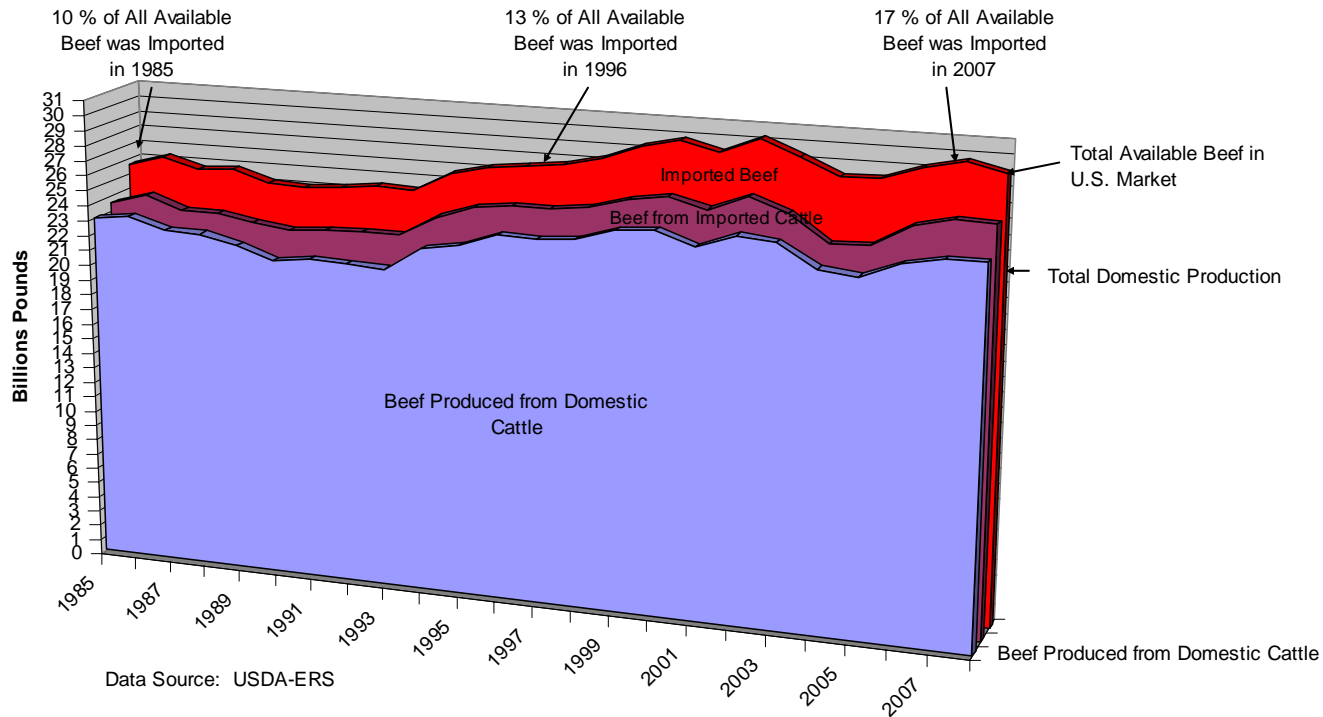
NAFTA Trade Deficit Represents Over Half of U.S. Global Trade Deficit in Cattle & Beef



Conversion of imported cattle to beef accomplished by multiplying the number of imported cattle by each year's average slaughter carcass weight.

Cattle and Beef Imports Capturing Growth in Domestic Beef Supply

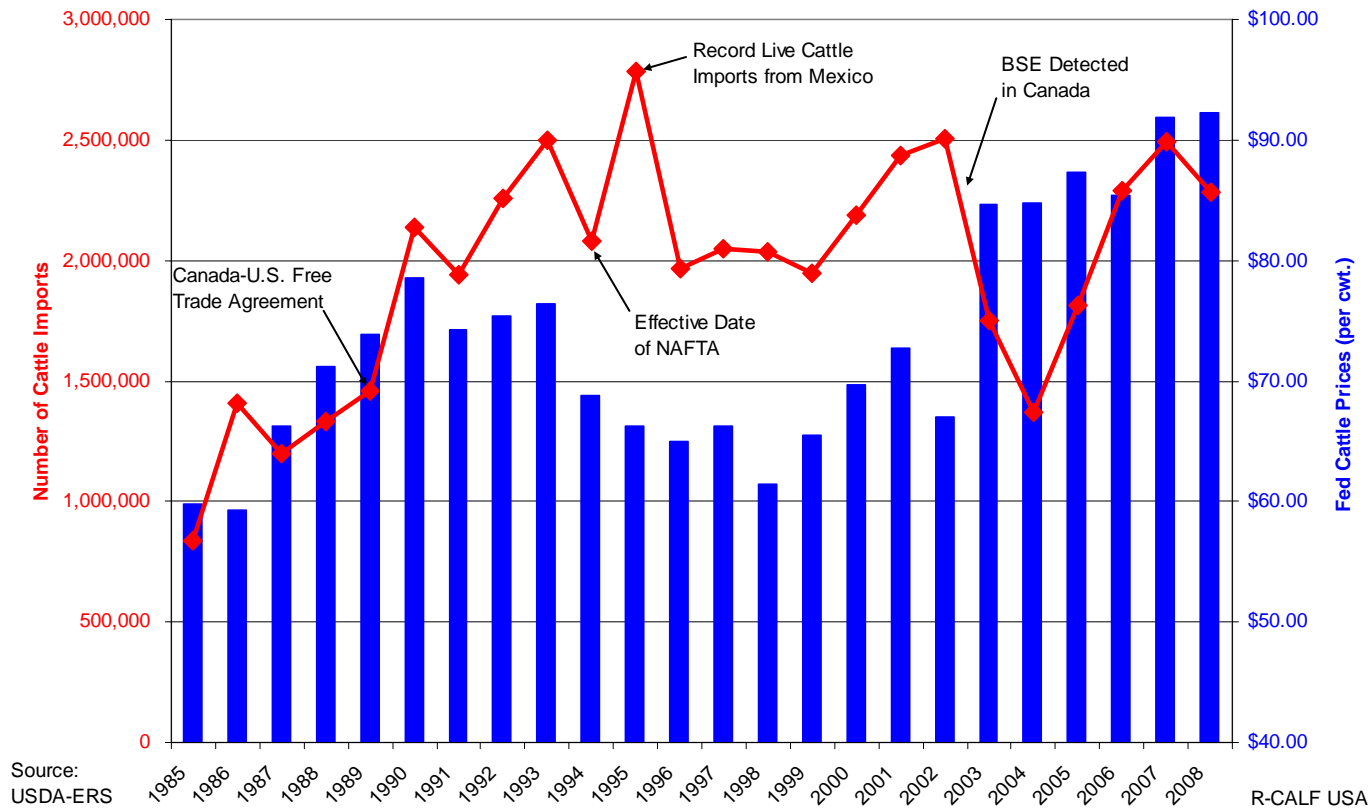
Origins of United States Beef Supply



Conversion of imported cattle to beef accomplished by multiplying the number of imported cattle by each year's average slaughter carcass weight.

Long-Run Price Depression Coincides with Increased Cattle Imports

RELATIONSHIP BETWEEN CATTLE IMPORTS AND FED CATTLE PRICES



U.S. Has Weakest Import Standards Against Introduction of Mad Cow Disease (BSE)

BSE STANDARDS OF MAJOR BEEF IMPORTING COUNTRIES

Country	Age Restriction	Specified Risk Material (SRM) Definition	Commodity Restrictions
Japan	20 months or younger	Head (excluding tongue and cheek meat), palatine and lingual tonsils, spinal cord and dura matter, distal ileum, vertebral column, and dorsal root ganglia.	No ground beef, processed beef, head meat, finely textured beef, or mechanically separated meat.
Korea	Under 30 months	Skull, brain, eyes, distal ileum, tonsils, spinal cord, vertebral column.	Cattle must be born and raised in the United States, or imported from a country deemed eligible by the Korean government to export beef or beef products to Korea, or raised in the United States for at least 100 days. Traceback records must be maintained for at least 2 years. No mechanically recovered meat or mechanically separated meat.
Mexico	Under 30 months	Skull, brain, eyes, tonsils, spinal cord, and small intestine.	No ground meat, feet, sweetbreads, weasand meat, or head meat.
Hong Kong	Under 30 months	Skull (including brain, eyes and trigeminal ganglia), tonsils, spinal cord, dorsal root ganglia (with the vertebral column) and intestine.	No ground beef, bone-in beef, edible offal, or beef derived from advanced meat recovery systems.

Source: USITC Publication 4033, September 2008, 4-9.

Fighting for the U.S. Cattle Producer!



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