*Chapter Eight*

# *Fighting Food Inflation through Competition*

America's farmers and ranchers are caught in an economic vise. When they seek to buy the various inputs that they need—for example, seed[1] and fertilizer[2] —they face increasingly concentrated markets and the exploitative strategies of producers. When they attempt to sell their products they have only a very limited number of buyers. The existence of concentrated buying markets creates the incentive and the capacity for such buyers to exploit producers by imposing lower prices and other burdens as well as entrenching their power against the threat of deconcentrating and effective competition.

Consumers are also poorly served by existing market structures and practices associated with the production and distribution of agricultural products. The spread between the price paid to the farmer and the price paid by the consumer has increased as concentration has increased in both food processing and retailing,[3] even after adjusting for increased processing of food. Increased concentration in the chain of buyers, processors, and retailers has undoubtedly contributed to the increased cost of food even if some processors and retailers claim that they are not making significant profits. This suggests that increased concentration results in higher prices but also results in economic inefficiency.[4] Reducing the anticompetitive "tax" on food will not eliminate all the

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[1] Seed prices have increased about 5% a year over the last several years. Mark Moore, Trait Rates (Why Prices are up), FARM INDUSTRY NEWS, Sept. 1, 2007, *available at* http://farmindustrynews.com/seed/trait-rates-prices/.

[2] Potash is an important fertilizer. Its price increased almost 300% between January 2004 and January 2008. Potash One, Inc., http://www.potash1.com/s/Prices.asp.

[3] *See* USDA Economic Research Service, Data Sets, *Historical monthly price spread data for beef, pork, broilers, turkeys, and eggs* (updated Feb. 20, 2008), *available at* http://www.ers.usda.gov/Data/MeatPriceSpreads. *See also*, Hearing on Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary, 110th Cong. (May 7, 2008) (testimony of Bill Bullard, CEO, Ranchers-Cattlemen Legal Action Fund, United Stockgrowers of America), *available at* http://judiciary.senate.gov/pdf/08-05- 07Bullard_Testimony.pdf [hereinafter *Bullard Testimony*].

[4] The basic theory of oligopoly is that prices to buyers will increase regardless of the profitability of the increased concentration. Leonard Weiss, *The Concentration-Profits Relationship and Antitrust*, *in* INDUSTRIAL CONCENTRATION: THE NEW LEARNING 184 (Harvey J. Goldschmid, H.M. Mann, & J.F. Weston eds., 1974). Subsequent investigation has confirmed that the basic theory was correct. CONCENTRATION AND PRICE (Leonard Weiss ed., 1989). One plausible explanation is that firms with some market power will expend the

upward pressure on prices resulting from increased income around the world, lagging development of new agricultural technology, and the impact of climate change. But it would reduce important avoidable pressures on prices and so protect consumers from even more exploitation.

Free and open markets are generally the best institutional structure for achieving all the important goals of economic policy: efficiency, dynamic growth, equitable allocation of resources and equal opportunity for all participants. Where markets are unconcentrated with many buyers and sellers, there is a strong tendency for efficient, workable, and fair methods to develop as a result of the interaction of many participants all seeking a neutral and open market place.

But no such inherent tendency exists in markets where there is a substantial difference in size between buyers and sellers and one side of the market is also highly concentrated. Moreover, when one side of the market has significant and persistent advantages in information or any other important element related to the transactions, there will be incentives for manipulative market conduct. Thus, there is a grave danger that strategic conduct will shape such markets and frustrate the goal of an efficient, open, fair and accessible marketplace.

When markets lack the inherent tendencies to create desirable conditions, the law can play a vital role in defining rules that reduce the capacity of some actors to engage in strategic conduct and restore greater balance among the participants. The statute books contain many such laws, including ones regulating credit, insurance, product safety, job safety, franchising of various kinds (e.g., gas stations, fast food, automobile dealerships), energy markets, and securities markets.

The markets for agricultural commodities provide a textbook illustration of how law and regulations can either facilitate or frustrate the accomplishment of the goals of an efficient, transparent, and equitable market context. Antitrust law enforcement over the past eight years has failed to deal effectively with either the substantial structural changes or the exploitative and exclusionary conduct manifest in both the input and output markets that farmers face. In addition, the U. S. Department of Agriculture (USDA) has

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gain to protect the position, thus wasting resources and at the same time imposing higher prices on consumers. *See* Richard Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807 (1975).

substantial authority to adopt and enforce market facilitating rules that could ameliorate some of the most serious problems of access, information disclosure, and exploitation. It, however, has consistently failed to use its authority to facilitate efficient market practices.

## MAJOR RECOMMENDATIONS

The next administration's agenda for agricultural market competition policy should include:

### Increased antitrust enforcement of merger and conduct rules including:

- Applying stricter standards to mergers in input markets
- Challenging anticompetitive, post-sale restraints in the sales of seed
- Developing agricultural market guidelines for assessing buyer mergers
- Challenging buyer mergers whenever they are likely to result in the exercise of buyer power
- Challenging collusive conduct by buyers that affects public market prices.

### Employ and augment USDA authority to regulate market conduct to facilitate fair, efficient, and open competition by:

- Adopting regulations under the Packers and Stockyards Act (PSA) to control abusive buying practices
- Adopting regulations under the Agricultural Marketing Agreement Act of 1937 (AMAA) to control abuse of market orders
- Seeking expansion of the PSA to cover all agricultural commodities and clarify its standards.

The consequence of the combined failure to enforce antitrust law and to fashion relevant market regulations is that farmers and ranchers were and are undercompensated for their production. But at the same time, consumers are paying higher and higher prices for food products because the bottlenecks in the process of moving food from the farm to the retail market have allowed processors and retailers to exploit both producers and consumers. Indeed, much of the concentration and buyer power in food processing are

the result of consolidation undertaken to counteract the buyer power of large food retailers.

This chapter will first examine the adverse effects of increased concentration in the markets supplying farmers and ranchers. A particular, pressing concern is the way in which new, efficiency enhancing genetically modified seeds are being produced and distributed. The second part will describe the competitive issues that exist in the markets in which farmers and ranchers sell their crops and livestock to processors. Farmers and ranchers experience substantial exploitation that is, if not unique, at least substantially more pervasive than that in other product markets. This part will identify the contexts where antitrust law could be effective in reducing anticompetitive risks but where actual antitrust enforcement has been deficient. It will also describe the contexts where market facilitating regulation could be relevant to achieving workably competitive, efficient markets, but where again the USDA has failed to use its existing authority to protect competition. The third part identifies antitrust strategies that the next administration should adopt to deal with the challenges facing farmers. The fourth part identifies the policies that the USDA should pursue, as well as the need for legislative additions to its jurisdiction, to facilitate the fair, open, and efficient operation of agricultural commodity markets.

## I. Supply Side Issues

### *A. Farm Supplies Generally*

Farmers and ranchers are buyers of large quantities of a wide variety of products that are used in the production of animals and crops. But they are rarely, if ever, powerful buyers. Essentially they are price takers obliged to pay whatever is demanded of them. As a result of their limited bargaining power, they are particularly vulnerable to exploitation resulting from higher prices imposed by oligopoly industries and by collusive agreements among sellers. The lysine cartel is perhaps one of the best known examples of such a cartel.[5] Because of explicit collusion between lysine producers, farmers and ranchers paid excessive prices for this input to cattle and poultry feed.

[5] *See* United States v. Andreas, 216 F.3d 645 (7th Cir. 2000) (upholding criminal convictions of top officials of Archer-Daniels-Midland Co. (ADM) for their blatant price fixing conspiracy).

Increased concentration has been a particular concern in the markets supplying seed to farmers. Since the 1990s, with the emergence of genetically modified seeds, a handful of large companies have acquired a very large number of small and midsized seed companies. The impact of these mergers has been to stifle innovation and reduce technological competition in the development of new genetic modifications and the introduction of competing technologies.

For example, Monsanto, the dominant supplier of genetic modifications, acquired Holden Foundation Seeds. Holden was and remains a key provider of basic seed germ to seed companies. Basic seed germ is necessary for developing new and different breeds of plants. The effect of the acquisition was to confer on Monsanto the ability to control access to seed germ for key crops. Thus, Monsanto expanded the range of components for new seed lines that it controlled. This in turn conferred increased ability to control the choices of seed developers and tended to foreclose Monsanto's competitors in developing alternative genetic modifications. The Antitrust Division of the Department of Justice (DOJ) apparently did not even investigate this acquisition although it did condition its approval of the subsequent massive acquisition of DeKalb Genetics Corp. on Monsanto's providing more access to Holden's corn genetics, but not to any of the other genetic lines in the Holden inventory.[6]

Another, more recent Monsanto acquisition has raised even more competitive concerns. In 2008, it acquired Delta Pine and Land Co. (DPL), the largest producer of cotton seed in the country. DPL sold over 50% of all cotton seed and had much greater shares in key regions. DPL did not engage in genetic developments of its own; rather it contracted with Monsanto to use its genetics. But starting after 2000, DPL entered into agreements with other innovators of genetics to develop new lines of seed using their genetics. These genetics would compete directly with Monsanto's herbicide resistant genes as well as with its pesticide gene. If carried to conclusion, such competition would have produced directly competing genetic options in cotton. Now because it is a part of Monsanto, DPL has no incentive to use the genetics of other innovators. These rivals of Monsanto are more likely to leave the market because they have lost a major customer in DPL. Because

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[6] Press Release, Antitrust Division, U.S. Dep't of Justice, Justice Department Approves Monsanto's Acquisition Of DeKalb Genetics Corp. (Nov. 30, 1998), *available at* http://www.usdoj.gov/atr/public/press_releases/1998/2103.htm.

cotton is not an edible crop, it provides an ideal test for the effectiveness of new genetics that can then be transferred to other crops.

In the late 1990s, Monsanto had sought to acquire DPL but DOJ had vetoed the deal. But when in 2007, once again, it sought to buy DPL, DOJ agreed, subject to a complex regulatory decree focused only on cotton seed.[7] Moreover, although it required Monsanto to sell some assets to one competing genetic developer and required return of a second line to Syngenta, the joint venturer in its development,[8] the decree effectively excluded DuPont, a third potentially major competitor in new genetics, from the market. Two factors combine to achieve this effect. First, the Monsanto-DPL entity will no longer work with DuPont to develop its genetic traits. Cotton, as noted above, is particularly useful for this purpose since the focus of testing can be on the effectiveness of the trait in its intended purpose and analysis of any risks to human consumption can be addressed later. Without the advantages of that collaboration, development of a new trait is much more costly and difficult. Second, cotton is one of three major crops that use genetic modifications extensively. (Corn and soybeans are the others.) The Monsanto-DPL combination, along with the linkage of the other less prominent cotton seed producers to upstream parents with their own genetic programs, means that none of the significant competitors will have an interest in using DuPont's traits, thus freezing it out of a major part of the market. This in turn means that the potential return from costly and time consuming development work would be substantially reduced. As a result, DuPont has announced that it will not pursue its trait development program because of the limited potential return.[9]

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[7] As discussed in the next section, the decree limited the restraints that Monsanto can impose on the seed partners who license its genetics with respect to combining (stacking) genetics from other sources. But the decree addressed only cotton seed producers and ignored all other types of seed subject to the same restraints.

[8] Thereafter, Syngenta and Monsanto settled antitrust litigation by Monsanto's taking a license from Syngenta to "stack" a Syngenta gene on its soybean and corn seeds. Matt Allen, *Monsanto, Syngenta reach licensing agreement; settle lawsuits*, ST. LOUIS BUS. J., *available at* http://www.bizjournals.com/stlouis/stories/2008/05/19/daily68.html?ana=from_rss. The origins of the case were in disputes over patent rights and exclusionary practices. The settlement results in what may well be a market allocation agreement between these major competitors in genetic innovations, as well as an increase in the barriers to entry for any other producer of genetic modifications for seeds.

[9] *See* DuPont submission to the federal court in the Tunney Act proceeding. 73 Fed. Reg. 18631, 18634 (Apr. 4, 2008), *available at* http://frwebgate2.access.gpo.gov/cgi-bin/PDFgate.cgi?WAISdocID=377947223798+36+1+0&WAISaction=retrieve.

Thirteen state attorneys general and a number of other groups protested the decree in the Tunney Act review proceeding.[10] The district court has expanded authority to review the merits of this settlement as a result of the recent modifications of the Tunney Act.[11] As of the end of June, 2008, however, the court has not acted.

Given the way the seed industry has become concentrated and subject to a number of very restrictive agreements, the already consummated mergers and acquisitions in this industry should be re-evaluated to determine whether they have had or are now likely to have anticompetitive effects and whether post-merger remedies might significantly improve the state of competition in those markets

### *B. Abuse of Patent Rights and Restrictive Licensing Agreements Damage Competition*

Biotechnology is having a massive impact on American agriculture. The most significant area is the development of genetically modified seed. Such seed provides farmers with plants that can be herbicide resistant or resistant to various pests such as the corn bore, thus greatly reducing the cost of weed or pest control. Despite some concerns about the long-run ecological consequences of these developments, American farmers have found that the advantages generally outweigh the risks and costs. Today, more than 90% of all soybeans grown in the United States have transgenic genes that allow them to withstand a popular herbicide. A very substantial part of the cotton crop comes from seeds with the same herbicide resistant characteristic as well, often, as another genetic trait that allows the plant to generate a poison against certain kinds of pests. Increasingly corn has also become genetically modified to include these two traits. Combining two or more traits is called stacking and allows the seed producer to create a greater set of attributes in its seed.

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[10] AAI filed Tunney Act comments in opposition to the merger. This filing is available at http://antitrustinstitute.org/documents/Monsanto_DPL/AAI%20Tunney%20comments_Monsanto_DPL.pdf. DOJ filed a 58-page response attempting to justify its position. The response, competitive impact statement, and proposed decree are available at http://www.usdoj.gov/atr/cases/monsanto.htm.

[11] The 2004 Antitrust Amendments changed the standard for review, see 15 U.S.C. § 16 (e), but DOJ has continued to urge that the old deferential standard applies. To date, the reviewing courts seem to have acquiesced in that view as well.

The producers of these genetics impose substantial fees for use of the genetic characteristics on top of the base price of the seed. There are relatively few successful developers of transgenic products. Monsanto is by far the most dominant of these developers. In addition to its own seed production, it also licenses other seed producers to use its technology. The licenses allow the seed company to include the genetic material in its seeds. The agreements require that the seed company collect a "license fee' from the farmer buying the seed. This "technology fee" is then remitted back to Monsanto. More troublesome, Monsanto imposes a variety of restraints on both seed companies licensing its genetics and on the farmers planting the seeds.

In licensing seed companies, Monsanto has required prior approval before its genetics can be combined (stacked) with those of other patentees. It has created economic incentives (including sharing the technology fees paid by farmers) contingent on the licensee's being loyal by not selling competitive genetic characteristics in any significant quantity. These actions create barriers to entry for competing technologies.

In licensing farmers, Monsanto has imposed an absolute, post-sale, ban on saving seed, a traditional practice among farmers raising cotton and soybeans. Hence, these farmers must buy new seed each year. Eliminating the competition from saved seed essentially allows the seed company to raise the price of the seed itself. Monsanto instead could have required that farmers pay a fee for seed that is saved and used for planting as is done in other countries.[12] The current restraint gives seed companies an additional reason to favor Monsanto over any potential competitor; competition in genetics would be very likely to result in modification or elimination of the no-replant policy and so create greater competition in the soybean and cotton seed markets.

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[12] It is costly to enforce the no replanting requirement. Monsanto has made a significant investment in this activity including a massive amount of litigation. For a farmer to save cotton seed for use in planting requires seed cleaning. Hence, the seed cleaner can act as the agent of the patent holder to collect re-use fees, just as the seed company licensees collect the fee for new seed. In the case of soybeans, cleaning is not essential for use in planting but is strongly recommended since among other things the cleaner tests the germination capacity of the seed. In the U.K., seed cleaners provide the service of collecting license fees for various rights holders. There is, overall, no reason to think that allowing saved seed, subject to payment of additional fees, would result in a more costly enforcement system than the present no-replant policy. Moreover, it would focus more directly on protecting the entitlement of the patent owner without interfering in the overall market for seed. *See* Peter Carstensen, *Post-Sale Restraints via Patent Licensing: A "Seedcentric" Perspective*, 16 *FORDHAM INTELL. PROP. MEDIA & ENT. L.J.* 1053 (2006).

Corn is hybrid seed and so can not be saved and replanted. It is also very difficult, indeed impossible without a vast investment of resources, to reverse engineer such seed by planting and selecting corn seed from the resulting plants. Yet patent holders such as Pioneer Hi-Bred International impose post-sale restraints on the buyer's use of that seed as well—limiting it to planting or animal feed.[13] Since it would be foolish to use expensive corn seed to feed animals, the real implication of this restraint is that the buyer may not resell the seed to another potential user. This restraint has nothing to do with protecting any interest in the patented genetics from misappropriation, but it does facilitate price discrimination. Pioneer gives volume buyers low prices relative to the list prices it charges small buyers. The differences are well beyond any cost justification.[14] Without the patent-based restraint and its potential penalties, there would be a substantial likelihood that volume buyers would engage in arbitrage directly or would sell surplus seed to intermediaries who would resell it. Absent the excuse that patent law authorizes such a restraint and exempts it from antitrust review, such naked exploitation of the market would probably be illegal.

So far the courts have not rejected any of these restraints.[15] DOJ did compel Monsanto to waive some of its restraints on seed companies with respect to stacking genes but only with respect to cotton seed.[16] Indeed, such restraints have a clear anticompetitive intent and effect with respect to innovation in genetics. The curious thing is that DOJ failed to insist on similar relief with respect to the other seed types in which Monsanto has a dominant market position. Moreover, it did not require Monsanto to allow cotton growers to save and replant seed.[17]

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[13] *See, e.g.*, Pioneer Hi-Bred Int'l, Inc. v. Ottawa Plant Food, Inc., 283 F. Supp. 2d 1018 (N.D. Iowa 2003) (holding that the patent holder had the inherent right to impose such a post-sale restraint).

[14] *See* Carstensen, *supra* note 12.

[15] *See, e.g.*, Monsanto Co. v. McFarling, 302 F.3d 1291, 1299 (Fed. Cir. 2002); Monsanto Co. v. Scruggs, 459 F.3d 1328 (Fed. Cir. 2006); *Pioneer Hi-Bred*, 283 F. Supp. 2d 1018.

[16] *See* Part VI.A of the proposed consent decree, *available at* http://www.justice.gov/atr/cases/f232200/232252.htm.

[17] *See* Carstensen, *supra* note 12.

So long as post-sale restraints were limited to farmers, the antitrust authorities turned a blind eye. In 2007, however, they modified their position when the targets of post-sale restraints were computer manufacturers. The Solicitor General then supported a challenge to the claim that post-sale restraints were valid exercises of patent rights and were, for that reason, inherently lawful.[18] The Supreme Court has now held, unanimously, that patent law provides no immunity for such post-sale restraints. It also reiterated that such restraints can be lawful as a matter of contract law, but any such contracts would be subject to antitrust law instead.[19] In light of the *Quanta* decision, the antitrust enforcement agencies should re-examine the restraints used in marketing seeds and challenge those that unreasonably interfere with the farmer's ability to save seed or sell seed.[20]

## II. Production Side Issues

### *A. Excessive Consolidation Creates Lower Prices for Farmers, Less Choice, More Exploitation Concerns and Less Innovation, But Produces No Gain for Consumers*

A central and pervasive feature of agricultural product markets is the existence of buyer power. Processors use that power directly to reduce prices and impose a variety of harmful conditions and restraints on farmers; they are the parties making the decisions whether and from whom to buy. As the number of such decision makers declines, each comes to have a great deal of discretionary power over potential sellers. For agricultural commodities, the markets are geographically limited by the costs of shipping and the

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[18] *See* Quanta Computer, Inc. v. LG Electronics, Inc., 127 S. Ct. 2087 (2007) (inviting the views of the Solicitor General). The government's amicus brief on the merits is available at: http://www.justice.gov/atr/cases/f227600/227630.htm. The position of the United States on post-sale restraints in seeds is not entirely clear. Certainly, there could be a basis to argue that some post-sale contractual restraints might be reasonable as a matter of both contract and antitrust law even if they were not immunized by patent law from judicial review on their merits. *See* Brief for American Antitrust Institute as Amicus Curiae in Support of Petitioners, Quanta Computer, Inc. v. LG Electronics, Inc., 128 S. Ct. 2109 (No. 06-937), *available at* http://www.antitrustinstitute.org/archives/files/06-937tsacAmericanAntitrustInstitute%20_111320071343.pdf. *See* Carstensen, *supra* note 12.

[19] *Quanta Computer*, 128 S. Ct. 2109 (2008).

[20] Monsanto or other trait producers can probably lawfully impose a contractual requirement that they be compensated for the re-planting of saved seed. Essentially, the contractual justification is that otherwise the trait producer would have to charge a very high price for the seed with the trait. But given the monopoly position of Monsanto, it should not unreasonably interfere with the competition between saved seed and new seed. *See* Carstensen, *supra* note 12.

need to preserve the freshness of perishable commodities. The product market is also narrowly defined in light of the product specific investment of the producer. This means that the producer has significant sunk costs in a particular type of production and so is especially vulnerable to exploitation by powerful buyers.[21] Agricultural markets illustrate the exploitative use of buyer power as well as the fact that exploitation of such power often has its most serious competitive effect two or three stages upstream from the initial point at which such power was employed.

Blair and Harrison propose an index of buyer power that rests on the elasticity of supply and the elasticity of demand of the rest of the firms in the market.[22] In the case of agriculture, supply is quite inelastic in the short to intermediate run. Cattle take up to three years from conception to slaughter, pigs mature in 9 to 11 months, and chickens in 6 to 8 weeks, while grains and fibers take a growing season**.** Hence, at any time, buyers face a largely finite supply. In the longer run, to be sure, there is potential for adjustment. At the same time, however, producers have very substantial sunk capital in the production of some type of animal or crop.[23] As a result, there is a great deal of production inertia. This institutional fact creates a significant potential for anticompetitive exploitation of buyer power. In addition, if there are few buyers in a region, each will be fully aware that bidding up prices will not significantly expand supply in the short run. Hence, tacit collusion on prices is particularly attractive.[24]
A survey of the several major commodities reveals the impact on farmers of increased

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[21] This is somewhat less true in grain, where farmers can switch among several crops, although regulations limit that flexibility. Moreover, the same buyers dominate all of the major grains. One interesting illustration of the effect of competition has been the rise of corn-based ethanol production. This has created a large number of alternative buyers for corn, which has probably played a role in the rapid rise of its price.

[22] ROGER D. BLAIR & JEFFREY L. HARRISON, MONOPSONY: ANTITRUST LAW AND ECONOMICS 48 – 61 (1993).

[23] For example, a chicken raiser needs between 15 and 25 years to amortize the fixed cost investment. Been v. O.K. Industries, Inc., 495 F.3d 1217, 1223 n.1 (10th Cir. 2007).

[24] As discussed *infra* text accompanying notes 37 & 45, in both hog and beef markets, the buyers use both captive supply, usually based on some contract, and open market purchases. The captive supply price is usually based on the price for open market purchases, which in the case of cattle, is often the price paid by the slaughterhouse receiving the captive cattle. This buying strategy creates an additional assurance among competing buyers that they will not raise prices for open market purchases because any such price increase will also affect the very substantial captive supplies obtained in the same time period.

concentration at various stages of the buying, processing, and distribution of farm products. There is a dual implication to this analysis. One implication is the potential role for antitrust to control both structure and conduct in these markets. A second implication is the role of market regulations that can (but do not at present) constrain the potential for buyers to exploit farmers.

### 1. Pork

One of the most instructive areas is the market for hogs. In 2003, Smithfield Foods, Inc., the largest pork processor, acquired Farmland Food's pork processing facilities,[25] and, in 2007, it acquired Premium Standard Brands (PSB).[26] The PSB merger consolidated the only two major processors serving the southeastern United States. The next closest major facility is about 400 miles away. Interviews with agricultural economists who had studied the industry showed that producers faced very substantial costs if they wanted to take their mature hogs to that more distant processor because it is costly to haul mature hogs over long distances.[27] As a result, hogs in the Southeast were often priced as much as 10% below the price paid for comparable hogs in the Midwest even before the merger.[28]

The inference of anticompetitive effect received strong confirmation from the Research Triangle Institute (RTI) study of the pork processing industry that USDA's Grain Inspection and Packers and Stockyards Administration (GIPSA) sponsored.[29] That study focused on the period from 2002 to 2005 and found that there was a statistically significant increase in buyer power in the market for mature hogs resulting in lower prices.[30] Thus, significant buyer power antedated Smithfield's acquisition of PSB.

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[25] Although no press release appears to exist, DOJ would have to have agreed to allow this acquisition. *See* Patrick Duffey, *Dismantling of Farmland Continues; Smithfield Buying Pork Business*, RURAL COOPERATIVES, Nov. – Dec. 2003, *available at* http://findarticles.com/p/articles/mi_m0KFU/is_6_70/ai_112167656.

[26] *See Smithfield Foods to Acquire Premium Standard Farms for 0.75 Times Revenue*, WEEKLY CORPORATE GROWTH REPORT (Sept. 25, 2006), *available at* http://findarticles.com/p/articles/mi_qa3755/is_200609/ai_n17189728.

[27] *See* Hearing on Concentration in Agriculture, *supra* note 3 (testimony of Peter Carstensen), *available at* http://judiciary.senate.gov/testimony.cfm?id=3329&wit_id=7164.

[28] *Id.*

[29] GIPSA, LIVESTOCK AND MEAT MARKETING STUDY, VOL. 4: HOG AND PORK INDUSTRIES FINAL REPORT (2007).

[30] *Id.* at ES-3.

Hence, that acquisition both eliminated direct competition in the Southeast and further increased the extent of buyer power.

A second important observation from this data results from the level of concentration in the pork industry that resulted in demonstrable buyer power. During the period when the RTI study found buyer power to exist, national concentration in pork processing rose from an HHI of 1042 in 2001 to an HHI of 1334 in 2005 (i.e., before the Smithfield-PSB merger in 2007).[31] According to conventional seller side analysis, increases in concentration in that range would be unlikely to cause an adverse effect on competition.[32] But here, sophisticated econometric evidence showed that lower levels of concentration sufficed to create buyer power. In addition, the RTI study used national concentration ratios to determine that buyer power already existed. Given that the RTI found buyer power at a national level, the more concentrated regional markets where most livestock are sold for slaughter likely experience an even higher degree of buyer power.[33]

Despite knowing that the PSB merger would in fact increase buyer power with demonstrable adverse effect on producers, DOJ failed to act.[34] The Antitrust Division claimed hog raisers in the Southeast would not be exploited because they could transport their hogs to other processors.[35] The closest facility that appears to exist, however, is

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[31] *See* PACKERS AND STOCKYARDS STATISTICAL REPORT, 2005 REPORTING YEAR, 48 at table 31 (Feb. 2007), *available at* http://archive.gipsa.usda.gov/pubs/2005_stat_report.pdf.

[32] The DOJ and Federal Trade Commission's Horizontal Merger Guidelines focus on seller power and largely exempt mergers that result in concentration below 1000 HHI. They suggest that only in limited circumstances would a merger producing an HHI for an industry below 1800 would raise serious concerns. Indeed, actual merger challenges seem to occur only at substantially higher levels of concentration.

[33] The economic fact is that it is much more cost effective to slaughter animals relatively close to the place where they are finished. National prices set benchmarks for negotiating local prices, but in the local negotiation, the number of potential buyers and the number actually willing to compete to buy any specific block of animals are crucial to the extent of competition and the possibility of favorable prices. In fact, as discussed *infra* text accompanying notes 37 – 38, & 43, the buying practices of major processors operate to further retard price competition in local supply markets.

[34] *See* Press Release, Statement of the Department of Justice Antitrust Division on its Decision to Close its Investigation of Smithfield Inc.'s Acquisition of Premium Standard Farms Inc. (May 4, 2007), *available at* http://www.usdoj.gov/atr/public/press_releases/2007/223077.htm.

[35] *Id.*

approximately 400 miles away. Shipping mature hogs that distance is costly and would be rational only if the price offered by the monopoly processor were significantly below the price offered by the distant buyer. In addition, DOJ claimed that farmers providing contract services in the Southeast could somehow switch to providing those services to "independent producers who own their own hog operations in the area."[36] But these large producers face the same problem of depressed prices that smaller producers would confront. Regardless of the scale of their hog production operations in the Southeast, the producers would have only one major buyer in the area.

Not only did DOJ make a bad decision, but its statement of justification demonstrates a major failure to understand both the dimensions of the market for mature hogs and to appreciate that buyer power, in fact, occurs at lower levels of concentration than DOJ associates with seller power.

Increasingly farmers who raise hogs are doing so under contracts of various kinds with processors. Basically, the contract guarantees the farmer an outlet for her hogs, but the prices for the hogs is often contingent on the price set in the cash market in the upper Midwest (Iowa-Southern Minnesota).[37] Since that market operates continuously during the day, these contracts usually use as their basis the price prevailing at mid-morning. As the number of hogs traded in the cash market has declined, the ability and incentive of firms to manipulate the reported (i.e., mid-morning) price has increased. This is done by withholding purchases until after the mid-morning report, if the goal is to depress price, or offering high prices up to mid-morning, if the goal is to raise rivals' costs.[38]

The Attorney General of Iowa has obtained and posted a number of hog buying contracts.[39] Combined with the fact that there are a significant number of major hog

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[36] *Id.*

[37] Some contracts pay farmers fees for feeding and caring for the hogs. The processor takes the entire market risk. Such contracts, somewhat similar to contracts in the poultry industry, could create different risks of exploitation. But so far in the Midwest, there appears to be enough competition among processors for the services of farmers that the terms of these contracts have not been oppressive.

[38] If processors pay farmers for feeding and care, as described *supra* note 37, they can have an interest in bidding up the price of hogs on the open market to increase their rivals' costs for their contract hogs.

[39] Iowa Dep't of Justice, Office of the Attorney General, Contracts,

processors in the Midwest including at least one new entrant, the result is that hog contract terms generally raise fewer concerns about inequitable treatment of farmers. In contrast, both beef and poultry markets show many more problems with abusive contract terms. In the case of hogs, serious concerns do remain about the risks of market price manipulation given the lack of full disclosure of the identity of buyers and the use of an artificially set time as the base point for price setting.

### 2. Beef

The most recent example of increased concentration in agriculture is the proposed acquisition by JBS Swift of National Beef Packing Co. and Smithfield Beef Group Inc..[40] These three companies are the third, fourth, and fifth largest beef processors in the United States. Moreover, the next largest processor is much smaller. Thus, after the acqusistions, steer and heifer slaughter capacity will be highly concentrated with about 90% held by the top four firms and more than 85% by the top three. In addition, Smithfield also owns the largest beef cattle feeding operation in the country with a capacity at its five locations of about 1.6 million cattle a year.[41] Currently, these cattle go to other slaughter houses because Smithfield's own facilities are not sufficiently close to its feeding operations. Shortly before announcing its intention to sell its beef business, Smithfield started and then abandoned work on a new slaughter house facility that would have used at least some of the cattle it produced.

The beef packing industry has not seen many anticompetitive acquisitions in the last 25 years. In fact, Smithfield's entry a few years ago with geographically dispersed foothold-type acquisitions was a clear plus for competition and may have moved the industry toward some modest deconcentration. In addition, Smithfield's beef feeding operations gave it a strong interest in the retention of a viable market for fed cattle. The same would be true of any other owner of those feeding operations that was not vertically

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http://www.iowa.gov/government/ag/working_for_farmers/contracts/index.html

[40] For a fuller discussion of the competitive issues that these acquisitions raise, see *Bullard Testimony*, *supra* note 3.

[41] The sequence of beef production starts with cow-calf farms and ranches that produce the steers and heifers. This is probably a national market and the young animals are shipped substantial distances for an intermediate stage of feeding. The final step in preparing beef cattle is usually delivery to a feedlot where the cattle are fed intensively for four to six months prior to going to slaughter. The Smithfield operation has the largest capacity of any single feeding enterprise in the United States.

integrated. Of course, such an owner is a potential de novo entrant into the slaughter market in the region near the feeding operation, as Smithfield threatened prior to its proposed sale. As long as such a firm stood in the wings, it would put pressure on existing firms to be more competitive. If actual entry occurred, it would stimulate a more competitive market for beef because it would increase the number of buyers in the market.

The existing, premerger level of concentration in the beef packing industry is substantially greater than that in pork processing. In pork, buyer power exists. It follows that buyer power already exists in the beef processing market. Moreover, the proposed acquisitions will substantially increase that concentration and create the kind of vertical integration that will make manipulation of the cash market even more possible. Hence, these acquisitions "may substantially lessen competition." This industry is one in which there is very inelastic supply over any intermediate time period given the long time it takes to bring a calf to slaughter weight. Hence, price competition among buyers will not increase supply but can increase costs significantly. Large retailers use their buyer power to insist on long term price guarantees. Hence, the packers have even less incentive to increase prices as long as they can by tacit agreement allocate existing supplies among themselves. Increasing concentration will only exacerbate this effect. There is no evidence of significant, acquisition-specific economies or other efficiency justifications for these acquisitions.[42]

There is significant evidence of manipulation of markets for cattle at various times in the last decade.[43] Twice, all the beef processors have withdrawn from the public market for feeder cattle. This caused a substantial drop in the price of cattle. On another occasion, the beef packers were aware the USDA was reporting misleadingly low prices for cattle.[44]

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[42] Peter Carstensen, *Concentration and the Destruction of Competition in Agricultural Markets: The Case for Change in Public Policy*, 2000 WIS. L. REV. 531, 537 (reviewing data showing that the minimum efficient scale of plants and firms is substantially below the current level of concentration).

[43] *See* Letter from R-Calf to The Honorable Thomas Barnett, Ass't. Attorney General, U.S. Dep't of Justice at 19 – 20 and exhibits 11 – 15 (Apr. 9, 2008) (documenting the manipulation of market prices for cattle), *available at* http://www.r-calfusa.com/industry_info/2008_JBS_merger/080409RequestDOJRegardingJBS-BrazilMerger.pdf.

[44] The Eighth Circuit has, however, denied farmers recovery for their losses by imposing a requirement that the packer have a specific intent to manipulate prices. Schumacher v. Cargill Meat Solutions Corp., 2008 WL

Although the packers did not cause the error, they recognized that the USDA was consistently understating the actual market prices. These USDA-reported prices provided a benchmark for pricing cattle sold via various kinds of captive supply agreements.[45] Hence, the packers took advantage of the USDA misstatement to achieve prices below their official contractual commitments.

The buyers of cattle use a variety of agreements to obtain control over a substantial part of the supply needed for their slaughter houses. These agreements are "confidential" and so the feed lot operators do not know what other feeders are receiving for their cattle. From a competitive perspective the greatest concern is that the buyers select the feeders that get the "benefit" of a contractual relationship. These feeders are favored relative to those in the open market in that they are assured that they will receive no less than the price paid for open market cattle and may well get a higher price depending on the specific terms of their contract. Access to slaughter houses is particularly important to cattle feeders since fed cattle have a relatively short period of optimal value. If they are not sold during that period, the feeder faces not only higher feeding costs, but a decreasing value of the cattle themselves as they add more fat and less meat. Despite the well-documented discrimination in access and prices among feeders, the courts have refused to find violations of the PSA by imposing unjustified and irrelevant burdens on complaining farmers.[46]

Although three or four major packers may have plants within reasonable shipping distance of a particular feeder's location, it is often the case that only one or two potential buyers will regularly visit the feed lot and, perhaps, only one will regularly make offers. The resulting pattern suggests that the buyers have worked out tacit allocation of feeders.[47] They are aware through regular visits of the number of animals each feed lot is

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222273 (8th Cir. 2008). This is the kind of restrictive interpretation of the PSA that has made it ineffective in protecting the interests of farmers in fair and open markets.

[45] Captive supply arrangements include packer-owned livestock, livestock committed under formal contracts in which the price term is based either on current reported national prices, i.e., the USDA reports, or even on the prices paid at the relevant slaughter house for cattle purchased in the open market that week.

[46] *See, e.g.*, Pickett v. Tyson Fresh Meats, Inc., 420 F.3d 1272 (11th Cir. 2005), *cert. denied*, 126 S. Ct. 1619 (2006).

[47] Lynn Hunnicutt, DeeVon Bailey & Michelle Crook, *Rigidity in Packer-Feedlot Relationships*, 36 J. AGRIC. & APPLIED ECON. 627 (2004).

likely to have for sale in any week. The risk to buyers is in competing for limited supplies. Increasing price will not change the number of cattle available that week. The number is largely fixed. Hence, by allocating the market, buyers can avoid price competition. But this does create a further problem because lower prices over time result in lower production of cattle. Slaughter houses have significant diseconomies when they work very much below capacity. For this reason, it is very helpful to buyers to have "captive supplies" that can be called up to fill any shortfalls, even if the cattle are less than the best. This avoids price competition and so protects the margins of the packer. A further implication of the long run exploitation of cattle producers is that American production of cattle will decline as some farmers and ranchers gradually redirect their investments to other farming activities, but for many producers the next best alternative is much less attractive. Hence, over the long run, a highly concentrated beef packing industry can exploit farmers and ranchers in this country as long as it augments supplies with imports.[48]

Another issue that raises serious competitive concerns is that the price for captive cattle (cattle purchased pursuant to contracts or other understandings) is often set based on the price being paid that week for cash cattle at the same slaughter house to which the captive cattle are sent. The incentive to manipulate cash prices is obvious, but the more subtle harm is that the buyer for such a plant will not raise his cash price even to get a good pen of cattle because the effect is to raise the price of all cattle coming to that plant that week. Thus, to induce captive supply, the packers give those feeders the benefit of a most-favored-nation system and the assurance that they will get the same or better price than the cash price. Moreover, given tacit allocation among buyers, the cash seller often has little or no capacity to attract other bidders. This pricing distorts buying practices and harms the cattle feeding business by restricting the flexibility of buyers in the cash market. Moreover, there are a number of alternative bases for pricing contract cattle that would significantly reduce the incentive to manipulate the cash price. Hence forbidding

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[48] The basic logic is that the packers will make significant gains by exploiting their buyer power against domestic producers and then filling unmet needs for beef by importing processed beef from other countries. So long as the gain from exploiting buyer power exceeds the extra costs of importing necessary additional supplies, the packers will gain despite the efficiency costs to the economy.

this practice would not undermine whatever efficiencies contract systems might produce. The USDA has the authority under the PSA to forbid this practice as "unfair."[49]

Similarly, DOJ is aware of this practice and other market manipulating practices including collective misstatements about future cash purchase plans and joint withdrawals from buying in the cash market. Yet it apparently has not even conducted a thorough investigation of these anticompetitive practices.

Overall, despite growing demand for beef in the United States and the rest of the world, the data show that the number of cattle on feed and being prepared for feeding has declined consistently for the last decade.[50] This has occurred despite the overall increase in the retail price of beef. These data show that buyer power is being used to drive down the price of the input with a resulting overall decline in production. To avoid increasing the price of cattle, packers have resorted to buying cattle in Canada and shipping them into their slaughter houses. This is expensive when looked at in isolation, but its effect is to sustain the depressed price for cattle bought in the American market.

### 3. Dairy

Having access to a fluid milk buyer is important to dairy farmers because only then can they share in the premium paid for fluid milk under the milk order system.[51] Most dairy farms produce Grade A milk suitable for use as fluid milk, but in fact upwards of two-thirds of that milk is used for other purposes, such as making cheese or ice cream.[52]

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[49] In September 2000, a group of experts evaluated the competitive implications of the use by packers of captive supply arrangements rather than the cash market to secure cattle. Although they disagreed about the competitive implications of this practice overall, they agreed that no packer should be allowed to use its current cash price at the plant receiving contract cattle as the basis for the contract price. Despite this expert consensus, the USDA has failed to adopt even this simple regulation. The written statements made at that forum are available at the USDA website, http://archive.gipsa.usda.gov/psp/issues/forum/forum.htm.

[50] *See* NATIONAL AGRICULTURAL STATISTICS SERVICE, CATTLE (Feb. 1, 2008), *available at* http://usda.mannlib.cornell.edu/usda/current/Catt/Catt-02-01-2008.pdf. *See also Bullard Testimony*, *supra* note 3.

[51] *See* 7 U.S.C. § 608c(5).

[52] ED JESSE & BOB CROPP, BASIC MILK PRICING CONCEPTS FOR DAIRY FARMERS 2 (Univ. of Wis. Agric. Extension, A3379, 2004), *available at* http://future.aae.wisc.edu/publications/basic_milk_pricing.pdf.

The theory of the milk order system is that all producers whose milk is useful for serving the fluid milk needs of a region should share in the premium paid for such milk regardless of the use made of the specific farm's milk. The farmer's share would depend on the percentage of milk used for fluid purposes relative to all Grade A milk produced in that region. Thus, in areas with high production costs, most milk is used for fluid purposes, and the premium applies to a substantial part of the production, while in low cost regions, such as the Midwest, the bulk of milk is used for cheese and other manufacturing purposes, and the premium is a much smaller, but still important, part of the farmer's check.

The current order system has a number of features that make it vulnerable to manipulation. To participate the farmer must deliver[53] a percentage of his milk to a fluid processor for at least a minimum number of days in each of several periods of the year.[54] In practice, most farmers belong to cooperatives or other buying groups, and it is the group that must make delivery of some percentage of its milk for some period to time in order for all the members of the group to qualify for participation in the higher price milk pool. But the law then deems the cooperative to be the producer of milk, and it is the cooperative that gets the premium.[55] It has no obligation to pass through the premiums to its members. In addition, when marketing milk in two or more order areas, a cooperative can decide how much any participating dairy farmer receives regardless of where the milk goes.[56] In combination, this gives a cooperative significant power to discriminate among its members if those members lack good alternatives. Moreover, the cooperatives by law have the right to cast the votes of all their members in approving or disapproving any changes in the market order.[57] In regions where one cooperative dominates the milk business, it has effectively exclusive control over ratification of the

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[53] Delivery is not the same thing as use. Once delivered, if the milk is not needed it can be returned to the same milk truck that delivered it and taken to a manufacturer, e.g., a cheese plant, which will then use it. It should be obvious that this system is very inefficient and irrational.

[54] The rules vary among the order areas as to exact percentages required as well as the minimum number of days in each period that milk must be delivered . *See, e.g.,* 7 C.F.R. §§ 1030 et seq. (market order for the upper Midwest region).

[55] 7 U.S.C. § 608c(5)(F).

[56] *See* AMERICAN BAR ASSOCIATION, SECTION OF ANTITRUST LAW, FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW, MONOGRAPH 24, 120 (2007).

[57] 7 U.S.C. § 608c(12).

order and plays a powerful role in revising the order's terms. Hence, a dominant cooperative, especially if it has exclusive contracts with most of the major fluid milk processors, can create significant barriers to entry and competition by insisting on higher percentages and more days of delivery. This forces small cooperatives to submit to its control.

Although the USDA has no general authority to regulate cooperatives, it has authority under the milk order system to impose rules to achieve fair and efficient behavior.[58] Thus, it could require more equitable treatment of dairy farmers, impose requirements of information disclosure, and even regulate the governance of cooperatives providing milk in the order system. It has done none of these things despite an ample and long standing record of abusive practices by dominant dairy cooperatives.

In 2001, DOJ allowed Suiza Foods Corp. to acquire Dean Foods Co.[59] This combination created the largest fluid milk processor in the country with a market share in excess of 30%.[60] DOJ approved this merger without formal objection (the so-called "fix it first" process),[61] but its review lasted many months and involved a substantial revision of the proposed deal. Basically, the new Dean agreed to divest a significantly larger number of milk processing facilities than it had originally proposed. In addition, the press release announcing approval implied that the new Dean would not enter into a long-term exclusive dealing contract with Dairy Farmers of America (DFA), the largest dairy cooperative, in areas of the country where DFA would achieve dominance.[62] However,

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[58] *Id.* at § 608c(7)(A).

[59] Press Release, U.S. Dep't of Justice, Justice Department Requires Suiza Foods and Dean Foods to Divest 11 Dairy Processing Plants (Dec. 18, 2001), *available at* http://www.usdoj.gov/atr/public/press_releases/2001/9721.htm. The press release is the only DOJ documentation relating to the merger.

[60] USDA ECONOMIC RESEARCH SERVICE, THE U.S. FOOD SYSTEM: RECENT DEVELOPMENTS 1997 – 2006 at 25 (2007), *available at* http://www.ers.usda.gov/Publications/ERR42/.

[61] *See* Press Release, *supra* note 59.

[62] *See id. See also* Hearing on Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. on the Judiciary, 110th Cong. (May 7, 2008) (testimony of Douglas Ross, Special Counsel on Agriculture, Antitrust Division), *available at* http://www.justice.gov/atr/public/testimony/232891.htm.

Dean and DFA quickly found ways around that commitment.[63] Thereafter, Dean refused to deal with independent milk producers who had traditionally been its direct suppliers. Instead, these high-volume, high-quality producers were forced to submit to DFA.

National Dairy Holdings (NDH) purchased the divested Dean facilities. DFA, owns 50% of NDH[64] and obtained an exclusive supply contract. The third major milk processor is HP Hood. Through various means, Hood and NDH, with the blessing of DOJ, have managed to combine their managements.[65] Only vigorous protests from a few cooperatives have kept Hood from completely embracing the DFA exclusive dealing arrangements.[66] But even then, the cooperatives have been obliged to come under DFA's wing.[67] DFA also negotiated exclusive supply agreements with a number of other processors. [68]

The divestitures should have provided a means of retaining competition in both the buying and sale of fluid milk. The limits on exclusive dealing were also important because DFA could use its control over access to the Dean and other processing facilities to coerce other cooperatives into merging with it or putting themselves under its control.[69] Indeed, this is exactly what has happened. In addition, DFA, Dean, and their affiliates, NDH and Hood, have successfully urged the USDA to increase the percentages

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[63] Dean and DFA entered into a series of one-year agreements that last for 20 consecutive years. Moreover, the agreements are guaranteed by a substantial bond posted by Dean that is void at the end of the 20-year period. *See In re* Southeastern Milk Antitrust Litigation, 2008 WL 2117159 at *2 (E.D. Tenn. 2008).

[64] *Id.* at *1.

[65] *See Hood and National Dairy Holdings Alter Merger Plan,* ICE CREAM REPORTER, May 20, 2003.

[66] Press Release, Office of Senator Patrick Leahy, Leahy, Jeffords Warn That Hood Milk-NDH Merger Could Hurt Vermont Dairy Farmers, *available at* http://leahy.senate.gov/press/200211/112002a.html.

[67] St. Albans, the largest independent cooperative in New England, having fought the Hood-NDH combination, ultimately decided to let DFA act as its marketing agent. *Cooperative Enters Marketing Agreement,* COUNTRY FOLKS, *available at* http://www.countryfolks.com/ME2/Audiences/dirmod.asp?sid=350E94585B37465F8B5F8BA068B734F5&nm=Features&type=Publishing&mod=Publications%3A%3AArticle&mid=8F3A7027421841978F18BE895F87F791&tier=4&id=05E394D27E5642A9A5912C29A40AD33C.

[68] *See In re Southeastern Milk Antitrust Litigation*, 2008 WL 2117159 at *2.

[69] *Id.*

of milk that must be delivered for a farmer or cooperative to qualify to participate in the fluid milk premium. With the elimination of competing cooperatives, dairy farmers faced the real prospect of lower payments for their milk. In addition, it is alleged that DFA has engaged in various discriminatory and preferential agreements with the result that many dairy farmers are getting less for their milk than they received when the buying side was more competitive.[70]

DOJ highlighted the misuse of DFA's assets when it challenged DFA's acquisition of a small Kentucky processor. The evidence showed massive payments to individuals who participated with DFA in the takeover even though these individuals had made only very small investments.[71] In May of 2008, DFA's new president disclosed that its prior president passed $1 million from the cooperative to the chairman of its board.[72] This transfer occurred at the time of the Dean-Suiza merger, but the use of the funds has not been revealed. The same news story also reported that DFA was under investigation by the Commodity Futures Trading Commission for manipulation of milk and cheese contracts on the Chicago Mercantile Exchange.

DOJ has an open investigation of the conduct of the milk industry. But the matter has been pending for years without any action. The general understanding is that the staff recommended a suit against DFA for its exclusionary practices, but the matter has stalled in the Assistant Attorney General's office.[73] In summary, then, the combined failure of DOJ to take firm action against the consolidation of processors and to challenge the panoply of anticompetitive practices rife in the industry has resulted in serious losses of income and coercion of farmers.

At the same time, the USDA has been complicit in allowing DFA and Dean to insist upon increased percentages of milk to be delivered for longer periods of time in order for

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[70] *Id.* at *2 – *3.

[71] United States v. *Dairy Farmers of America, Inc.*, 426 F.3d 850, 853 – 54 (6th Cir. 2005).

[72] *See* Andrew Martin, *Yes, It's a Cooperative. But for Whom?*, N. Y. TIMES, May 18, 2008, *available at* http://www.nytimes.com/2008/05/18/business/18feed.html?n=Top/Reference/Times%20Topics/Organizations/A/Agriculture%20Department,%20U.S.

[73] *See* Hearing on Concentration in Agriculture (testimony of Peter Carstensen), *supra* note 3.

any farmer or group of farmers to share in the fluid milk premium. These changes further entrench DFA's control over the supply of milk. Although the USDA has authority to impose regulations, it has never used this authority to control the abusive and anticompetitive conduct of large cooperatives.[74]

Moreover, the depressed prices to farmers have not resulted in lower prices to consumers. Professor Ron Cotterill of the University of Connecticut has documented the increased concentration in both processing and retailing. The result is an increasing spread between what farmers receive for milk and what consumers pay for it.[75] Thus, the failure of antitrust enforcement in dairy has resulted in harm to both producers and consumers.

### 4. Poultry

Both the structure and conduct of the poultry business have been transformed. Vertical contract integration is now the norm. In fact, there is no longer a commercial cash market in chickens or turkeys. Basically, integrators (processors) own the birds and pay farmers to raise them. The resulting contracts have a number of competitively suspect terms. The farmer's pay is usually based on comparative performance including feed costs (the integrator supplies the feed), loss of birds, and weight gain.[76] The period of feeding is short, 6 to 8 weeks, and the standard contract does not guarantee any continuation of the relationship. The farmer gets new flocks after the completion of one cycle at the discretion of integrator. At the same time, integrators often demand substantial investments and upgrades in farm facilities that can only be amortized only over a long period of years.[77]

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[74] DFA has over 18,000 members. Dairy Farmers of America, http://www.dfamilk.com/ (last visited July 6, 2008). If it were a public company, it would be required to issue audited financial statements and annual reports and adhere to a number of requirements related to its corporate governance. From the perspective of the thousands of farmers who are dependent on DFA, it is the equivalent of a major public corporation, but it is one about which they have little information and whose management and directors are not held to the standards deemed essential in comparable public enterprises.

[75] *See* Ronald W. Cotterill, Adam N. Rabinowitz & Li Tian, *Milk Market Channel Structure: Its Impact on Farmers and Consumers, and the Inadequacies of Antitrust Enforcement as a Foundation for Dairy Policies: Evidence from the Northeast Dairy Industry* (testimony before the S. Comm. on the Judiciary, October 30, 2003), *available at* http://www.fmpc.uconn.edu/research/milk/Testimony103003.pdf.

[76] For a discussion of contract provisions, *see* Been v. O.K. Industries, Inc., 495 F.3d 1217 (10th Cir. 2007).

[77] *See id.* at 1217 n.1 (amortization takes 15 to 25 years).

The best option for a chicken raiser would be to have access to competing poultry firms. But that would require relatively close proximity between competing plants because chickens cannot be transported very far once they reach the size of processing. Even then, it is unlikely that any farmer would have more than two potential buyers. In this context, the ability of the firms to tacitly agree not to compete with each other for the services of any particular farmer would be very substantial. The end result is that farmers are essentially tied to a single buyer for the duration of their participation in the business of raising chickens. There is a long-standing literature discussing the problems inherent in the structure of this branch of agriculture.[78]

Absent active protection of the farmer via regulation and its enforcement, the processors have great power to impose whatever burdens they wish. The USDA has the capacity to police these contract terms to some extent (there is a debate as to the scope of its rule-making authority with respect to poultry), but to date has failed to do anything to define reasonable and unreasonable terms. At the same time, the number of competing integrators in both the chicken and turkey branches of poultry production has declined markedly with a significant increase in concentration. In poultry, the four largest firms have a 58.5% market share (the top two account for 47% of that total), while in turkey production, the four largest have a 55% share.[79] To date there has been no challenge to the increased concentration in these industries despite the reasonable probability that increased concentration resulting from the reduction in both actual and potential competition on the buying side has only increased the extent of buyer power.

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[78] *See, e.g.*, Randi Ilyse Roth, *Redressing Unfairness in the New Agricultural Labor Arrangements: An Overview of Litigation Seeking Remedies for Contract Poultry Growers*, 25 U. MEM. L. REV. 1207 (1994–1995); Neil D. Hamilton, *Broiler Contracting in the United States—A Current Contract Analysis Addressing Legal Issues and Grower Concerns*, 7 DRAKE J. AGRIC. L. 43 (2002); Glenn A. Hegar, Jr., *Adhesion Contracts, Debt, Low Returns and Frustration—Can America's Independent Contract Farmer Overcome the Odds?*, 22 HAMLINE L. REV. 213 (1998).

[79] In both cases, the increase in the last ten years has been substantial. The top four chicken processors had 49% of the market in 1998 and the four largest turkey producers had 45% in 2000. MARY HENDRICKSON & WILLIAM HEFFERNAN, CONCENTRATION IN AGRICULTURAL MARKETS 2007, *available at* http://nfu.org/issues/economic-policy/resources/heffernan-report.

### 5. Commercial Crops—Corn, Grain, Soybeans and Cotton

In 1999, DOJ allowed Cargill, Inc. to acquire Continental Grain's grain operations subject to some modest divestiture. The immediate result was to increase concentration in the business of buying grain such as corn, wheat, and soybeans. Farmers found themselves with less competition at the farm gate for their crops. As in the case of pork, the levels of concentration that resulted are such that there is a significantly increased risk of buyer power. Despite the recent increases in the prices for most grains, the point here is that the industry structure facilitates the extraction by intermediaries such as ADM and Cargill of much of the gain that ought to go to the farmer.[80]

In flour milling in 2005, the top four had a 63% share.[81] Twenty years earlier the top four had 44% of capacity. In soybeans, the concentration is even higher with the top four having 80% of capacity with the top three sharing 71%. The one area of grain consumption that has shown a dramatic decrease in concentration is ethanol production, which has dropped from a four-firm concentration of 67% of capacity in 1999 to 31.5% in 2007. The change is the result of massive entry by small producers, including farmer-owned entities. These farmer groups now account for about 39% of total ethanol capacity. In part, the changing prices at the farm gate for corn is traceable to this dramatic increase in the number of local buyers for that crop. This indirectly affects other crops because of the incentive to switch to corn from soybeans and perhaps other row crops because of the relative price advantage. This in turn requires buyers needing soybeans to raise their prices to induce continued production.

Because grain sales are not as time sensitive as livestock or poultry sales, there have been fewer publicly observed concerns with specific buying techniques. Due to the overall reduction in the number of upstream buyers and a reduction in the number of competing local buyers, however, farmers can still face serious buyer power concerns given the increasing costs of transporting grain to more distant outlets. Moreover, in any year, there is substantial supply inelasticity because farmers must commit to the type of crop they will grow at the beginning of the year. As the volatility in grain markets increases,

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[80] In late June, 2008, Bunge Ltd. announced its plan to acquire Corn Products International, Inc. Bunge is the among the largest processors of soybeans as well as one of the leading grain buyers. Corn Products is a major processor of corn into high fructose syrup and other uses. This merger, if allowed, will further concentrate the grain processing and buying businesses and make it more likely that the three leading firms (ADM, Cargill, and Bunge) will be able to coordinate their buying practices.

[81] The market share date in this paragraph is drawn from HENDRICKSON & HEFFERNAN, *supra* note 79.

farmers have a greater concern with market manipulation and access to affordable hedging options. The Commodity Futures Trading Commission, to its credit, has initiated policy reviews aimed at dealing with these issues.[82]

### 6. Grocery Consolidation

Another factor that is very important in the overall evolution of buyer power in agricultural markets is the increased concentration in the grocery business. In the last decade, concentration has more than doubled with the five largest grocery retailers increasing their share from 24% of grocery sales in the country to 48% as of 2006.[83] As grocery retailing becomes more concentrated the retailers acquire greater buyer power and use that power in ways that cause adverse effects on upstream markets. Indeed, one continually reads as a justification for mergers among food processors that they need to combine in order to have bargaining power with retailers. The other side of that power is an increase in their own buying power. They use that power to drive down the prices they pay even as they try to keep up prices with respect to what retailers pay for their goods.

The Federal Trade Commission (FTC) is largely responsible for enforcing antitrust law in the grocery business. It has failed to take appropriate account of the creation and entrenchment of buyer power in its reviews of such mergers. Although this may seem only indirectly to affect farmers, the reality is that upstream power is transmitted back onto the suppliers least able to transfer the impact further.[84] A major error, therefore, in the analysis of buyer power in merger cases is the failure to look for the places where the diffusion and exploitation of such power will come to rest. If such a focus had been

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[82] Diana Henriques, *Commodity Regulation to Toughen*, N.Y. TIMES, June 3, 2008, at C1.

[83] HENDRICKSON & HEFFERNAN, *supra* note 79.

[84] A classic example occurred in the cheese business, where Kraft buys about 30% of all cheese sold in this country. Cheese prices were set based on private negotiations using the price established on Fridays at the Green Bay cheese exchange. Although very little cheese was sold at that market, it was the source of the base price for most transactions. Kraft, particularly at times of high or low demand, entered as a seller on the exchange, thus deflating the price of all the cheese it purchased. The result was that cheese makers got lower prices for their cheese. But the cheese makers reduced the price they paid for milk (the relationship of milk to cheese is a well-known formula in the industry). Hence the dairy farmers were the ones who paid the price of the artificially reduced price of milk. WILLARD F. MULLER, ET AL., CHEESE PRICING: A STUDY OF THE NATIONAL CHEESE EXCHANGE, WIS. DEP'T OF AGRIC., TRADE, AND CONSUMER PROTECTION INVESTIGATION INTO CHEESE PRICING (1996).

used, the FTC and DOJ would have observed that there is a more substantial risk of adverse effects on competition from mergers creating buyer power.

### *B. The Implications of Consistent Failure to Enforce Antitrust Law*

The history of the last decade of antitrust enforcement related to agricultural markets is lamentable. As the foregoing summary shows, the results have been a substantial increase in concentration that has resulted in exploitation of farmers even as consumers faced higher retail food prices. Moreover, there has been an abysmal failure to challenge any of the anticompetitive practices that these firms employ.

More specifically, DOJ has failed to enforce merger law with respect to combinations creating excessive buyer power. Unlike the contexts discussed in *The New Kid on the Block: Buyer Power* contained in this report, where the use of countervailing buyer power may in fact have pro-competitive effects, the use of buyer power in agriculture oppresses individual farmers and ranchers who have minuscule shares of the output market. The fundamental error in merger enforcement appears to be a failure of DOJ to develop and employ standards that are designed to evaluate the competitive implications of combinations in agricultural markets where crops and animals often need to be sold in a timely fashion in order to avoid spoilage or loss of value.

The FTC has exacerbated the problem by its refusal to evaluate grocery store mergers in terms of their effects on upstream food processors and suppliers. As those firms face retailer buyer power, they respond by seeking to merge into larger units to create counterbalancing bargaining power in their selling markets. But the consequence of such combinations is also to increase the buyer power of the resulting firms. This in turn produces even more capacity to exploit upstream suppliers, particularly farmers and ranchers. Indeed, as the downstream buyer power of retailers grows and the intermediate supply industry consolidates, the inevitable result is to increase the exploitative pressure on the least powerful suppliers—farmers and ranchers. This sequence of effects also highlights the need to assess the competitive impact of mergers by looking beyond the first level of supply and investigating where and how the effects of buyer power in retail or final processing will come to rest.

In addition to a failure to pursue a thoughtful and informed merger policy the antitrust agencies have failed to act with respect to a number of conduct issues. The two most

prominent areas are dairy and beef markets. In both markets there is public information showing exploitative and exclusionary conduct by leading firms, i.e., the major beef packers with respect to coordinated market withdrawals and false declarations of reduced purchases and DFA and its associates, including Dean, NDH, and Hood, with respect to exclusionary contracts and exploitation of dairy farmers.

There is no indication that DOJ has even investigated the various examples of apparently collusive market manipulation in the livestock markets. However, in the case of the dairy industry, DOJ conducted a multiyear investigation and reportedly received a staff recommendation that an antitrust suit be filed. This recommendation was made some time in 2006 or 2007, but to date there is no indication that any decision to pursue or close the matter has occurred.

The failure to challenge collusive market manipulation strategies shows once again the failure of the antitrust enforcement agencies to recognize and respond to the kinds of anticompetitive conduct that constitute a violation of the antitrust laws and that impose serious harm on farmers. In part, once again, the enforcement failure comes as direct result of the lack of appreciation of the nature of buyer markets and the kinds of conduct that will most likely cause harms in those markets.

In the late 1990s, in response to repeated concerns about the failure to enforce antitrust law in agricultural markets, DOJ created a position of Senior Counsel for Agriculture. The hope was that this would provide better engagement with agricultural issues. It is clear after a decade that the position carries no authority to initiate or oversee cases. The incumbent, a holdover from the previous administration, is a dedicated civil servant in the difficult position of justifying decisions over which he has no control. What this tells us is that institutionally DOJ has not been able to provide the kind of oversight of anticompetitive conduct and mergers in agriculture that Congress expects.

### *C. Market Facilitating Regulation*

Because of the inherent characteristics of most agricultural product markets, there will be significant size disparity between the relatively few buyers and the numerous sellers. To operate efficiently and fairly, such markets require regulations that minimize the capacity of the dominant parties to engage in strategic and exploitative conduct. Such regulations

are a recurring feature of a workably competitive economy. They are used in a variety of consumer protection contexts, to constitute and regulate the market for corporate securities, both when initially issued and when traded in the public market, and in a variety of other contexts.

Agriculture is an area that has long been subject to regulations that seek to protect food purity and facilitate the markets for agricultural products. The key statutes are the Grain Inspection Act, the PSA, the AMAA, the Capper-Volstead Act, and the Agricultural Fair Practices Act. Taken as a whole, these statutes set forth a strategy of market facilitation intended to reduce exploitative, discriminatory and exclusionary practices and to authorize regulations that will make markets in agricultural products work more effectively. The USDA has the authority under PSA and the AMAA to adopt regulations that would address a number of market conduct concerns in livestock and dairy markets. Unfortunately, the USDA has basically failed to implement this regulatory scheme.
For example, under the PSA, the USDA could adopt a regulation that would forbid the use by buyers of the prices of livestock, especially cattle, of their own slaughter house as the basis for calculation of contract prices. More controversially, the USDA could address the problems of access to livestock contracts by adopting regulations requiring packers to offer such contracts so that all potential sellers have access to that option. Indeed, fuller disclosure of the terms of such contracts would make the entire market for livestock much more transparent and open.

Poultry growing has been completely removed from the open market and become entirely a product of contracts. These contracts often include a variety of exploitative and abusive conditions. Despite repeated recommendations that the USDA adopt regulations implementing the PSA's prohibitions on unfair and discriminatory conduct, it has to date failed to make any effort to protect vulnerable growers from exploitation.

The dairy situation is somewhat different legally, but the consequences of USDA's inaction are similar. The USDA does not have general authority to regulate the conduct of milk markets, but it does have authority under the AMAA to review and modify milk marketing orders. Moreover, it has explicit authority to deal with anticompetitive conduct in such markets. As discussed earlier, DFA in collaboration with the leading fluid milk processors has sought to control access to the fluid milk segment of the market. Moreover, because of the separation between membership and actual control of

the business, DFA has acted against the interests of its membership. Remedying these problems by revisions to the milk orders does face some real difficulties. Since DFA, as a cooperative, has a proxy for its members' votes, it can veto any change in an order that it finds unacceptable. But, since the vote on the order is an up or down vote, the effect of rejecting a change would be termination of the order. If many orders were terminated, DFA's power would be significantly impaired, and it might well dissolve. Dairy farmers could then organize alternative cooperatives and restore the order under better regulatory terms.

Although the AMAA and the PSA provide jurisdiction for the USDA to adopt market facilitating regulations in some key sectors of agriculture, they do not provide a comprehensive authority to regulate the markets for agricultural commodities in the interest of efficient, fair and open market processes. There have been a number of efforts in Congress to expand the scope of these laws, but special interest lobbying has frustrated those reforms.

## II. Policy Directions for Antitrust Enforcement in Agriculture

### *A. Administration of Antitrust Enforcement in Agriculture*

The current position of Special Counsel for Agriculture in DOJ has proven ineffective in developing a better appreciation of the competitive issues facing agriculture or in providing leadership in developing cases. The next administration should carefully consider whether, in order to ensure effective support for economically efficient and socially desirable competition in agricultural markets, the antitrust laws should be amended to provide more explicit recognition of the unique aspects of agricultural market competition and its preservation.[85] As suggested below, agriculture-specific guidelines are needed, but in addition, the administration of DOJ should be reorganized to confer authority on the Special Counsel or a Deputy Assistant Attorney General to oversee directly enforcement in this field.

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[85] Currently pending in Congress is the Grassley-Kohl bill, S. 1759 (the Agriculture Competition Enhancement Act) that would modify antitrust law standards so that they focused explicitly on the buyer side competitive issues.

### *B. Mergers on the Input Side*

- The enforcement agencies should provide more focused review of mergers that increase concentration in the markets supplying farmers and ranchers. Particular attention should be focused on mergers involving new biotechnology in the seed industry.

- The enforcement agencies should re-evaluate the major mergers allowed in the seed industry to ensure that they are not now causing anticompetitive harms with respect to prices and innovation in that industry.

### *C. Mergers on the Buying Side*

- The agencies should be especially vigilant in the future to ensure that they do not allow acquisitions that subject farmers or ranchers to monopsonistic exploitation.

- The agencies should develop agriculture-specific guidelines for the investigation and evaluation of mergers that increase concentration on the buying side of the market. Empirical evidence demonstrates that buyer power exploitation in these markets occurs at levels below those currently considered to raise competitive concerns on the seller's side.

- The exercise of buyer power in agriculture can cause harm even when it does not reduce output. In evaluating mergers of buyers, the agencies should consider whether the transaction is likely to cause adverse effects beyond an immediate reduction in output, such as a transfer of wealth from suppliers to the merged firm.

- The exercise of buyer power in retail grocery markets or other downstream processor or resale markets can cause harms that affect upstream producers two or more levels removed from the initial exercise of that power. For this reason, merger analysis must consider the ultimate impact of the exploitation of buyer power.

- Coercively induced mergers among cooperatives as well as joint ventures

between cooperatives and noncooperatives are subject to antitrust law. The enforcement agencies should examine such transactions for their potential anticompetitive effect and challenge all those that create cognizable risks, especially so long as the USDA has not adopted regulations that respond effectively to the competitive risks created by the powers given cooperatives under market orders.

### *D. Exclusionary and Exploitative Behavior in Input Markets*

- The enforcement agencies should examine critically the use of exclusionary agreements in the distribution of agricultural inputs generally and specifically in the case of seeds. Current licensing agreements between owners of patented rights and seed producers significantly restrict the freedom of the seed companies to combine genetics and so create innovative products. Such agreements also can impose significant penalties for developing and marketing competing seed lines to the detriment of buyers of seed.

- The enforcement agencies should challenge the current practices of owners of genetic patent rights that impose post-sale restraints on farmers or other buyers that exceed any legitimate interest in protecting the patent rights of those enterprises. These post-sale restraints facilitate exploitation of farmers through denying them the opportunity to save and replant seed as well as facilitating unjustified price discrimination.

### *E. Exclusionary and Exploitative Conduct in Supply Markets*

- The agencies should investigate the apparently coordinated efforts of major livestock buyers to manipulate market prices.

- The agencies should examine the use of exclusive contract terms in the buying of cattle, hogs, and poultry because these restraints can significantly reduce the long term competitiveness of the markets for these products. This includes formal or informal allocation of producers among buyers, limiting actual competition.

- The agencies should examine the use of contract terms that facilitate manipulation of prices, such as the use of the price paid at a slaughter house as the basis for pricing contract purchases of cattle at that same facility. Where such conduct is coordinated among buyers, it should constitute an antitrust violation and where the buyer has substantial monopsony power, this conduct should constitute a presumptive antitrust violation even if it is also in violation of relevant regulations governing such markets.

## III. Market Facilitating Regulation—The Role of the USDA

As an initial matter, the USDA needs to reorganize its handling of the market facilitating regulations that it administers. There is a clear need for administrative leadership in the form of a Deputy Secretary with background in competition law and policy and a commitment to effective policy development and enforcement. It is also imperative that the oversight of the various market regulation functions of the USDA be consolidated under the leadership of someone who has both the skills and the knowledge to use the existing legislative authority to achieve real reforms in the operation of the markets in which farmers sell their products.

- The USDA has the legal authority to impose regulations in many markets for agricultural commodities that would both limit the capacity of dominant buyers to manipulate and exploit those markets and facilitate improved efficiency in the market process.

- The USDA has failed to use its existing authority to achieve the public interest goals underlying the legislation creating that authority. As a result, livestock and poultry producers do not have the benefit of markets for their products that are as workably competitive as they could be. The regulations should ensure as much open access to markets as is feasible, full disclosure of terms for both cash purchases and contractual arrangements of all kinds, and should prohibit unjustified practices, including use of own-facility prices in setting the basis for contract transactions, unfair arbitration terms, and imposition of new costs on contract producers in poultry without a matching commitment to continue to buy from those producers.

- Congress should reform the PSA to apply its prohibitions on unfair and discriminatory practices to all sales of agricultural commodities, reverse decisions such as *Pickett v. Tyson Fresh Meats, Inc.*,[86] which have imposed excessive and onerous conditions on plaintiffs seeking relief from discriminatory and exclusionary practices, and provide successful plaintiffs with a right to a reasonable attorneys' fees.

- The USDA should reform its enforcement of the PSA to ensure that it is an effective source of enforcement responsive to contemporary market conduct.

- The USDA should use its authority under the AMAA to terminate the exploitative and exclusionary practices common under milk marketing orders and other marketing orders. It should also use its authority under that law to require full disclosure comparable to that required of publicly held corporations of any large cooperative that participates in any market subject to an order under the AMAA.

## Conclusion

The structure and conduct of both the industries supplying farmers and those that buy and resell agricultural products are causing serious anticompetitive harm to agriculture. Failures in antitrust enforcement of merger and conduct law and the USDA's enforcement of existing law governing market conduct have brought about these conditions. While more general reform of agricultural policy is also essential, from the perspective of competition policy there are important changes that can be made in the analysis of agricultural issues, especially recognizing the different character of buyer power in agriculture, and the enforcement of both antitrust law and the laws that seek to ensure fair, open, and efficient markets in agricultural products. Change is vital if American agriculture is to retain its viability.

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[86] 420 F.3d 1272 (11th Cir. 2005), *cert denied,* 126 S. Ct. 1619 (2006).