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

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July 11, 2016

The Honorable Charles E. Grassley
Chairman
U.S. Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Patrick J. Leahy
Ranking Member
U.S. Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Mike Lee
Chairman
Senate Judiciary Committee Subcommittee on Antitrust, Competition Policy, and Consumer Rights
330 Hart Senate Office Building
Washington, DC 20510

The Honorable Amy Klobuchar
Ranking Member
Senate Judiciary Committee Subcommittee on Antitrust, Competition Policy, and Consumer Rights
825 Hart Senate Office Building
Washington, DC 20510

The Honorable Loretta E. Lynch
Attorney General of the United States
U.S. Department of Justice
950 Pennsylvania Avenue, NW
Washington, DC 20530-0001

The Honorable Renata B. Hesse
Principle Deputy Assistant Attorney General
U.S. Department of Justice
950 Pennsylvania Avenue, NW
Washington, DC 20530-0001

Re: **Corrected Version of Request for Immediate Enforcement of U.S. Antitrust Laws to Stop a Mega-Feedlot Merger in the U.S. Cattle Industry**

Dear Committee Chairman Grassley, Subcommittee Chairman Lee, Committee Ranking Member Leahy, Subcommittee Ranking Member Klobuchar, Attorney General Lynch and Principle Deputy Assistant Attorney General Hesse:

We respectfully request immediate enforcement of U.S. antitrust laws to stop the proposed acquisition of two feedlots owned by Cargill Cattle Feeders, LLC, by Friona Industries.

On July 8, 2016, the *Amarillo Globe-News* reported that Amarillo-based Friona Industries (Friona) will acquire all of the cattle feeding assets of Cargill, Inc., (Cargill) located in the Texas Panhandle, which would include two of Cargill Cattle Feeders, LLC's (Cargill Cattle Feeders') four feedlots.[1] According to data provided by *Cattle Buyers Weekly*, Cargill Cattle Feeders and

[1] Amarillo Company Buys Cargill's Texas Panhandle Feedyards, Globe-News Staff, July 8, 2016, available at http://m.amarillo.com/news/business/2016-07-08/amarillo-company-buys-cargills-texas-panhandle-feedyards?utm_medium=social&utm_source=facebook_Amarillo_Globe-News#gsc.tab=0; see also Friona

Friona are tied for third-place among the United States' largest cattle feeding companies, each with a one-time capacity of 300,000 head.[2] If the acquisition is consummated, Friona will remain the third-largest feedlot company with a new one-time capacity of about 440,000 head while Cargill Cattle Feeders, which would retain capacity for about 160,000 head, would rank approximately 15th in size.[3]

As discussed more fully below, while R-CALF USA supports the divestiture of Cargill's cattle feeding assets, this proposed sale of two feedlots to Cargill's closely aligned feedlot, Friona, does nothing to remedy Cargill's ongoing ability to manipulate prices with its massive volumes of captive supply cattle (*i.e.*, cattle committed to Cargill for more than seven days prior to slaughter, which includes formula cattle committed to the company without a negotiated base price).

Instead, this proposed acquisition will substantially and severely reduce competition in the U.S. feeder cattle market, *i.e.*, the market in which light-weight cattle are purchased from U.S. cattle producers by feedlots who subsequently sell the cattle for slaughter after they are fed a grain-based diet for approximately 120 days.

Assuming, arguendo, that there is competition among meatpackers for cattle currently fed by Friona, this proposed acquisition would also substantially and severely reduce competition among meatpackers for fed cattle, *i.e.*, slaughter-ready cattle.

<u>Competition will be Reduced in the Feeder Cattle Market</u>

Feedlot companies compete for available feeder cattle produced by U.S. cow/calf producers, backgrounders (*i.e.*, operators of pre-conditioning feedlots), and stockers (*i.e.*, operators with lighter-weight cattle about one-year of age that are grazed on grass or winter wheat before they are mature enough to enter feedlots). Mergers of already concentrated feedlot companies, therefore, reduce the number of buyers available to offer bids and ultimately purchase cattle from U.S. cattle producers.

The average beef cow herd on U.S. farms and ranches in 2012 (latest available data) was about 41 head.[4] The estimated number of cattle fed by Cargill Cattle Feeders in 2014 was

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Industries, L.P. – Acquisition of Cargill Feedyards, July 8, 2016, available at http://www.frionaindustries.com/media/pdfs/FI-Press-Release-July-8-2016.pdf.

[2] Top 30 Cattle Feeders 2015, Cattle Buyers Weekly, available at http://r-calfusa.com/wpcontent/uploads/2013/04/160125-Top-30-Cattle-Feeders.pdf.

[3] *Id*.

[4] There were 729,000 beef cattle operations in the U.S. in 2012 (Farms, Land in Farms, and Livestock Operations 2012 Summary, U.S. National Agricultural Statistics Service (NASS), February 2013, at 18, available at http://usda.mannlib.cornell.edu/usda/nass/FarmLandIn//2010s/2013/FarmLandIn-02-19-2013.pdf.). The U.S. beef cow inventory in 2012 was 30,157,900 head (Cattle, NASS, February 2013, at 4, available at

800,000 head.[5] Thus, Cargill Cattle Feeders currently competes annually against Friona for the purchase of about 800,000 cattle that are offered for sale by approximately 19,500 U.S. cattle producers.[6] R-CALF USA estimates that the two Cargill Cattle Feeders feedlots subject to the proposed sale marketed about 350,000 cattle in 2014.[7] Thus, the proposed sale would eliminate Cargill Cattle Feeders as a competitive rival to Friona for the purchase of 350,000 cattle offered for sale by approximately 8,500 U.S. cattle producers.[8]

This reduction in the number of buyers available to approximately 8,500 U.S. cattle producers is significant because the eight feedlots owned between Cargill Cattle Feeders and Friona are among only 71 of the nation's largest feedlots (*i.e*., feedlots with a one-time capacity of over 50,000 head) that together controlled 33 percent of all fed cattle marketed in 2014.[9] In 2009, the Congressional Research Service estimated that the market share of the two merger prospects was approximately 10 percent.[10]

Since JBS' 2008 acquisition of top-ranked Five Rivers Cattle Feeding Company, the number of U.S. feedlots – hence competition for feeder cattle, dropped dramatically. In 2008 there were 82,170 feedlots (*i.e*. marketing outlets) available to purchase cattle produced by U.S. cattle producers.[11] By 2015, the number of U.S. feedlots dropped 67 percent, to only 27,189 feedlots.[12] Only 2,189 of those feedlots have a one-time capacity of more than 1,000 head and they marketed a full 87 percent of all cattle marketed in 2015.[13]

Clearly, mega-feedlots Cargill Cattle Feeders and Friona are dominant feedlots with substantial market shares in the already highly concentrated U.S. feedlot sector within the U.S. live cattle supply chain. A merger between these two monolithic feedlot companies will substantially reduce competition for feeder cattle. This loss of competition within the live cattle supply chain will directly harm U.S. independent cattle producers.

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http://usda.mannlib.cornell.edu/usda/nass/Catt//2010s/2013/Catt-02-01-2013.pdf.). Thus, the average U.S. beef-cattle herd size in 2012 was approximately 41 head of beef cows.

[5] *See* footnote 2, *supra*.

[6] Estimate calculated by dividing the number of head marketed by Cargill Cattle Feeders, LLC, by the average size of the U.S. beef herd.

[7] Estimate based on a feedlot turnover factor of about 2.5 times, which assumes the feedlot fills its one-time capacity feedlot 2.5 times each year.

[8] *See* footnote 6, *supra*.

[9] *See* Cattle on Feed, NASS, February 19, 2016, at 15, available at http://usda.mannlib.cornell.edu/usda/nass/CattOnFe//2010s/2016/CattOnFe-02-19-2016.pdf.

[10] *See* Recent Acquisitions of U.S. Meat Companies, Congressional Research Service, March 10, 2009, at 2, available at http://nationalaglawcenter.org/wp-content/uploads/assets/crs/RS22980.pdf.

[11] Cattle on Feed, NASS, February 20, 2009, at 14, available at http://usda.mannlib.cornell.edu/usda/nass/CattOnFe//2000s/2009/CattOnFe-02-20-2009.pdf.

[12] Cattle on Feed, NASS, February 19. 2016, at 15, available at http://usda.mannlib.cornell.edu/usda/nass/CattOnFe//2010s/2016/CattOnFe-02-19-2016.pdf.

[13] *See id*.

<u>Competition will be Reduced in the Fed Cattle Market</u>

During the joint U.S. Department of Justice and U.S. Department of Agriculture livestock industry workshop held August 27, 2010, in Fort Collins, Colorado, the president of Friona, James Herring, suggested that Friona is immersed in a highly competitive marketplace where four packers are competing for Friona's cattle on a regular basis. Mr. Herring stated, "[W]e have an active participating marketplace out there with four interested parties [packers] that are trying desperately to fill up their capacity every single day and every single week. And that creates a pretty stimulative marketplace."[14]

However, the veracity of Mr. Herring's claim was soon challenged by another workshop witness, Mr. David Domina, who stated it was his belief that Cargill purchases 100 percent of Friona's cattle and, "if that's so, there's no bidding for those cattle by those other three packers."[15]

Assuming, arguendo, that Mr. Herring's claim of competition for Friona's fed cattle by four meatpackers is true, this proposed merger would then be expected to eliminate that competition. This concern is based on: 1) the reported representation by Cargill's representative who told the *Amarillo Globe-News* staff that, 'The Texas feedyards we are selling will continue to supply cattle to our beef processing plants while also enhancing Friona Industries' feedyard portfolio;'[16] and, 2) the *Amarillo Globe-News* article's claim that a company news release stated "Friona currently provides 700,000 cattle per year to Cargill's packing facility in Friona." Given *Cattle Buyers Weekly's* estimate that Friona marketed 680,000 cattle in 2014, it is likely that the 700,000 head of cattle Friona provides to Cargill represents all of Friona's cattle. In other words, it appears that all of Friona's cattle are or will be committed to Cargill, thereby eliminating competition for all of the fed cattle produced by Friona after the merger.

This is alarming given the competitive process whereby, according to Friona, four meatpackers continually compete for Friona's cattle, is disappearing fast. This disappearance is revealed by the thinning of the competitive cash market where both Cargill Cattle Feeders and Friona feed and market their cattle. As shown below, the volume of fed cattle marketed in the competitive cash market shrank from 47.2 percent ten years ago to just 2.6 percent in 2015.

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[14] Transcript of the Colorado Workshop, August 27, 2010, at 209 (14-18), available at https://www.justice.gov/sites/default/files/atr/legacy/2012/08/20/colorado-agworkshop-transcript.pdf.
[15] *Id*., at 215 (13-17).
[16] *See* Footnote 1, *supra*.

TEXAS -OKLAHOMA-NEW MEXICO											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Cash	47.2%	42.5%	36.7%	31.5%	26.4%	21.5%	17.0%	10.2%	6.1%	3.0%	2.6%
Formula	42.2%	42.2%	48.4%	53.3%	60.4%	66.9%	72.7%	76.0%	83.0%	84.6%	85.9%
Forward Contract	3.1%	5.0%	4.4%	5.8%	5.4%	4.9%	4.4%	5.4%	4.0%	7.4%	9.3%
Negotiated Grid	7.5%	10.3%	10.5%	9.3%	7.8%	6.7%	5.9%	8.4%	6.9%	5.1%	2.1%
Source: USDA AMS Livestock, Poultry & Grain Market News											

Clearly, the proposed merger will significantly reduce competition in the fed cattle market as Friona has reportedly committed all or nearly all of its future fed cattle inventories to Cargill. It appears from the news accounts, therefore, that after the merger Cargill would no longer need to compete against its three rival packers for the estimated 350,000 new cattle that Friona will feed and eventually provide to Cargill if the merger is approved.

Abusive Monopsony Market Power will not be Reduced in Cattle Markets

As stated above, R-CALF USA supports the divestiture of Cargill's feedlots. However, the sale of two of Cargill Cattle Feeders feedlots to Friona, which is already aligned (presumably contractually) with Cargill, is not really a divestiture at all. Instead, Cargill is simply trading one form of direct control over the fed cattle supply chain for another.

In fact, Cargill is mimicking Tyson, which boasts that it feeds (*i.e.*, controls) cattle with formula contracts that accord the company market leverage that is equal to or superior to owning the cattle outright. Because Tyson has already explained why formula contracts provide such leverage and what impact the shift to contracts has on the market, below is an excerpt from the South Dakota Law Review that succinctly addresses the instant proposal by Cargill.[17]

> A working paper by C. Robert Taylor states that an affidavit contained in the *Pickett v. Tyson* litigation record reveals an acknowledgement by former IBP, now Tyson Fresh Meats, Inc. ("Tyson"), CEO Bob Peterson on how captive supply arrangements provide meatpackers with significant market leverage over cattle feeders. Peterson stated in a 1988 discussion with the Kansas Livestock Association:
>
>> These (forward) contracts coupled with packer feeding could represent a significant percentage of the fed cattle during certain

[17] Under Siege: The U.S. Live Cattle Industry, Bill Bullard, South Dakota Law Review, Vol. 58, Issue 3, 2013, at 581-582, citations omitted, available at http://r-calfusa.com/wp-content/uploads/2013/04/130101UnderSiegeSDlAWrEVIEWBillBullard.pdf.

> times of the year . . . . We believe that it's having a significant impact . . . on the cash market place.:
>
> . . . we believe that some of those who are feeding cattle and using forward contracting are creating aberrations within the market place by coming in and out of the market; that is not reflecting the true value of the cash market.
>
> But with the packers in the feeding business and forward contracting, there's going to be a major, major shift against the leverage system.
>
> In my opinion the feeder can't win against the packer in the real fair play if we go into the feeding and the hedging program. Do you think that if we had a million cattle on feed and we thought cattle were going to get higher we'd kill ours first and wait for yours until last?
>
> Or do you think we'd kill yours first and wait for ours until last? Do you think if it's going down we're going to buy yours and wait for ours until last? This is pretty basic. Boy Scouts and Girl Scouts are nice, but when you get back to money in the bank and the facts, I'm telling you the facts.

Then, after IBP entered into widespread captive supply arrangements in 1994, Peterson expressed:

> [N]ot formula cattle but packer-fed cattle, which can be killed early or late to fill a particular time frame, be it a day or a week grant the packer far greater flexibility to move in and out of the market. On the way down (in price), he kills his cattle first and on the way up, last.

Peterson also explained how formula contracts give beef packers comparable, if not superior, leverage in the market when compared to packer-owned cattle. In July of 1994, Peterson stated:

> I don't know if we should be proud or ashamed but I'm telling you we started formula pricing. Why did we do it? So we have the same leverage our competition had. And we feed cattle through the process of formula pricing.

> Well, we aren't going to change. We will have formula—that is our way of feeding cattle.

In December of 1994, Peterson said:

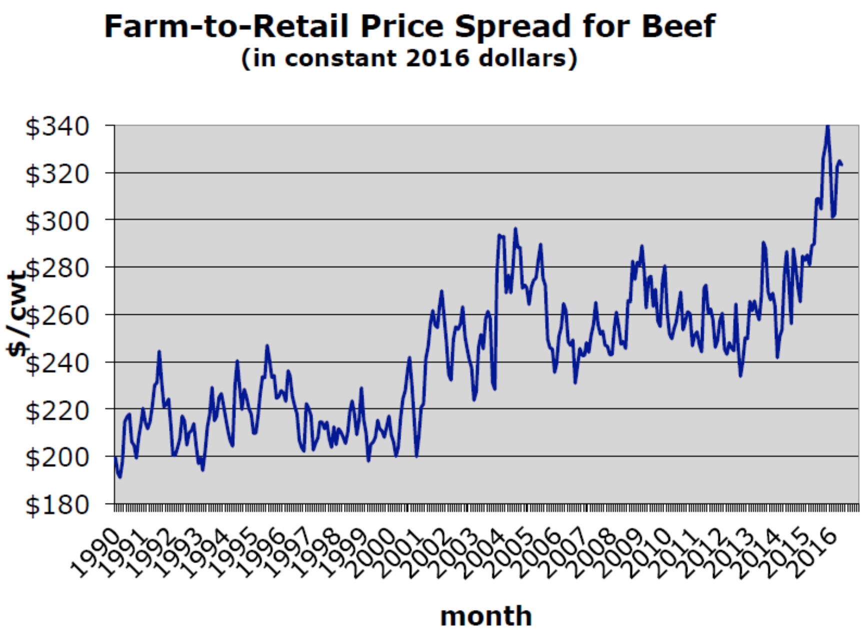
> I told your industry right here at the KLA convention (in 1988) that if it allowed packers to feed their own cattle, IBP (Tyson) would do whatever was necessary to level the playing field. Ladies and gentlemen, the leveling is called formula and contract buying. Thus far, we have been able to partially offset the leverage our competitors have by the use of formula cattle and contract buying. Will we stop doing it? No. Will we feed cattle? If we have to. As most of you know, our recent purchase of Lakeside Farm Industries in Canada includes a feedyard. I am only trying to tell you one thing. IBP (Tyson) will do whatever is necessary to remain competitive.

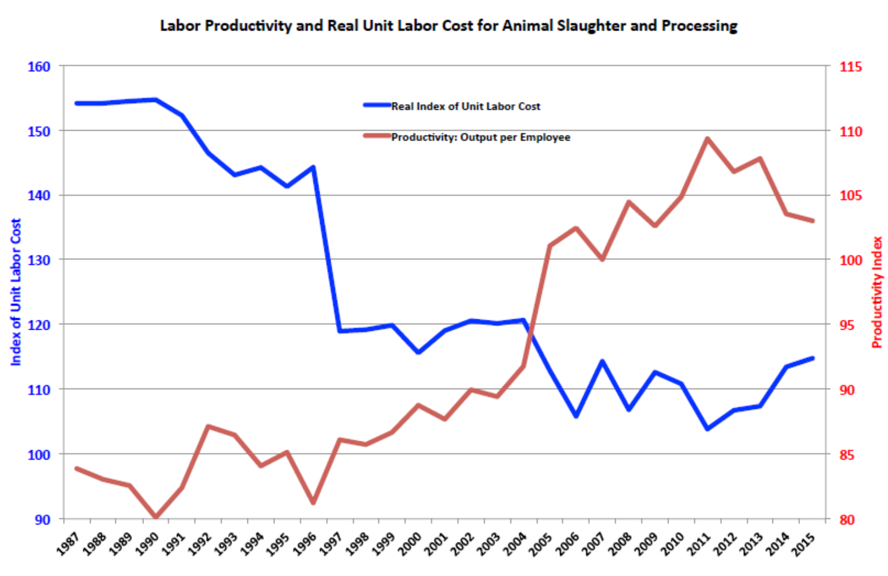
It is clear that Cargill's proposal to divest two of its feedlots will in no way diminish Cargill's leverage over the live cattle market. This is because Cargill is merely trading one abusive, monopsony market tool for another. And, the new tool now coveted by Cargill, *i.e.*, using Friona as its captive supply source presumably through formula contracts, is likely to accord Cargill with even more monopsony market power than it has now.

<u>Consumer Welfare will be Reduced if the Proposed Merger is Consumated</u>

The discussion above reveals that meatpackers have systematically increased their leverage over the marketplace. This has caused the cattle feeding sector to become increasingly concentrated and controlled by meatpackers. Although the largest meatpackers argue they are achieving efficiencies through economies of scale, history shows the opposite has occurred – that concentration in the U.S. cattle market results in the exploitation of consumers.

As shown below in the two charts created by Dr. C. Robert Taylor, Professor Emeritus of Agricultural Economics & Policy, Auburn University, the cost of converting cattle to consumable beef has increased about 50 percent while packing and retailing expenses have gone down. These two charts strongly suggest that meatpacker and meat retailer profits have increased significantly during the period of increasing market concentration. These two charts also strongly suggest that the ongoing concentration of the U.S. cattle market is resulting in the exploitation of U.S. cattle producers on one end of the supply chain and U.S. consumers on the other.





For the foregoing reasons, R-CALF USA respectfully request immediate enforcement of U.S. antitrust laws to stop the proposed acquisition of two feedlots owned by Cargill Cattle Feeders, LLC, by Friona Industries.

Thank you for your consideration and please contact me at 406-670-8157 or billbullard@r-calfusa.com if your respective offices would like any additional information.

Sincerely,

Bill Bullard, CEO