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"Concentration in Agriculture and an Examination of the JBS/Swift Acquisitions"

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Introduction

Mr. Chairman, Ranking Member Hatch, and other distinguished members of the Antitrust Subcommittee of the Antitrust Subcommittee of the Senate Judiciary Committee, I want to thank you for giving me the opportunity today to speak about the competitive problems that arise from increased concentration in agricultural markets and, specifically, on the competitive impact of JBS/Swift's proposed acquisitions of Smithfield and National.[1]

My testimony today is based on over a quarter century as an antitrust practitioner, the majority of which was spent as an enforcer in the Antitrust Division of the Department of Justice, and in several senior management positions, including Policy Director at the Federal Trade Commission ("FTC"). I currently regularly practice before both the agencies, and frequently represent consumer groups, producers, and other service providers, raising concerns about mergers under investigation by the Antitrust Division or the FTC.

My message today is a simple one: Based on the preliminary public facts, JBS' proposed acquisition of Smithfield and National poses very serious competitive concerns and will likely harm competition in the purchase of cattle.[2] Today's hearing and continued monitoring by this Committee are vital to assuring a competitive marketplace in agricultural markets. Unfortunately, the standards currently applied by the Antitrust Division of the DOJ have eroded and we are in a period of particularly lax merger antitrust enforcement. The Antitrust Division has not been to federal court to enjoin a merger in five years. They have not challenged an agricultural processing merger in almost a decade.

My testimony is divided into three parts.
I begin by providing the framework of the competitive analysis of the merger. This merger will reduce the number of national beef processors from 5 to 3. Permitting the consummation of these acquisitions will lead to lower prices to cattle producers, and, ultimately, higher prices to consumers. Second, I analyze whether the merger may on balance benefit consumers perhaps from increased buying power or the potential efficiencies of the merger. I conclude that those efficiencies are unlikely to be a substantial counterweight to the potential anticompetitive effects of the merger. Finally, I close with some general observations about how to improve the approach to agriculture competition issues.

Competition Analysis

I begin with three important concepts to consider in analyzing the potential impact of JBS' acquisitions.

First, the primary concern addressed by this panel is the potential exercise of monopsony power; that is, the power to decrease the price paid to cattle producers for their cattle. It is well recognized in antitrust jurisprudence that the antitrust laws condemn any exercise of market power, whether it harms producers, service providers, or the ultimate consumer or the producers of the product. Indeed, the legislative history of the Sherman Act is unequivocal: The statute was enacted, in part, to protect cattle producers from anticompetitive activity of the beef trust. As a leading DOJ economist observed "[i]n both houses of Congress, participants in debates often singled out the beef trust for condemnation, and they condemned it for reducing the prices paid to cattle farmers more than for raising prices to consumers."[3] This merger, by reducing the number of competitors from five to three, poses the potential for a level of concentration that the founders of the beef trust in the late nineteenth century could not even imagine.

Second, some might suggest that the impact on cattle producers should not be a significant concern unless it can be demonstrated that the exercise of monopsony power would harm consumers. That view is inconsistent with the law and the purpose of the statute. The antitrust laws seek to prevent any misuse of market power, regardless of the victim. Indeed, economic theory teaches that in the end, the exercise of monopsony power leads to reduction of output and that output reduction will ultimately increase prices to consumers. Moreover, it seems relatively clear that recent agricultural processing mergers that may have increased "buyer power" have not led to lower prices for consumers.

Third, merger analysis needs to focus on the unique economic conditions of each market. In any matter involving beef processing, it is tremendously important to realize the fragile nature of competition. As the other witnesses will testify, beef producers can only sell their cattle in a short time window, or the cattle will degrade in quality and value. Moreover, many beef processors are vertically integrated, and this vertical integration offers the opportunity for several types of market manipulation. Each of these factors suggests that the DOJ should be even more concerned about the potential exercise of market power, because even a modest degree of market power will enable processors to harm competition.

What Are the Potential Anticompetitive Effects of the Merger?

Merger analysis begins with the definition of the relevant market. There should be little dispute on this issue: from the producer side of the equation that the relevant market is the purchase of cattle. Cattle producers simply have no alternative but to turn to a beef processor for the sale of their cattle.

The relevant geographic market can vary depending upon the alternatives of the cattle producer. Generally, in agricultural processing matters, the geographic markets are defined by the "draw areas" of the processing facilities. The scope of these draw areas is defined by the distance a producer can efficiently transport its product. We believe that those draw areas will be relatively limited, a distance of perhaps 200 miles. Based on this perspective there may be several geographically limited relevant markets.

One area of particular concern may be the Plains states of Nebraska, Colorado, Kansas, Oklahoma, New Mexico, and Texas. National's two processing facilities in Dodge City and Liberal, Kansas are less than 162 miles from JBS/Swift's facility in Cactus, Texas. For producers relatively close to those three facilities the merger may have a particularly substantial anticompetitive impact.

Once the markets are defined it is necessary to calculate concentration to gather some measure of the potential competitive effect. Concentration calculations are included in Appendix A. I have calculated concentration based on two groups of competitors: all beef processors and the five major beef processors.

Including all beef processors will understate the level of concentration for several reasons. First, some processors just process cows and are not an alternative for steers and heifers. Second, many processors are specialized and focus only on certain types of cattle. Other processors are too small to purchase entire lots. Finally, only the largest five processors act as the “market makers” and smaller processors do not have a significant impact on the bidding process. As the courts have held, only those alternatives which have the significant ability to restrain the exercise of market power should be considered as part of the relevant market. Thus, it would be reasonable to conclude that only the five largest firms (JBS/Swift, Smithfield, National, Tysons, and Cargill) should be included in the relevant market.

In any case, regardless of which firms are included the proposed acquisitions establish a prima facie violation under the law and the Merger Guidelines. In the broad national market of all processors, JBS/Swift’s market share increases from 11.6 percent to 31.1 percent, and the HHI increases from 1370.4 to 2008. If only the five largest firms are included, JBS/Swift’s market share increases from 15.9 percent to 38.1 percent and the HHI increases from 2507 to 3314.2.

As the Committee is aware, antitrust merger analysis as currently conducted by the Federal Trade Commission and Department of Justice is not simply a matter of counting the number of competitors and calculating concentration. Rather, the agencies have taken upon themselves the obligation of identifying the likely competitive effects of a merger: how the merger will lead to higher prices or less output. Thus, a central part of the analysis is to determine how the merger will lessen competition either by unilateral action by the merged firm or by coordinated action by the merged firm and other remaining firms. In this case, there are significant concerns of potential unilateral or coordinated effects.

Unilateral concerns arise when, because of a merger, the merged firm can unilaterally increase prices or reduce output substantially. The concern in this case is straightforward: The merger will reduce the number of bidders for a substantial number of producers from four to three, or perhaps from three to two. Economic theory predicts that the elimination of a bidder will likely result in lower bids for the products of producers. In fact, the Antitrust Division has challenged several mergers in which the number of bidders for services or goods were reduced from four to three. A careful analysis of the bidding histories of the merging processors would likely provide convincing proof that the proposed merger poses significant competitive concerns.
Let me turn to the concern of coordinated interaction. As the D.C. Circuit Court observed in its seminal decision in *FTC v. Heinz:* “The combination of a concentrated market and barriers to entry is a recipe for price coordination. . . . Where rivals are few, firms will be able to coordinate their behavior, either by overt collusion or implicit understanding, in order to restrict output and achieve profits above competitive levels.”[4] Preventing market environments that foster coordination is a central purpose of merger enforcement. As the leading antitrust treatise notes, tacit coordination:

> Is feared by antitrust policy even more than express collusion, for tacit coordination, even when observed, cannot easily be controlled directly by the antitrust laws. It is a

> central object of merger policy to obstruct the creation or reinforcement by merger of such oligopolistic market structures in which tacit coordination can occur.[5]

These acquisitions raise very serious concerns of coordinated interaction. By reducing the number of significant bidders from four to three, collusion will be readily simplified. It is simply easier to reach agreement with fewer competitors.

Moreover, the nature of the beef processing market may facilitate coordination. As any antitrust enforcer will tell you, secrecy is the enemy of collusion: Where information about the nature of offers or agreements is secret it may be more difficult for firms to coordinate their conduct either explicitly or tacitly. However, in the beef processing market, information is relatively transparent. Auctions are conducted in a relatively public fashion and buyers may be well aware of the nature of each other's bids. Not surprisingly, the Department of Justice has brought several criminal cases against "buyer cartels" in auction settings and has, in fact, brought a criminal case against beef buyers for engaging in collusion.[6]

Finally, the acquisition of Smithfield by JBS may significantly improve the opportunities for collusion. Smithfield owns Five Rivers, the largest feed lot in the country. By acquiring Five Rivers, which supplies other processors, JBS will now have access to critical information about purchases and the bids made by its rivals. Moreover, to the extent that JBS' processing rivals are dependent on Five Rivers, JBS will be in the catbird seat, aware of the competitive initiatives of those rivals; and that, in turn, can lead to tacit collusion.

Because this hearing focuses on the impact on producers, that has been the focus of my testimony. But the increase in concentration from this merger also poses a significant threat to the consumers of beef. Prices of beef have increased recently, and additional concentration will likely not improve this trend. On the contrary, it could lead to higher prices and reduced choices for consumers. The oligopolistic nature of the market suggests that reducing the number of competitors from five to three will lead to tacit collusion. Some may suggest that any collusion is unlikely because the major supermarkets are sophisticated buyers with significant buying power. Of course, the fact that supermarkets may have been victimized by an alleged cartel of chocolate manufacturers suggests that they are not immune from anticompetitive conduct by food processors.

Countervailing Factors

The next issue is whether there are significant efficiencies that may counterbalance the potential anticompetitive effects of the merger. The parties have not been particularly forthcoming about the potential efficiencies of the merger, but they face an appropriately difficult burden in demonstrating that these efficiencies are likely to outweigh the anticompetitive effects of the merger. The antitrust agencies and the courts consider only those efficiencies likely to be accomplished solely through the proposed merger. In other words, if there are other means of achieving these efficiencies short of merger, these efficiencies are not "merger-specific." Moreover, it is critical to recognize that merger-specific efficiencies count only to the extent that they do not arise from anticompetitive reductions in output or service. Ultimately, the parties must demonstrate that efficiencies "likely would be sufficient to reverse the merger's potential harm to consumers in the relevant market, e.g., by preventing those increases in the market."

Perhaps the parties may suggest that the merger will be procompetitive by increasing the buying power of JBS. Buying power should not be included in the calculus of procompetitive effects unless it results in lower prices to consumers. Again, history is instructive: If past acquisitions led to increased buying power consumers did not benefit. There is no evidence that those lower costs resulted in lower prices to consumers.

Another efficiency might arise from increased economies of scale. Sometimes the opportunities to combine multi-plant operations can lead to increased economies of scale. However, in beef processing, most plants seem to achieve significant economies of scale at relatively modest capacity. Each of the JBS/Swift, National, and Smithfield facilities probably operate at an efficient scale.

The Weakening of Merger Enforcement

Some have observed that the current level of merger enforcement is substantially below that of the previous administration. A recent article published by the former chief economists of the Federal Trade Commission and the Antitrust Division of the Department of Justice strongly substantiates that merger enforcement appears to be significantly more lax than in the prior administrations.[7] They found "with no change in the underlying statute, the Clayton Act, the weight given to market concentration by the federal courts and by the federal antitrust agencies has declined dramatically." This is a critical issue for the proposed merger.

In the prior administration, the DOJ took a relatively tough stance toward beef processing mergers. It conducted an extensive investigation of a proposed acquisition by Cargill of Beef America and that investigation appeared to lead Cargill to drop its consideration of the transaction. In 1999, the then-Deputy Assistant Attorney General for the Antitrust Division noted in congressional testimony that the concentrated nature of beef processing required special vigilance:

> We are fully aware, for example, that the concentration level in the steer and heifer segment of the beef packing industry is very high, which makes it very likely that we would take a careful look even at transactions producing only a modest change in concentration."[8]

The Department's "tough cop on the block" stance may have deterred other types of proposed anticompetitive acquisitions. Certainly, it seems to me that if this transaction had been announced in 1999, it would have been challenged by the Department of Justice.

It appears that the Department is applying a more lax standard to mergers in numerous industries. In agriculture industry, for example, the Department approved Monsanto's acquisition of Delta Pine with divestitures, even though that same acquisition had effectively been challenged by the Department in 1999.[9] Last year, the Department approved Smithfield's acquisition of Premium Standard, even though it led to a monopoly in the southeastern U.S. hog processing market.

It is vital for this Committee to fully examine why the Department has taken a more lax position on agriculture mergers than the previous administration. Each new antitrust administration notes with pride that politics do not matter and there is underlying consistency to the agencies' approach regardless of which party is in control. I certainly believe that is correct. But the current administration needs to explain why it takes a different stance on agricultural mergers than its predecessors.

Conclusion

No other industry has had as many congressional hearings in the past 12 years on competition issues as agriculture. Yet over the past seven years there have been no merger enforcement actions in the agricultural processing sector, no actions against anticompetitive practices, and no criminal enforcement actions. It is not surprising if farmers and producers believe that antitrust enforcement is failing to protect these markets. This is not to criticize my former colleagues at the staff level at the Department of Justice, who are dedicated, hard-working public servants. But it seems that after seven years of minimal enforcement we are on the wrong track, and that further hearings on the issues are insufficient. Let me make some modest suggestions to address this problem.

First, the Department should intensely investigate this merger. The preliminary public facts suggest a very significant competitive problem. The beef processing market is one with years of evidence of market manipulation, one which is ripe for collusion. As antitrust enforcers often observe "a merger is forever" and these acquisitions pose a threat of permanently weakening competition in a particularly vulnerable market.

In this investigation I have two suggestions. First, it is important for DOJ to focus on all groups of producers, especially smaller producers. Obviously, the easiest producers to contact will be those producers with large, sophisticated operations. Yet, those producers may be the ones who have a greater range of alternatives in response to anticompetitive conduct. It is vital to survey the smallest producers who may be the most vulnerable. Second, it is important to fully engage the opponents of the merger, such as my co-panelists, in a meaningful dialogue about their competitive concerns. Such a dialogue can be particularly important in testing the assertions made by the merging parties as to why a merger is not anticompetitive.[10]

Second, the DOJ and the FTC need to utilize all their tools to address agricultural competition issues. To their credit the FTC and DOJ have conducted hearings and workshops on various industries and substantive areas such as merger enforcement. In 2004, they held hearings on merger enforcement which included testimony on agricultural issues and monopsony analysis.[11] Yet the end product of those hearings—a "Merger Commentary"—did not address agricultural processing mergers, and only made a passing mention of one case involving monopsony (a health insurance case). This was clearly inadequate to address an issue that has been the subject of so many congressional hearings. Clearly, there needs to be greater analysis and transparency about DOJ's approach to both monopsony and agricultural issues. As a starting point, I suggest that the DOJ, along with the Department of Agriculture and the FTC, conduct hearings on agricultural competition issues, with a goal of issuing a report discussing the industry-specific factors that are central to competition analysis in these markets.

Third, the question that arises is why the Department has not taken enforcement actions in past merger agricultural processing investigations. I suggest that this Committee ask the General Accounting Office to conduct a study of the Department's decisions not to take enforcement actions in agricultural processing mergers.[12] That will better inform this Committee and the thousands of farmers who depend upon a competitive market why there is not a greater degree of enforcement and the impact of the DOJ's enforcement decisions.

Fourth, it is important to focus on the unique factors involving agricultural markets. The agencies always suggest that their approach under the Merger Guidelines is equally applicable to all markets. But this "one size fits all" approach may lead to misleading results. A good example of this is the problems endured by the agencies in litigating hospital mergers. During the 1990s the FTC, DOJ, and state attorney generals lost seven consecutive hospital mergers. In part this was because they applied a test for defining geographic markets that was used in a wide variety of markets, known as the Elzinga-Hogarty test. This test almost inevitably led courts to define markets in an overbroad fashion, ultimately finding no competitive problems for the challenged merger. Over time the agencies recognized that the Elzinga-Hogarty test was not an accurate predictor for describing the geographic dimensions of hospital competition. In a recent case involving a merger between hospitals in suburban Chicago, the FTC successfully argued that the Elzinga-Hogarty approach was inappropriate for hospital markets. That experience presents an important lesson for antitrust enforcers: There may be general tools that can be used for analyzing the dimensions of competition, but those tools must be consistent with the marketplace realities. This is simply to suggest that the agencies need to apply tools in agricultural markets that fully recognize the dimensions of competition from the producers' perspective.

Finally, I agree with my co-panelists that the time may have passed to expect that the agencies have the necessary tools to adequately enforce the law. The trend in many agriculture markets is becoming clear: Producers receive less and consumers pay more. The past seven years of minimal enforcement show the inadequacy of the Merger Guidelines and the agencies' "one size fits all" approach. This Committee should support the enactment of the Grassley-Kohl bill, S 1759, which proposes changes to the merger review process that would give the USDA and the DOJ the tools to effectively protect competition.

I appreciate the opportunity to testify and look forward to your questions.

Beef Processing Concentration: All Firms

Pre-Merger

Firm	Capacity Head/Day	Share	HHI
Tyson	32,600	23.6%	
Cargill	29,000	21.2%	
JBS Swift	15,850	11.6%	
National Beef	13,700	10.0%	
Smithfield	8,350	6.1%	
American Foods	6,500	4.7%	
Greater Omaha	2,700	2.0%	
Nebraska Beef	2,600	1.9%	
AB Foods	1,600	1.2%	
FPL Foods	1,500	1.1%	
Others	22,665	16.6%	
Total	137,065		1370.4

Post-Merger

Firm	Capacity Head/Day	Share	HHI
JBS Swift National Beef Smithfield	20,500	31.1%	
Cargill	29,000	21.2%	
Tyson	28,700	21.0%	
American Foods	6,500	4.7%	
Greater Omaha	2,800	2.0%	
Nebraska Beef	2,600	1.9%	
AB Foods	1,600	1.2%	
FPL Foods	1,500	1.2%	
Others	22,665	16.6%	
Total	137,065		2008.0

HHI Increase: 629.6

Beef Processing Concentration: Five Major Firms

Pre-Merger

Firm	Capacity Head/Day	Share	HHI
Tyson	32,600	32.8%	
Cargill	29,000	29.1%	
JBS Swift	15,850	15.9%	
National Beef	13,700	13.8%	
Smithfield	8,350	8.4%	
Total	99,500		2507

Post-Merger

Firm	Capacity Head/Day	Share	HHI
Tyson	32,600	32.8%	
Cargill	29,000	29.1%	
JBS Swift National Beef Smithfield	38,100	38.1%	
Total	99,500		3314.2

HHI Increase: 807.2

Endnotes

[1] My testimony is also supported by The Consumer Federation of America. CFA is a nonprofit association of 300 consumer groups representing more than 50 million Americans that was established in 1968 to advance the consumer interest through research, education, and advocacy.
[2] My testimony focuses on the impact on cattle producers. As explained in my testimony it may also lead to higher prices to consumers.
[3] Gregory J. Werden, "Monopsony and the Sherman Act: Consumer Welfare in a New Light," 74 Antitrust L.J. 707, 714-16 (2007).
[4] 246 F.3d 748 (D.C. Cir. 2001).
[5] 4 Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law* P 901b2, at 9 (rev. ed. 1998).
[6] Statement of Joel I. Klein, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Hearing on Antitrust Issues in Agricultural Business, Senate Committee on Agriculture" (Jul. 27, 1999). Collusion in an agricultural auction setting is not that unusual. During the 1990s, tobacco manufacturers engaged in a conspiracy to depress prices to tobacco growers at auctions. The conduct was challenged in private antitrust litigation which ultimately secured extensive injunctive relief and damages of several hundred million dollars.
[7] Jonathan B. Baker and Carl Shapiro, "Reinvigorating Horizontal Merger Enforcement" (Oct. 2007).
[8] Statement of John M. Nannes, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Hearing on Competitiveness in Agriculture, House Committee on the Judiciary" (Oct. 20, 1999).
[9] The proposed consent decree faced an almost unprecedented level of opposition in the Tunney Act process. There were 12 comments opposing the proposed decree, including the comments of 13 state attorneys generals.
[10] Based on my experience in advocating against the Premium Standard/Smithfield merger, I believe the DOJ may not have had a complete view of the anticompetitive impact of the merger because they failed to engage in that type of dialogue. For a description of this issue see my letter to the Assistant Attorney General, Antitrust Division of May 2, 2008.
[11] There was extensive testimony about the reasons why special standards should apply to agriculture and monopsony issues. *See* C. Robert Taylor, "The Many Faces of Power in the Food System," presented to the DOJ/FTC Workshop on Merger Enforcement (Feb. 17, 2004); Peter C. Carstensen, "Buyer Power Merger Analysis: The Need for Different Metrics," prepared for the DOJ/FTC Workshop on Merger Enforcement (Feb. 17, 2004).
[12] This study could be patterned after either the GAO study on oil mergers, or the GAO study on divestitures in retail markets.