

**Testimony of Mr. James E. Link, Administrator  
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U.S. Department of Agriculture**

**Before the  
Subcommittee on Livestock, Dairy, and Poultry,  
House Agriculture Committee  
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**Introduction**

Mr. Chairman, and members of the Subcommittee, good morning. Thank you for the opportunity to discuss USDA's efforts to promote fair trade practices by prohibiting unfair trade practices and enforcing the law against anticompetitive practices in the marketing of livestock, meat and poultry. Accompanying me today is Mr. Alan Christian, Deputy Administrator for Packers and Stockyard (P&S) Programs, and Dr. Gary McBryde, Director of P&S Industry Analysis. My testimony will provide an overview of trends in the critical components of the U.S. livestock market, and changes USDA has made to more effectively deal with and regulate the industry.

My appointment to the Grain Inspection, Packers and Stockyard Administration (GIPSA) began October 17, 2005. Although I am new to the Department of Agriculture, I certainly am no stranger to the agricultural industry. Growing up on a farm and devoting my entire professional career to the livestock industry has given me a rich and diversified background from which I am able to speak to you today. My job is to enforce fair business practices and take action against anticompetitive practices in the market of livestock, meat, and poultry. Shortly after my arrival at GIPSA, I was given a briefing about an ongoing Office of the Inspector General audit. Now, over the past year we have worked extensively to enhance GIPSA's ability to regulate livestock marketing and procurement practices. Today, it is an honor to share with you the current trends we see in the industry and the steps we are taking in GIPSA to better enforce against unfair or anticompetitive acts or practices.

**Trends in Structure and Financial Performance**

The Packers and Stockyards Program of GIPSA administers and enforces the Packers and Stockyards Act (P&S Act) and monitors financial and business practices in the livestock, meatpacking, and poultry industries. All dealers, auction markets, and packers purchasing \$500,000 or more of livestock annually are required to file an annual report with us. Data available from these reports provide a snapshot of trends in industry structure, financial performance, and business practices.

***Aggregate Industry Trends***

Through this data we have been able to see and analyze aggregate industry trends. The number of plants reporting slaughter of any species to GIPSA has declined by approximately 100 plants or 38 percent from 1995 through 2003 as plant size increased and smaller plants closed. This trend shows some signs of slowing since 2002. Let me share with you the species breakdown of the trend. The total volume of cattle (steers, heifers, cows, and bulls) slaughtered by firms reporting to GIPSA fluctuates with the cattle cycle and has trended downward over the last 10 years. Hog slaughter has trended

upward in the last 10 years while the number of hog slaughter plants has declined over time. However, the rate of decline has slowed since 1999 and the number of hog slaughter plants actually increased in 2004. The volume of sheep and lambs slaughtered by packers reporting to GIPSA increased in 2004 for the first time since 1998 but declined in 2005. The number of plants slaughtering sheep and lambs declined by 43 from 1995 through 2002 but has been relatively stable since then.

In the poultry industry, federally inspected broiler slaughter (measured in pounds of ready-to-cook broilers) has trended upward since 1995, while turkey slaughter has been relatively constant. USDA's World Agricultural Outlook Board (WAOB) estimates that broiler and turkey slaughter will be 1 percent and 3.3 percent higher, respectively, in 2006 than in 2005.<sup>1</sup>

I will use two financial ratios, one for expenses and one for income, to provide a summary of financial conditions in the meat packing industry. First, operating expense expressed as a percentage of sales of meat packing firms has trended upward over the last several years, illustrating the combined effects of changes in input costs and in firms' production practices on the costs of doing business over time. This ratio for large firms tends to be lower than is the case for smaller firms. Second, operating income as a percentage of sales, a measure of profitability, has trended slightly upward in recent years, with considerable year-to-year variation.<sup>2</sup> These underlying financial conditions have implications at all levels of the market.

I would like to share some specific detail on the financial conditions for each livestock species. Large packers tend to have lower operating income on a per-herd basis than small ones, despite having lower operating expenses, due to the larger packers paying a higher average price for livestock. The four largest steer and heifer slaughter firms have accounted for between 78 and 82 percent of total annual volume of that type of slaughter since 1995. GIPSA expects a modest additional increase in the combined market share of the four largest firms in 2006. Among hog slaughter firms, slaughter concentration increased from 55 percent in 2002 to about 64 percent in 2003 and has remained at 64 percent since. We expect very little change in the four largest firms' market share in 2006. The combined market share of the four largest sheep and lamb slaughter firms has trended downward since 1998, but in 2005 the four largest firms increased their combined slaughter volume while total industry slaughter declined. We expect concentration to be close to 63 percent in 2006. In poultry slaughter, concentration has remained fairly constant since 2003, with slight declines in broiler and turkey slaughter in 2005. Recent firm acquisitions will likely increase concentration in broiler slaughter and turkey slaughter slightly in 2006.

### **Trends Related to Livestock & Poultry Procurement, Business Practices, and Vertical Coordination**

I will share with you the vertical trends of the livestock and poultry industry, having reviewed the horizontal aspects of industry structure. Vertical structure relates to the relation between segments in the market channel.

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<sup>1</sup> Sources: World Agricultural Outlook Board, World Agricultural Supply and Demand Estimates, WASDE-445-31, WASDE-445, April 10, 2007, <http://www.usda.gov/oce/commodity/wasde/latest.pdf>

<sup>2</sup> Operating income as summarized here is sales minus cost of sales (primarily cost of livestock) and minus operating expenses, and is essentially a measure of profit before taxes.

Packers use multiple procurement methods to obtain livestock for slaughter but the methods commonly fall into two categories: (1) cash sales for immediate delivery or normally within a 2-week period, and (2) “committed procurement” arrangements that commit livestock to a particular packer in excess of 14 days prior to delivery. These committed procurement methods include marketing agreements, forward contracts, and packer feeding.

We collect and audit data on the major committed procurement methods used by the four largest firms that slaughter fed cattle. Marketing agreements account for 24 percent of total procurement in 2006 by the four largest steer and heifer slaughter firms. Packers obtain six percent of their total slaughter from feeding arrangements and forward contracts. The remaining 70 percent is obtained on the spot market.

Approximately 10 percent of hogs are sold on the spot market, 70 percent through forward contracts and market agreements, and the remaining 20 percent are packer owned.<sup>3</sup>

Procurement methods used in the purchase of sheep and lambs for slaughter are similar to those used for other species and include purchase in spot markets, use of marketing agreements, use of various other forms of advance sales contracts, and packer feeding. On the other hand, we have seen the poultry industry become almost completely vertically integrated for several decades, and the use of spot markets for poultry is virtually nonexistent. Live poultry production is coordinated through production (grow-out) contracts, company-owned farms, and marketing agreements. With production contracts, the integrator (poultry slaughter and processing firm) owns the birds and the feed, and the grower’s compensation is based on the services the grower provides. With marketing agreements, growers retain ownership of both the birds and the feed, and growers’ compensation is determined by the difference between the stipulated price of the finished product and the cost of producing it. There are no marketing agreements in broiler production, but they are used in turkey production.

### **Administrative Implications of Industry Structural Trends**

Now that I have reviewed the current market structure, I will share with you what this means for our organization. GIPSA has authority under the P&S Act to prohibit unfair or anticompetitive acts or practices in the marketing of livestock, meat and poultry. We do not have authority to review or prohibit mergers and acquisitions but often cooperate with and lend our industry expertise to the Department of Justice (DOJ) in DOJ’s review of mergers in the livestock, meatpacking, and poultry industries.

Changes in concentration, vertical integration, producer complaints, or other changes in industry structure may lead us to focus more attention on particular firms or specific industry behavior. It is important to note that many of the changes in coordination associated with industry consolidation may also provide for improved performance of the industry. For example, structural change can facilitate penetration of retail markets with branded products. The capability to increase branded retail products depends on high levels of input supply management to achieve uniform and high levels of packing plant utilization, and production of carcasses that can be processed into uniform retail products.

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<sup>3</sup> Grimes, G. Excerpt from U.S. Hog Marketing Contract Study. Based on MPR data. Jan., 2006. <http://agebb.missouri.edu/mkt/vertstud06.htm>

Recently we completed a broad study of marketing practices in the entire livestock and red meat industries from farmers to retailers, food service firms, and exporters. The study, completed under contract by RTI, Inc., included analysis of prices, costs, efficiency, livestock and meat quality, and of risk levels associated with alternative marketing arrangements (AMAs), and assessed the implications of potential future changes in the use of various types of marketing arrangements. The study found that the cash market continues to serve an important role in the industry for price discovery and in particular for smaller producers and packers. Cash market prices are also frequently used as the base for formula pricing under AMAs and are important for marketing arrangements using formula pricing. As long as prices are reported for different types of marketing arrangements—as with current USDA price reporting—base prices reflect expected supply-demand conditions.

While in the aggregate AMAs were given a good bill of health by the study, the measurements of the stability of the respective (cattle, versus hog, versus sheep) cash market prices indicate their sensitivity to volume changes and the need for monitoring to identify individual instances when AMA use maybe associated with a violation of the P&S Act and result in a need for enforcement action. Increased consolidation calls for increased vigilance by the P&S Program due to the increasingly complex nature of new marketing and procurement practices, and to the arguably increased potential for anticompetitive behavior.

We will continue to evaluate complaints alleging anticompetitive behavior, including those that arise from concerns about high levels of concentration, such as attempted restriction of competition, failure to compete, apportionment of territory, price discrimination, price manipulation, and predatory pricing. While we do not direct the form of continuing consolidation and increased coordination, we will play a role in helping the marketing system operate in a competitive manner to the maximum potential benefit of the industry members and also to the benefit of U.S. food consumers. As we evaluate the current status of the industry, we have also evaluated our own organization.

### **Current Initiatives**

The following are some of the steps we have taken to strengthen the P&S Program in the last year:

#### **Reorganization**

We have reorganized our headquarters and regional office to deliver more efficient and effective services nationwide. Utilizing input from management consultants and organizational analysis, we initiated multiple changes in the structure of the organization and operations. At headquarters, we eliminated a complete layer of management in the P&S Program by dissolving the Regional Operations Division and having regional directors report directly to the deputy administrator. Further, we have combined all of our agency-wide support services into a single unit that provides “shared services” (e.g., personnel, purchasing, safety and health, labor relations, training, etc.) across all GIPSA programs. We also removed structural and policy boundaries that prevented direct communication across the organization. We now encourage through written policies, communication at all levels of the organization to effectively deal with policy development and program implementation issues. For example, our legal specialists now work directly with the Office of the General Counsel to improve the quality and

timeliness of investigations. Our Financial and Business Practices Units hold monthly conference calls between the regions and headquarters to share investigative experiences and work on unit related issues collectively. Also the development of a comprehensive internal review program has improved monitoring and reporting on agency activities. All this in effect have reduced management layers and added additional cost savings to the Agency which allowed us to move 4 FTE's to field offices.

### **Policy and Direction**

When I first began my role at GIPSA, I redirected the Agency to focus on our underlying mission to take action against business practices and anticompetitive practices in the marketing of livestock, meat, and poultry. It quickly became apparent to me that to really protect farmers and ranchers, and to adequately serve them in a consistent manner, we had to focus on updating our policies, procedures, and regulations in accordance with our mission.

In the past year, we have undertaken a top to bottom review of our regulations and policy. We established a regulation review task force to review existing regulations to ensure they were up to date and effectively addressed the current conditions in the industry. Several regulatory work plans were developed with the intent of proposing changes for public comment. A number of proposals to better define and enhance the regulations affecting poultry marketing will be published for public comment in the near future.

We have also issued 37 GIPSA Directives and 20 P&S Policy Memoranda providing instruction and guidance to the P&S employees. Much of the initial effort was in response to the OIG audit of January, 2006, but since that time we have established a permanent process to request and track policy issues that may be raised from anywhere in the organization. Also beginning in 2006 and continuing at 6 month intervals, we are updating our Employee Manual. The manual contains specific instruction to carry out the core functions of the organization and is an essential guide for both new and experienced personnel.

In response to an OIG recommendation and to strengthen accountability within P&S, we have developed a comprehensive internal review program. The accountability program monitors and assesses administrative and program activities for compliance with Agency policy, procedures, and performance measures.

### **Training**

Both a Government Accountability Office report and OIG alluded to the importance of training the GIPSA investigators to conduct complex investigations. Beginning in 2007, we are sending all of our investigators to the Department of Homeland Security's Federal Law Enforcement Training Center for basic investigative and interviewing training. We have completed 3 of the planned 5 courses and have received positive feedback from the employees on the value of the training. We have included the some of the Office of the General Counsel attorneys in the training courses to prepare them to better assist our investigations in more complex competition investigations and to foster a strong working relationship between P&S and OGC.

In addition, DOJ's Antitrust Division provided training for P&S and OGC on an issue that arose in competition investigations in 2006, and we are planning another training program with DOJ for later this year.

Internally, based on an employee assessment survey, we are developing a mandatory training program for investigators and a mentoring program for our remotely located resident agents

### **Strategic Business Plan**

As we developed our new business plan we laid out 4 goals to 33 strategic activities with related measurable outcomes. Our intent is not only set forth goals but also to have tangible ways to measure our progress as we implement and evaluate our new business initiatives.

The four goals that we set forth are to (1) increase the level of compliance with the Packers and Stockyards Act through preventive regulatory actions; (2) attain compliance through investigation and enforcement; (3) implement directives, policies, regulations, and perform industry analysis that effectively and efficiently keep pace with the changing livestock, meat, and poultry industries; and (4) improve organizational efficiency and effectiveness. These four goals are the foundation for the steps we have taken over this past year.

To increase voluntary compliance with the P&S Act and increase enforcement against unfair trade practices and anticompetitive practices, we are focusing our first 2 programmatic goals on our regulatory reviews and investigation. We intend to determine the current compliance levels in the industry and target the areas with lower compliance rates for more inspection and regulatory activity. Some examples in the Business plan include:

1. Inspecting scales and carcass evaluation devices at all packing plants that kill over 1,000 head per year.
2. Inspecting scales at livestock markets to obtain a statistical sample of the compliance level at all markets to the 90% confidence level.
3. Checking prompt pay and custodial account compliance at packers, livestock markets and dealers to obtain a statistical sample of the compliance level to the 90% confidence level.
4. Initiate rapid response investigations within 2 business days of the complaint or event.
5. Decrease the average number of days to investigate and resolve potential violations by 5%.

### **Standard Operating Procedures**

From October, 2006 through March, 2007 we undertook a complete review and reengineering of all of the P&S Program business processes. On April 2, 2007 we implemented the new standard operating procedures nationwide in headquarters and the 3 regional offices. Our new procedures will ensure we treat our customers and the regulated industry uniformly no matter where they are located. The new processes were developed from best practices we identified across the country and provide performance measures to compare and gauge our success at meeting our program goals. Our streamlined activities will allow more staff time to be devoted to program delivery – the regulatory reviews and investigations that are so important to enforcing the law against unfair and anticompetitive practices.

## **Investigations**

In response to the 2006 Inspector General audit, GIPSA distinguished between investigations and regulatory compliance activities. The term Investigation means an activity that follows up on previously identified violations of the Act; is conducted in response to industry driven complaints, or is conducted in response to possible violations found in the course of compliance activities. In contrast Regulatory Compliance means activities of a routine nature that assess whether a subject entity is operating in compliance with the Act. These are activities conducted when P&SP has no reason to believe a violation has occurred.

Investigations are a top priority for us. Just this year by implementing our new business plan we have made significant progress. We look forward to continuing our progress and investigating for alleged violations in a timelier manner over the course of this fiscal year.

GIPSA is currently investigating a number of potential violations of Section 202 of the Packers and Stockyards Act by packers that include allegations of unfair or deceptive practices and attempts to apportion purchases or manipulate prices by packers. Some examples of current activity include:

***Manipulation of the Cash Price*** -We have five open investigations that are focusing on allegations that packers attempted to manipulate the negotiated prices through buying, or selling. Three of the investigations involve the allegations of manipulating the cash price for hogs and one involves an allegation that packers conspired or agreed to act in concert to affect the cash market for cattle. GIPSA is working jointly with the Department of Justice on one of the investigations and OGC attorneys are working closely with us on the others.

***Failure to Disclose Purchase Terms*** -We are investigating the alleged failure of at least two packers to fully disclose purchase terms and to properly apply premiums and discounts in their carcass merit or value-based purchases.

***Failure to Properly Weigh***- We have four open investigations involving allegations of improper weighing or instances where the entity did not pay based on the hot weight as required. These investigations include inaccurate scales, inaccurate tare weight for the scale trolleys, not using the hot weight in payment, not rounding the weight correctly and not weighing properly. Altogether in 2006 we had 57 investigations conducted against livestock dealers, markets and packers to protect farmers and ranchers from unfair practices. We had an additional 11 poultry inspections on weighing practices. In another case, GIPSA has filed a complaint against a packing company for improper recording of weights from 2001 to 2004.

***Failure to Pay Promptly***- GIPSA has two open investigations involving allegations that packers did not pay promptly as required by regulation. The investigations deal with cattle sold on a formula or non-cash basis. Also in 2006, 13 livestock dealers, 9 auction markets, and 5 packers experienced financial failures. These failures resulted in investigations that led to livestock sellers being compensated.

***Unfair Competitive Practice***- GIPSA has three open investigations focusing on allegations of unfair or discriminatory behavior including a packer's financial interest in a

marketing agency, turn taking at livestock markets and refusals to purchase from certain sellers. These ongoing investigations are a significant piece of our efforts to regulate the industry, and again OGC attorneys are working closely with our investigations.

While the example mentioned above focuses on violations of Section 202 of the Act that regulates packers, live poultry dealers, and swine contractors, GIPSA is committed to enforcing the Act and regulations uniformly with regard to all regulated segments of the industry. We are aggressively pursuing violations involving prompt pay, custodial accounts, weighing, bonding and failure to register by dealers, market agencies and unregistered entities. The Act provides financial protections and enforcement authority over unfair trade practices throughout the marketing channels for livestock, meat and poultry. We are committed to improving our monitoring of all regulated activities for compliance. The increase in cases referred for formal administrative or civil action during 2006 and the first half of 2007 demonstrates our commitment to enforcement to ensure farmers and ranchers are not victimized by unfair practices or financial failures by buyers.

### **Immediate Concern - Bonding**

As the current market structure changes, we will continue to adjust our regulatory efforts to monitor more efficiently and effectively the regulated industries. One issue of immediate concern is the level of financial protection provided by the current bonding requirements.

Over the past several years, we are finding that, in the event of a dealer market failure, sellers of livestock are only able to recover about 13 to 23 cents on the dollar from the current bonding required by regulation. For packer failures, the sellers are able to recover about 20 cents on the dollar partly due to the statutory trust fund that also provides protection. We are currently evaluating several options, both regulatory and legislative, to remedy the situation.

I am proud to serve as the administrator for GIPSA in a time where not only the industry, but also the organization is being evaluated, assessed and improved. It is exciting to be a part of such fundamental changes. With the continued work and efforts of the individuals within GIPSA, we will look forward to improving and becoming even better at regulating an industry where constant change is not only expected, but inevitable.

### **Conclusion**

Mr. Chairman, Thank you again for the opportunity to appear before you today. We look forward to working with the Subcommittee to regulate these very important components of U.S. agriculture, particularly the livestock meat marketing sector. I will be happy to answer any questions that members might have for me.