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## **Public Comments on the U.S. Department of Justice and the Federal Trade Commission Draft Vertical Merger Guidelines**

By Ben Gotschall

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### **Introduction**

For 22 years, Organization for Competitive Markets (OCM) has worked to promote transparent, fair, and truly competitive agricultural and food markets. OCM is committed to the establishment of competitive markets for the exchange of goods and products used in agriculture, and produced by farmers and ranchers throughout the United States. OCM maintains that true competition reduces the need for economic regulations. The responsible role of government in the agricultural economy is to be a regulator and enforcer of those rules necessary to assure that markets are fair, honest, accessible, and competitive.

Consolidation and globalization in the food industry have reached a point where the top four firms in almost every sector have acquired abusive levels of power. This corporate control has allowed the top firms to reap record profits, paying lower prices to the farmers who produce our food and charging higher prices to consumers of that food. The U.S. is losing farmers at an alarming rate, agricultural jobs and wages are drying up, and rural communities are being hollowed out. These problems can be mitigated by reining in corporations and their economic power, enabling U.S. farmers and ranchers to compete in fair and open markets.

The current crisis of the American family farm is the direct result of mergers, integration, and globalization in the food industry. Using CR4 ratios, an economic measurement of concentration that calculates the total percentage of a market controlled by the industry's largest four firms, Professor Mary Hendrickson of the University of Missouri calculated the extent of concentration in the food industry between 1990 and 2011. In all sectors except flour milling, concentration increased dramatically during that time. In pork production, control by the largest four firms nearly doubled over just 10 years. A CR4 ratio over 45% indicates a highly concentrated market where

abuses are likely. As of 2011, CR4 ratios were above 50% in pork, broiler and turkey slaughter, and ratios were above 80% in beef slaughter, wet corn milling, and soybean processing.<sup>1</sup>

This high rate of concentration in agriculture will continue not only to threaten, but also virtually eliminate competition in the farming and food sector of the economy unless meaningful changes are made to antitrust guidelines. Enforcement of antitrust laws must accompany these changes, and penalties for violations must be substantial enough to discourage common abuses, which have for too long been allowed to continue under the guise of reasonable and customary practices in the industry.

It is with this general background that we submit the following comments and suggested changes to the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) draft vertical merger guidelines.

## **A New Framework is Needed**

We agree with Commissioners Chopra and Slaughter that the 1984 Non-Horizontal Merger Guidelines should be rescinded and rewritten, and that the recently proposed DOJ and FTC guidelines do not adequately address the many concerns surrounding vertical mergers. The guidelines must establish a clear framework for decision making that addresses the problems we face today.

While we understand that the DOJ and FTC do not enforce or make rules relative to the Packers and Stockyards Act (PSA), which is enforced by the United States Department of Agriculture (USDA), the PSA is an important companion to the Clayton Act as a means of curbing agricultural corporate power. Our experience shows that subjective interpretation of the PSA has led to widespread anticompetitive behavior. These abuses have been permitted for so long that they are now considered to be common industry practice, and are inappropriately justified as “reasonable business decisions.”<sup>2</sup> We have called for the establishment of a detailed rule that outlines specific PSA violations, creates an appropriate framework for identifying competitive harm, is enforceable, and applies significant consequences for companies that commit violations. We ask the same of the DOJ and FTC regarding its vertical merger guidelines.

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<sup>1</sup> M.K. Hendrickson 2015. “Resilience in a concentrated and consolidated food system.” *Journal of Environmental Studies and Sciences*.

<sup>2</sup> *United States Department of Agriculture, Agricultural Marketing Service. Undue and Unreasonable Preferences and Advantages Under the Packers and Stockyards Act*, Subsection 201.211(d). 13 January 2020. <https://www.federalregister.gov/documents/2020/01/13/2020-00152/undue-and-unreasonable-preferences-and-advantages-under-the-packers-and-stockyards-act>

## **Restore the Intent of the Clayton Act**

We call for the restoration of the intent of the Clayton Act, with a particular focus on its incipency doctrine. As the Clayton Act has historically been interpreted by the courts, the effects of a merger do not have to be proven definitively to cause competitive harm. Our experience with court interpretations of the PSA leads us to strongly suggest DOJ and FTC refocus merger reviews with an eye to the incipency doctrine. Again, looking to the PSA for reference, the USDA has long held that not all violations of the PSA require a showing of actual or likely harm to competition. In other words, a producer who has been harmed by an abusive act by a meatpacking company should not have to demonstrate how the effects of competitive harm apply to the entire industry, but rather only that they (the individual producer) were, or could be, harmed by such action.

The burden of proving industry wide competitive harm is unreasonable and goes against the producer protection standard of the PSA (see next section) as well as the incipency standard of the Clayton Act. Yet, we see this burden of proof cited time and again by agencies dismissing complaints against anticompetitive behavior in agriculture. We agree with Commissioner Slaughter that the proposed Guidelines do not sufficiently capture the incipency standard of Section 7 of the Clayton Act.<sup>3</sup> Vertical mergers should be investigated using a more holistic approach that applies multiple theories of competitive harm.

To date, the theories of economic efficiency and consumer welfare have been the dominant doctrines utilized to evaluate mergers. Coupled with these theories is a predisposition by the agencies to offhandedly regard mergers as predominantly pro-competitive. As the Open Markets Institute has pointed out, the Clayton Act is intended to stop mergers that are probable threats to competition, regardless of their possible economic efficiencies.<sup>4</sup> We recommend that the guidelines recognize the multiple ways competitive harm can occur through vertical mergers, including that of regulatory evasion. What constitutes unacceptable mergers is not currently clarified in the draft guidelines. It should be addressed, particularly in the consideration of upstream effects of vertical mergers.

## **Implement Producer Protection Standard**

Consideration of upstream effects, which we refer to as “producer protections” or the “producer protection standard,” is vital to any revision of merger guidelines. Producers in agriculture not only refer to the farm businesses providing raw products but also to the laborers involved in planting,

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<sup>3</sup> Statement of Commissioner Rebecca Kelly Slaughter, FTC-DOJ Draft Vertical Merger Guidelines, Commission File No. P810034, 10 January 2020.

[https://www.ftc.gov/system/files/documents/public\\_statements/1561721/p810034slaughtervmgabstain.pdf](https://www.ftc.gov/system/files/documents/public_statements/1561721/p810034slaughtervmgabstain.pdf)

<sup>4</sup> Open Markets Institute, “The Urgent Need for Strong Vertical Merger Guidelines,” (2018). FTC 5th Session Hearings on Competition and Consumer Protection in the 21st Century (Docket ID FTC-2018-0091-0001).

raising, harvesting, and processing commodities. Anticompetitive practices, including horizontal and vertical mergers that jeopardize the ability of producers to compete, have drastic upstream economic consequences, particularly in rural areas and among minority populations.

Agriculture has witnessed devastating upstream consequences from vertical mergers. Consolidation has virtually eliminated competition in many agriculture markets, leaving family farmers and ranchers with little to no control over the prices they pay for inputs or the prices they receive for their products. As a result, the farmer's share of every retail dollar has fallen from 50 percent in 1952 to less than 16 percent today.<sup>5</sup> These dire economic conditions are driving family farmers out of business. This, in turn, undermines the economies of rural communities across America, where job opportunities dry up, stores lose customers, churches lose congregants, and schools lose students.

Since 1980, 90% of U.S. hog farmers and 41% of U.S. cattle producers have gone out of business, and over one million U.S. family farmers have been driven off the land. Today, 71% of America's poultry growers live below the federal poverty level. Since 1990, the number of large farms has tripled and the number of very large farms has increased sevenfold. Over the same period, the number of farms overall decreased by 10%.<sup>6</sup> The median (midpoint) hog farm now produces 40,000 hogs per year, compared to 1,200 in 1987. The median size is now nearly 40 times larger than it was three decades ago, but only a quarter of the producers are left.<sup>7</sup> As beef packer concentration has increased, so too has the number of large farms with over 500 beef cows, while the total number of beef cattle farms and small farms with between 10-200 beef cows decreased.<sup>8</sup> Even in the face of these demonstrated negative upstream effects, vertical integration in agriculture and food production is allowed to continue unchecked.

Recently, the vertical integration of Walmart into the dairy processing arena has had substantial upstream effects. When Walmart built its own dairy processing plant in Fort Wayne, Indiana, it significantly impacted Dean Foods, its main upstream supplier for its Great Value private-label milk. Dean Foods then cancelled over 100 contracts with its farmer-suppliers, forcing many out of business.<sup>9</sup> Dean Foods has since declared bankruptcy, citing the loss of Walmart's volume milk sales as a significant factor in that decision.

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<sup>5</sup> National Farmers Union. *Policy Brief: Consolidation* (2020). <https://1yd7z7koz052nb8r33cfxyw5-wpengine.netdna-ssl.com/wp-content/uploads/2019/03/Consolidation-Final.pdf>

<sup>6</sup> U.S. Department of Agriculture. Census of Agriculture. Available at <https://www.agcensus.usda.gov/>. Accessed August 2017.

<sup>7</sup> MacDonald, James M. 2016. "Concentration, Contracting, and Competition Policy in U.S. Agribusiness." *Concurrents Competition Law Review* 1.:3-9.

<sup>8</sup> U.S. Department of Agriculture. Census of Agriculture. Available at <https://www.agcensus.usda.gov/>. Accessed August 2017.

<sup>9</sup> Lucas, Amelia. "Dean Foods, America's Biggest Milk Producer, Files for Bankruptcy." 12 Nov. 2019. <https://www.cnbc.com/2019/11/12/dean-foods-americas-biggest-milk-producer-files-for-bankruptcy.html>

We have called for USDA to focus on upstream effects and producer protections in enforcing the PSA, and we are calling on the DOJ and FTC to do the same in crafting its vertical merger guidelines.

## **Elimination of Double Marginalization**

We do not see the elimination of double marginalization as a necessary indicator of the removal of anticompetitive behavior. Theoretically, the elimination of double marginalization would occur if a meatpacking company acquired both a feedlot and a slaughter plant. This meatpacking firm could then capture the margin from the sale of fed cattle to the slaughter plant, as well as any downstream margins from further processing of cut-and-wrapped beef. This would allow the meatpacking company to reduce the downstream margin and lower retail prices, while keeping the upstream prices paid to producers the same or even raising them.

While this may sound positive in theory, in reality it very rarely happens in food and agriculture. In fact, the meatpacking industry has a poor track record when it comes to sharing benefits realized by eliminating double marginalization with producers and consumers. In 2016, the largest pork producer in the U.S., Chinese-owned Smithfield Foods, credited its enhanced profits to the 14-year low prices paid to farmers for live hogs and the higher selling prices for pork to consumers.<sup>10</sup> Meanwhile, in the beef industry, from 2013-2016, prices paid to cattle producers dropped by 13%, while beef prices at the grocery store increased by 4%.<sup>11</sup> This type of market manipulation at the expense of producers and consumers alike is allowed to happen due to the fact that the largest four meatpackers have been able to eliminate double marginalization through vertical integration, with no agency action to stop anticompetitive practices of predatory pricing and collusion.

## **Remove Market-Share Safe Harbor**

We agree with Commissioner Slaughter that the arbitrary 20% market share number is not an effective measure of competitive harm and establishes what amounts to a safe harbor for merged firms with market share below that threshold, regardless of any anticompetitive effects of the merger. In the case of agricultural markets, large firms in an industry often do not actually compete on price marketwide, nor do they compete for total market share. The illusion of competition is often due to the division of markets into *regional* market shares.

The FTC employed the theory of regional antitrust in a 2019 decision regarding the acquisition of Services Group of America, Inc.(SGF), a regional food distributor, by US Foods, Inc. (USF). In that

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<sup>10</sup> Smith, Dennis. "Who is Watching Out for the Independent Producer?" National Hog Farmer. 31 Oct 2016. Available at <http://www.nationalhogfarmer.com/marketing/who-watching-out-independent-producer>. Accessed August 2017.

<sup>11</sup> U.S. Department of Agriculture Economic Research Service. Meat Price Spreads. Available at <https://www.ers.usda.gov/dataproducts/meat-price-spreads/>. Accessed August 2017.

ruling, the FTC determined probable harm to competition in four local (regional) markets, in that the acquisition of SGF by USF would limit competitions in those local regions. In that case, the FTC determined that, “the transaction would eliminate a key broadline distributor in each of these markets, limiting customers’ ability to switch between distributors and leverage them in order to obtain more competitive pricing and better service. The few remaining competitors in the relevant markets would be insufficient to alleviate competitive concerns.”<sup>12</sup>

These same concerns apply to agricultural producers. Livestock and perishable food commodities must be delivered to markets within a reasonable distance from the origin of production. In more sparsely populated and geographically isolated parts of the country, due to the distance between marketing and processing facilities, there may be as few as two or only one feasible market outlet. Thus, in the case of agriculture, the 20% market share number effectively establishes a safe harbor loophole that could be used with anticompetitive effects in these regions.

In many areas of the country in which agricultural consolidation has already taken place, markets for products such as livestock and milk are serviced by one or two main buyers. Those buyers may not control 20% of the total market share in their respective industries, but it is entirely possible for them to control 50% or more of a market in a particular region. Due to the nature of the products sold, this capture of a regional market share by a single firm amounts to monopolization and operates in virtual absence of competition.

This has occurred with Dairy Farmers of America (DFA), the nation’s largest milk handler, who according to Open Markets Institute, handles 30 percent of the national raw milk supply with a *far higher share in many regions* (emphasis ours), leaving many dairy farmers unable to get their milk to market without accepting DFA’s terms. DFA also has vested interests across the entire dairy supply chain, owning or working closely with milk processors and marketers. These entities make more money when they pay DFA farmers less for their milk, creating a clear conflict of interest. In 2012, farmers in the Southeast received a \$140 million settlement after a class-action lawsuit alleged that DFA and Dean Foods colluded to lower prices for dairy farmers. In 2014, DFA paid \$50 million to around 10,000 dairy farmers to settle a class-action lawsuit that alleged DFA and its marketing arm, Dairy Marketing Services LLC, had conspired to monopolize the raw milk market in the Northeast. And in the Southeast, DFA has refused to allow dairy farmers to sell to the co-op to address regional supply shortages. Instead DFA has forced grocery stores to import milk from the group’s members in the Midwest.<sup>13</sup> These facts are troubling, given that DFA is currently discussing a merger with Dean Foods, the largest dairy processing company in the U.S. Mergers of this type should be halted

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<sup>12</sup> Federal Trade Commission. *Analysis of Agreement Containing Consent Orders To Aid Public Comment In the Matter of US Foods Holding Corp. and Services Group of America, Inc.*, File No. 181-0215, Docket No. C-4688. September 2019. [https://www.ftc.gov/system/files/documents/cases/181\\_0215\\_c4688\\_us\\_foods\\_sga\\_analysis.pdf](https://www.ftc.gov/system/files/documents/cases/181_0215_c4688_us_foods_sga_analysis.pdf)

<sup>13</sup> Open Markets Institute. *Food and Power: Addressing Monopolization in America’s Food System*. March 2019. [https://openmarketsinstitute.org/wp-content/uploads/2019/04/190322\\_MonopolyFoodReport-v7.pdf](https://openmarketsinstitute.org/wp-content/uploads/2019/04/190322_MonopolyFoodReport-v7.pdf)

in their incipency, due to demonstrated violations of producer protections by one or more of the merging firms.

## **Review of Completed Mergers**

Along with the need for anticompetitive mergers to be prevented in their incipency, we also call for regulatory authority to retrospectively review completed mergers to ensure merged firms continue to promote competition. We agree with Commissioner Slaughter that the Guidelines should explicitly state that the Agencies are allowed to adapt enforcement strategies and theories according to research, learning, and retrospective analysis.<sup>14</sup> If a merger fails to promote competition, we call on regulators to implement penalties and other corrective measures if monopolistic conditions exist, or if merged firms have failed to achieve agreed-upon terms and conditions of the merger. These penalties must be significant enough to deter continued anticompetitive behavior, so as not to be seen merely as the cost of doing business.

Merged firms can escape penalties altogether through regulatory evasion, which is often achieved through regulatory capture. The idea that a regulatory agency would abandon its public mission in favor of a narrow one is not a new concept. In fact, it is a common view of analysts on the left and on the right. The left critique of regulation originates with the work of historian Gabriel Kolko, whose 1963 book, *The Triumph of Conservatism*, argues that the regulatory reforms of the Progressive Era were really a response to demands by big business that the federal government rationalize ruinous competition. George Stigler, a leading figure in the conservative Chicago School of Economics, argued in a widely cited 1971 article that industries seek regulation to control entry into the field and otherwise restrict competition.<sup>15</sup> Critiques such as these have made the principle of “regulatory capture” a standard element of contemporary economics. Our concern is that regulatory capture amounts to regulatory evasion.

Often in agriculture we see former representatives of industry become regulators of those industries. Not only can these regulators share information with industry about how to avoid enforcement actions, but the standards governing enforcement can be created or influenced by former industry insiders. The possibility of discriminatory enforcement against competitors exists, and one-size-fits-all requirements and penalties often create a barrier to smaller or entry-level firms. We feel the DOJ and FTC are impartial, independent regulatory agencies, but we do not always see that same independence and impartiality in agricultural regulatory agencies.<sup>16</sup> We

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<sup>14</sup> STATEMENT OF COMMISSIONER REBECCA KELLY SLAUGHTER, FTC-DOJ Draft Vertical Merger Guidelines, Commission File No. P810034, January 10, 2020.

[https://www.ftc.gov/system/files/documents/public\\_statements/1561721/p810034slaughtervmgabstain.pdf](https://www.ftc.gov/system/files/documents/public_statements/1561721/p810034slaughtervmgabstain.pdf)

<sup>15</sup> George J. Stigler, “The Theory of Economic Regulation,” *Bell Journal of Economics and Management Science*, vol. 2, no.1, Spring 1971, p.3.

<sup>16</sup> Mattera, Philip, *USDA INC.: How Agribusiness Has Hijacked Regulatory Policy at the U.S. Department of Agriculture*. 23 July 2004. <https://competitivemarkets.com/wp-content/uploads/2017/11/USDA-INC.pdf>

recognize the authority of the DOJ and FTC to make meaningful changes to antitrust enforcement, and we hope those changes are the result of the best current information, using the guidance of sound principles reflective of today's challenges.

## **Conclusion**

Robust competition is vital for the agriculture and food economy to remain viable. Decades of consolidation in agriculture have driven farmers off the land, reduced farm income, and eroded small towns and rural economies. With a growing population, food security and scarcity are becoming problems, and innovations in food production, processing, and distribution are needed. The ability of new firms to enter the market, compete, and contribute to innovation in the agriculture economy is hindered by vertical integration in virtually all sectors of agriculture and food production.

OCM recommends that any new guidelines for vertical mergers take into account the many different ways competition can be harmed, especially for upstream producers of agricultural products. More focus on producer protection, closer scrutiny on the elimination of double marginalization, removal of market share safe harbors, the inclusion of regulatory evasion as a theory of harm, and a return to the incipiency standard, as the Clayton Act originally intended, are all meaningful changes that we support. We believe that a sincere effort by the DOJ and FTC to improve these guidelines will contribute to the promotion of transparent, fair, and truly competitive agricultural and food markets that will benefit U.S. food producers and consumers alike.

OCM wishes to send Ben Gotschall, its Policy and Research Director, to the Vertical Merger Guidelines Workshop on March 11 or March 18. Gotschall requests to speak about these comments. Gotschall is employed by OCM, which is affiliated with several entities that research, analyze, and comment on this and other relevant topics. OCM does not provide funding to any of those entities. Gotschall can be reached at [info@competitivemarkets.com](mailto:info@competitivemarkets.com).