2009 Annual Report

Packers & Stockyards Program

United States Department of Agriculture
Grain Inspection, Packers and Stockyards Administration

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MISSION:

"To protect fair trade practices, financial integrity, and competitive markets for livestock, meat, and poultry."

March 2010

2009 REPORT HIGHLIGHTS

- ***Packers and Stockyards Program (P&SP) performance and efficiency remain robust. P&SP's key performance measure of*** industry compliance with the Packers and Stockyards Act of 1921 (P&S Act) remained at 80 percent in 2009, sustaining 2008's improvement over the 73-percent rate of 2007. The program's efficiency, a measure of the average number of days comprising an investigation, was 107 days in 2009, 35 percent below the 165-day average of 2006, before P&SP began its Business Process Re-engineering initiative (see page 27).

- ***P&SP increased the number of weighing and carcass evaluation inspections.*** P&SP agents conducted 589 weighing and carcass evaluation equipment inspections in 2009 versus 398 in 2008, and found 69 violations versus 28 last year (see page 18).

- ***P&SP provided statistical summary of data on investigations as specified by Congress*** in the Food, Conservation, and Energy Act of 2008 (Farm Bill) (see page 30).

- P&SP launched a ***new online P&SP Employee Library***, a complete official policy, procedural, and instructional resource for P&SP employees (see page 33).

- P&SP established a ***new Change Control Working Group*** (CCWG) as a single P&SP point for aggregating and ensuring action on continuous improvement initiatives. The CCWG ensures that all P&SP employees have a voice in the program's direction and decision-making (see page 33).

- ***P&SP implemented paperless (electronic) investigation case files.*** Cases are conducted, documented, and tracked through the agency's standardized investigation workflow from beginning to end. This enterprise automation allows the program to operate more efficiently, strengthens P&SP's ability to track major case milestones, and significantly reduces costs involved with performing investigations (see pages 35-36).

- P&SP completed the 2009 ***Assessment of the Livestock and Poultry Industries*** as required in Section 415 of the P&S Act (see page 40).

EXECUTIVE SUMMARY

Overview—The Packers and Stockyards Program (P&SP) operates under the authority of the Packers and Stockyards Act of 1921 (P&S Act). P&SP is administered by a Deputy Administrator, who reports to the Administrator of the Grain Inspection, Packers and Stockyards Administration (GIPSA). The Deputy Administrator provides leadership to five program directors, two in the Washington, D.C. headquarters and three in regional offices located in Atlanta, Georgia; Aurora, Colorado; and Des Moines, Iowa.

Each regional office director manages a Business Practice Unit, a Financial Unit, and two Resident Agent Units, which enforce the Act through regulatory actions and investigations. The director also oversees the administrative Program Support Unit.

Unit Level Activities—To ensure compliance with the P&S Act, P&SP agents conduct two broad types of activities: investigative and regulatory. Investigations are carried out when a violation of the Act appears to be occurring. Regulatory activities are monitoring activities to determine if a regulated entity is complying with the P&S Act, and result in rectification of identified non-compliances. For example, in 2009, P&SP conducted 589 weighing verifications (including "checkweighs") that found 69 violations, in which cases P&SP initiated corrective measures; 284 custodial account audits resulted in account corrections worth slightly more than $4 million.

Strategic Business Plan—Management of P&SP is achieved through tactical short-term operational and long-term strategic goals. These goals are communicated to all employees primarily via a Strategic Business Plan. The 2010 plan identifies four strategic business goals that articulate longer term strategies into annual operational objectives. These goals are:

1. Increase the level of compliance with the P&SP Act through preventative regulatory actions.
2. Attain compliance through investigations and enforcement.
3. Implement directives, policies, and regulations and perform industry analyses that effectively and efficiently keep pace with the changing livestock, meat, and poultry industries.
4. Improve organizational efficiency and effectiveness.

Objectives under goals (1) and (2) are implemented at the field and headquarters levels and yield P&SP's overall aggregate performance measure, which is the industry's compliance rate with the P&S Act in any given year. Compliance in 2009 remained at 80 percent, as in 2008, versus 73 percent in 2007. In 2009, goal (3) was attained by the development of new competition monitoring programs, expanding existing rules for production and poultry contracts to cover swine contractors, and defining feed weighing standards for swine contractors.

The investigations conducted in accordance with goal (2) also provide information on the level of efficiency that P&SP achieves when obtaining compliance with the P&S Act under goal (4) of the Strategic Business Plan. Efficiency is defined as the average number of days from the beginning date of an investigation until it is closed within P&SP or until investigation is referred to the U.S. Department of Agriculture (USDA) Office of the General Counsel (OGC) for possible formal prosecution. Investigation efficiency has improved since 2006 — investigations remained in P&SP 114 days in 2009 compared to 165 days in 2006. P&SP closed 986 investigations in 2009. An additional 73 investigations were closed in 2009 that had been referred to OGC, including 19 that OGC had referred to the U.S. Department of Justice (DOJ).

Initiatives—P&SP is carrying out three major initiatives that span multiple years to achieve greater industry compliance with the P&S Act and to increase our efficiency in achieving compliance. These initiatives include refining recently developed standardized business processes for key activities; modernizing management information systems to establish a single program data warehouse and automated work flow systems to capture real-time agency data; and centralizing processing of industry annual reports into a single unit in the Western Regional Office.

Accomplishments—In fiscal year 2009 and early 2010, P&SP finalized three regulations related to swine contractor activities, scales and weighing, and poultry contracts. Three proposed rules were also published related to registration, required scale tests, and the swine contract library. Two additional work plans have been prepared for proposed rules related to the 2008 Farm Bill. P&SP also completed the implementation of a paperless case management software system in December 2009.

Industry Assessment—P&SP completed the annual assessment of the industries regulated under the P&S Act, which is based on data from the annual reports filed by regulated firms covering the firms' 2008 fiscal year. The assessment indicates that the four largest firms' share of the total value of livestock purchases (i.e., aggregate industry concentration) has been relatively stable over the past 5 years but saw a slight increase in 2008. Four-firm concentration ratios by volume of steer and heifer slaughter and fed beef production both declined in 2008.

Concentration in poultry slaughter has trended upward since 2000. Cow and bull slaughter concentration increased from 1999 to 2007 and remained steady in 2008. Concentration in hog slaughter increased sharply in 2003, was stable until a decline in 2006, returned to the previous level in 2007, and held there in 2008. Concentration in sheep slaughter declined from 1998 through 2004, increased sharply in 2005, declined in 2006, but then returned to slightly above the 2005 level in 2007 and 2008.

Trends in the marketing practices of packers vary by species. The volume of carcass-basis purchases of cattle trended upward from 1998 through 2002, remained constant in 2003, fell to a lower plateau in 2004 through 2006, and then increased in 2007 and 2008. By comparison, carcass-basis purchases of hogs have generally increased since 1998.

Historically, as the volume of carcass-based procurement has increased, packers have increased the development and testing of carcass evaluation devices in the beef industry. Changes in carcass merit programs for hogs were not significant in 2007, perhaps reflecting the fact that carcass-based purchases of hogs stabilized at high levels in recent years as packers seem to be satisfied with the current degree of leanness in hogs.

The use of committed procurement methods by the largest beef packers has continued to trend upward since 2005. Marketing agreements represent the largest portion of committed cattle procurement.

As the tight credit and weak demand at the end of 2008 persisted into 2009, industry contraction led to greater concentration rates particularly at the market level and firm plant level. These rates were above those seen in the past due to consolidation that resulted from the adoption of cost-saving technologies. Financial stress for those with interests in the livestock-meat sector is creating an unprecedented demand on the financial protections provided to livestock sellers and poultry growers under the P&S Act. P&SP has also observed an increase in the number of business practices that fall in between defined trade practice violations and anticompetitive practices, particularly in relation to production contracts. The DOJ-USDA workshops in 2010 will in part discuss these practices.

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OVERVIEW OF THE PACKERS AND STOCKYARDS PROGRAM

This section provides a brief overview of the Packers and Stockyards Program's (P&SP) authority and responsibilities under the Packers and Stockyards Act of 1921 (P&S Act), P&SP's position within the organizational structure of the U.S. Department of Agriculture, and P&SP's own internal organization.

Authorities and Responsibilities

Under the P&S Act, the Secretary of Agriculture (Secretary) has authority over businesses engaged in the marketing of livestock, meat carcasses, and poultry. The Secretary has delegated this authority to the Packers and Stockyards Program for regulation and enforcement. Regulated business entities include livestock market agencies (which include auction markets), livestock dealers, stockyards, packers, swine contractors, and live poultry dealers (this includes most poultry slaughterers or "poultry integrators"). These businesses assemble and process livestock and poultry, and move their products through the first manufacturing, or meatpacking, phases of the livestock and poultry marketing channel. Livestock producers, feedlots, and poultry growers at the originating or upstream ends of the market channels and most retailers at the opposite downstream end of the market channel are not under P&SP's jurisdiction.

The P&S Act prohibits unfair, deceptive, unjustly discriminatory, and fraudulent practices. It also prohibits regulated businesses from engaging in specific anti-competitive practices.

In addition to describing unlawful behavior, the P&S Act mandates certain business practices by regulated industries. For example, market agencies and dealers must be registered; market agencies, packers (except those whose average annual livestock purchases do not exceed $500,000), and dealers must be bonded to protect livestock sellers; and buyers must make prompt payment for livestock. To protect unpaid cash sellers of livestock, packers are also subject to trust provisions that require that livestock inventories and receivables or proceeds from meat, meat food products, or livestock products be held in trust for unpaid cash sellers until payment is made in full. A similar provision applies to live poultry dealers.

P&SP uses its statutory authority to investigate alleged violations of the P&S Act and regulations, and prosecutes violations identified through those investigations in administrative actions prosecuted by USDA's Office of the General Counsel or through referrals to the U.S. Department of Justice.

Under the Food Security Act of 1985, States may establish central filing systems to pre-notify buyers, commission merchants, and selling agents about security interests against farm products. P&SP administers the section of the statute commonly referred to as the "Clear Title" provision by certifying the filing systems of States that apply to P&SP for certification. P&SP does not have authority to de-certify States unless a State requests such decertification, and it does not have the authority to determine if States are maintaining certification standards.

Packers and Stockyards Program's Business Organization

The Packers and Stockyards Program is administered by a Deputy Administrator, who reports to the Administrator of the Grain Inspection, Packers and Stockyards Administration (GIPSA). In addition to the Packers and Stockyards Program, the GIPSA Administrator oversees the Federal Grain Inspection Service. Within the U.S. Department of Agriculture, the GIPSA Administrator reports to the Under Secretary for Marketing and Regulatory Programs (Figure 1).

P&SP's appropriated budget for 2009 was $22.4 million, a 1.5 million increase over 2008 levels. P&SP is using the increased funds to hire new field staff, including seven Resident Agents (RAs) to cover the following areas: Oklahoma, South Carolina, Nebraska, Michigan/Indiana, Illinois/Indiana/Kentucky, Missouri/Iowa, and Arkansas. In addition to the RAs, P&SP will hire one Resident Auditor (Kansas) and two Marketing Specialists (Iowa and Colorado) with expertise in scales, grading devices, and software used to determine payment to producers.

Table 1. **P&SP Appropriated Budget for Fiscal Years 2005-2009**

Year	2005	2006	2007	2008	2009
Funds ($000)	19,510	20,257	20,172	20,901	22,412

The Deputy Administrator of the Packers and Stockyards Program provides strategic leadership to five program directors, two in headquarters in Washington D.C., and three in regional offices in Atlanta, Georgia (Eastern Regional Office); Aurora, Colorado (Western Regional Office); and Des Moines, Iowa (Midwestern Regional Office) (Figure 2). As of November 23, 2009, P&SP had 166 full-time staff.

Each regional director manages an administrative Program Support Unit and four program units: a Business Practice Unit, a Financial Unit, and two Resident Agent Units. The units are organized based on responsibilities under the P&S Act and are designed to capitalize on the tactical advantages of placing staff in the field. Each unit is comprised of 5 to 10 staff members. Each unit has a supervisor who reports to the Regional Director. Staff members supervised in the regional offices are responsible for conducting investigations and regulatory activities such as business audits, weighing verifications, and day-to-day industry monitoring. These activities are described in greater detail in the next section.

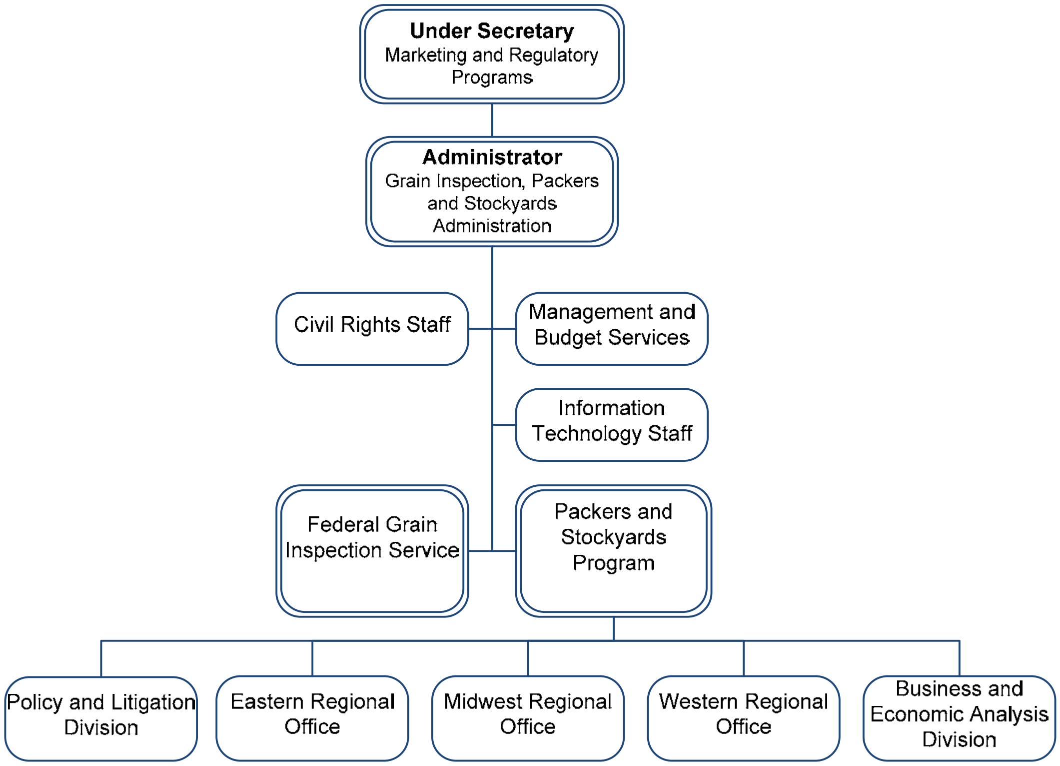

Figure 1. **Grain Inspection, Packers and Stockyards Administration Organizational Structure**

Each regional office is expert in one or more species of livestock. The Eastern Regional Office focuses on poultry, the Midwestern Office on hogs, and the Western Regional Office on cattle and sheep. Forty resident agents, who report to the regional offices, are located throughout the country to provide core services nationwide (Figure 2). The geographically dispersed resident agents enable P&SP to maintain close contact with the entities that it regulates, which are similarly dispersed throughout the United States (see Figures 3 through 6).

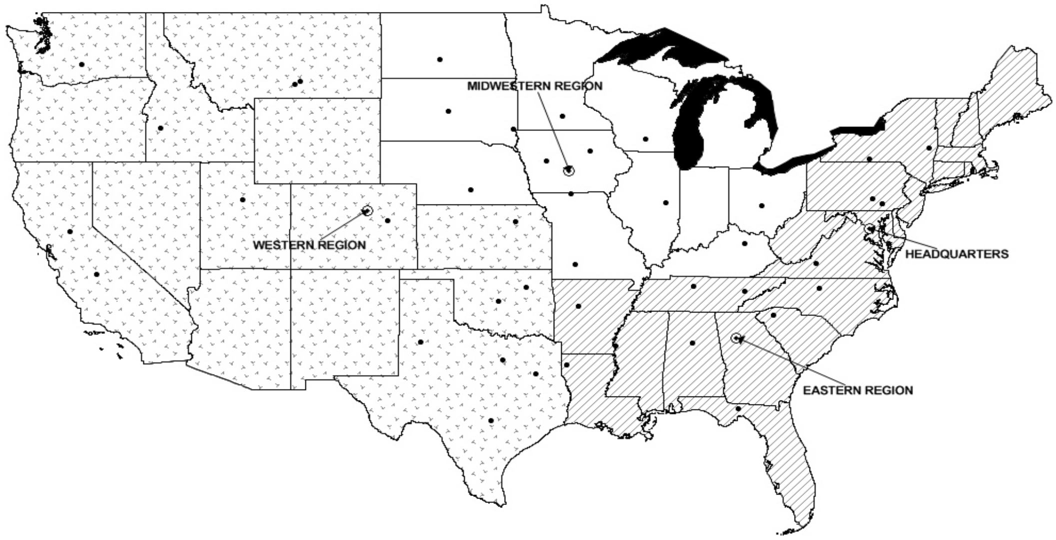

Figure 2. **Packers and Stockyards Program Regional Office and Resident Agent Locations**

Figure 3. **Location of Livestock Packers Subject to the P&S Act**

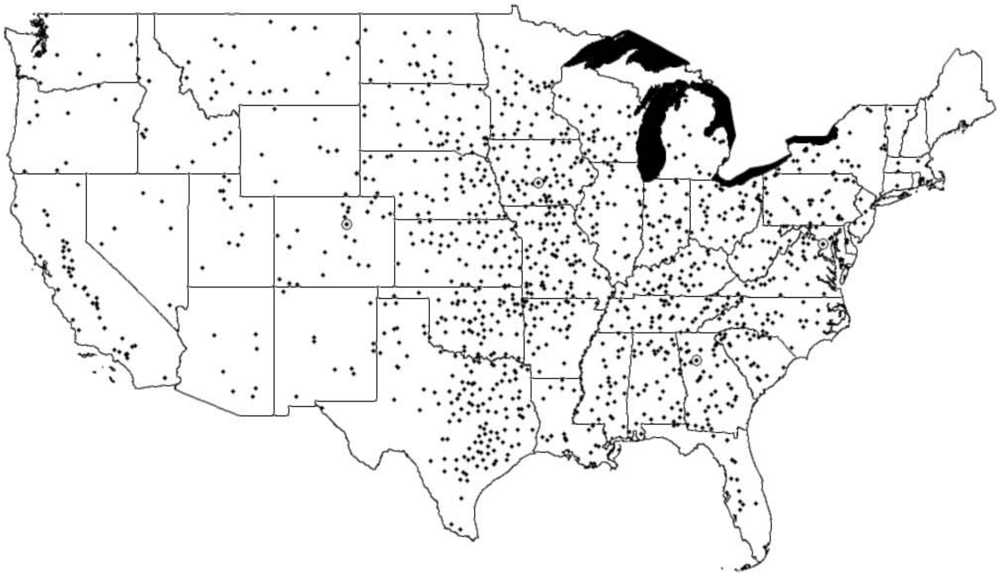

Figure 4. **Location of Livestock Markets and Firms Selling on Commission Subject to the P&S Act**

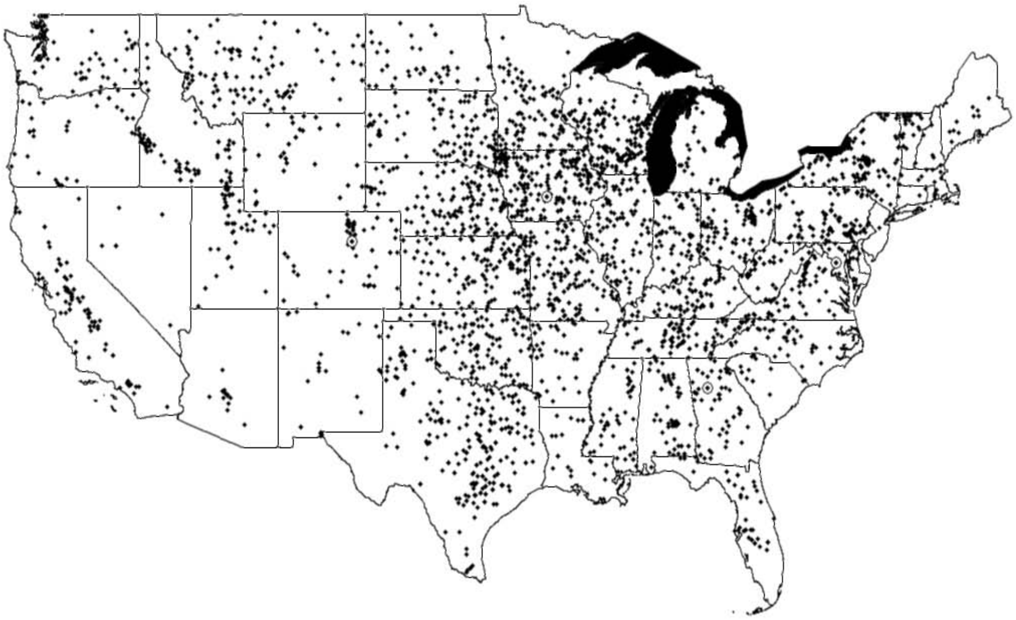

Figure 5. **Location of Livestock Dealers Subject to the P&S Act**

Figure 6. **Location of Live Poultry Dealers Subject to the P&S Act**

PACKERS AND STOCKYARDS PROGRAM UNIT-LEVEL ACTIVITIES

P&SP conducts two broad types of activities at the unit level to enforce the P&S Act: investigative and regulatory. Investigations are conducted when there is reason to believe a violation of the Act is occurring or has occurred. Regulatory activities are monitoring activities carried out to determine if a regulated entity is complying with the Act. The most in-depth, complex investigative and regulatory activities are performed by the regional offices' Business Practices or Financial units. The Business Practices units include legal specialists, economists, and marketing specialists who focus on competition and trade practice issues. The Financial units are staffed with auditors who investigate and undertake regulatory activities related to enforcing the complex financial requirements of the Act. Routine activities are conducted by resident agents who work closely with regulated businesses and livestock sellers and poultry growers.

Investigations at a firm level may be a followup to previously identified violations of the Act, or may be initiated in response to complaints from industry participants, possible violations found while conducting regulatory activities on a business's premises, or possible violations found through other monitoring. Investigations may be conducted as rapid response actions to prevent irreparable harm to the regulated industries.

Members of the livestock and poultry industries and the public may report complaints and share concerns via a toll-free number (1-800-998-3447) or e-mail address (PSPComplaints@usda.gov). Individuals or firms with complaints about the livestock and poultry industries also are encouraged to call the appropriate regional office to discuss their concerns, anonymously if desired.

P&SP responds to all of these external contacts. The Agency also initiates investigations independently, for example, as a result of information obtained from monitoring industry behavior.

Regulatory activities include, but are not limited to: check-weighing; custodial account and prompt payment audits; procurement and marketing business practice reviews; registering market agencies, dealers, and packer buyers who operate subject to the P&S Act; helping producers file bond and trust claims; analyzing trust and bond claims; and conducting orientations for new markets and new packers.

Regulatory activities also include market-level monitoring, which is generally conducted using data that are available in the public domain. Examples include, but are not limited to, monitoring fed cattle and hog prices and analyzing structural changes in the livestock, meat, and poultry industries. Monitoring activities have led to firm-level investigations. Regulatory activity may occur entirely or partially at an entity's place of business or at a Regional Office.

P&SP regulatory and investigative activities are categorized as generally addressing areas of competition, trade practice, or financial concerns. Program expenditures on investigations and regulatory activities are greatest within the financial area of enforcement (Table 2).

Table 2. **Total Regulatory and Investigation Expenditures, 2001-2009**

	Regulatory (K$)			Investigation (K$)		
Fiscal Year	Competition	Trade Practice	Financial	Competition	Trade Practice	Financial
2001		N/A		3,431	4,117	5,318
2002		N/A		3,575	4,290	5,541
2003		N/A		3,755	4,506	5,820
2004		N/A		3,905	4,686	6,053
2005		N/A		4,050	4,860	6,277
2006	----	6,705	----	1,775	2,640	3,869
2007	----	7,142	----	1,488	4,259	3,419
2008	----	3,664	----	330	6,220	6,238
2009	205	2,047	3,281	245	3,330	9,244

Table notes: "N/A" indicates data not available. Prior to fiscal year 2006, regulatory activities and investigations were not differentiated; in 2006-2008, regulatory categories were not differentiated.

P&SP's regulatory and investigative actions frequently find that entities are in compliance with the P&S Act. When violations are discovered, P&SP levies agency-established fines (stipulations) for admitted violations or pursues litigation through USDA's Office of the General Counsel before a USDA Administrative Law Judge or through the U.S. Department of Justice. Litigation may result in a fine against the offending entity (Table 3), or in suspension of the entity's P&S registration. Not all cases result in monetary penalties. In 2009, penalties when imposed in administrative cases averaged $18,235, and in civil (U.S. Department of Justice) cases averaged $4,583. Total administrative and civil penalties combined were $424,280 in 2009.

Table 3. **Penalties Levied for P&S Act Violations, 2005-2009**

Type Judgment	2005	2006	2007	2008	2009
Stipulations ($)	NA	NA	9,750	23,275	30,775
Administrative Penalties ($)	114,300	196,350	404,150	657,770	364,700
DOJ Civil Penalties ($)	NA	NA	36,500	51,240	59,580
Complaints Issued	-	25	50	46	40
Suspensions	-	-	-	-	19

Table note: Prior to 2007, administrative and DOJ penalties were combined. P&SP began using stipulations in 2007, in which entities agree to fines set by P&SP. Penalties and suspensions are not mutually exclusive; there may be both a fine and a suspension for a given case. Penalties and suspensions shown are not necessarily linked to current-year complaints.

Enforcing Business Practice Provisions

The regional business practice units include responsibilities for inspections and investigations of trade practice and competition provisions of the P&S Act.

Supported by resident agents, the units conduct investigations of alleged anti-competitive practices and unfair and deceptive trade practices at auction markets, livestock dealers and order buyers, slaughtering packers, live poultry dealers, and meat dealers and brokers. Economists and legal specialists in the units conduct competition investigations and regulatory activities. For example, an economist might monitor market and firm prices for indications of anti-competitive firm behavior. Marketing specialists conduct trade practice investigations and regulatory actions related to inaccurate weighing practices or carcass evaluation instruments and compliance with contracts. The competition and trade practice work conducted by these units is discussed in more detail below.

Competition

Investigations are a central activity of our competition program. P&SP investigates complaints alleging anti-competitive behavior such as attempted restriction of competition, failure to compete, buyers acting in concert to purchase livestock, apportionment of territory, price discrimination, price manipulation, and predatory pricing. P&SP's economists and legal specialists collaborate with USDA's Office of the General Counsel (OGC) on all competition investigations. When the results of an investigation indicate that the evidence and circumstances support legal action, P&SP formally refers the case file to OGC for action.

P&SP conducts many activities that monitor changes in industry behavior in order to understand the nature of and reasons for changes, and to anticipate potential competitive issues that may result from those changes.

Details of specific, ongoing individual monitoring efforts are described in the next three sections.

Fed Cattle and Hog Market Price Monitoring

P&SP undertook a price monitoring initiative in response to market issues that evolved from the announcement of the first case of bovine spongiform encephalitis (BSE) in the United States on December 23, 2003. A national task force comprised of P&SP economists modified an econometric model in use since the mid-1990s that detected price differences in regional fed cattle markets. The statistical model relied on publicly reported price data to assess regional price differences. If a statistically significant price difference was detected, P&SP initiated a regulatory review work plan to determine whether those price differences were caused by an undue or unreasonable preference or disadvantage in violation of section 202 (b) of the Act or by uncontrollable external factors, such as weather or other external macroeconomic conditions. The statistical model is similar to the model used by the Federal Trade Commission in 2008 to monitor retail gasoline prices.

The current fed cattle market price program was first implemented in 2004, but has since evolved into an enhanced program that includes a weekly internal reporting regime and a detailed work plan to conduct in-depth investigations into possible violations of the Act if the initial regulatory reviews of price differences do not clarify whether they were caused by external market factors. The model and the historical database upon which the monitoring program is based have also been enhanced through further economic and statistical research activity conducted by P&SP economists.

The model is run weekly, and any price outlier that is not caused by certain technical statistical factors triggers a regulatory review by P&SP. If the regulatory review does not determine that the price outlier was caused by certain external factors or readily observable market conditions, then a formal investigation is initiated to determine the cause of the price outlier. The formal investigation involves deeper examination of the price data and cattle characteristics, and interviews with buyers, sellers, and other market participants.

The fed cattle price monitoring program initiated 25 regulatory activities in 2009, and of these, 3 indicated cause for investigation (Table 4).

Table 4. **Regulatory Activities and Investigations Resulting From Weekly Statistical Monitoring of Fed Cattle Markets**

Fiscal Year	Regulatory Activities Initiated	Investigations Initiated
2006	25	6
2007	13	0
2008	19	4
2009	25	3

Of the three investigations initiated in 2009 with a request for data from the Agricultural Marketing Service (AMS), all three are ongoing with field interviews being conducted. Although no competition violations have been identified, P&SP continues to actively monitor market prices on a weekly basis and initiate timely regulatory reviews and investigations, if necessary, of observed market price anomalies.

Effective September 9, 2009, a statistical model similar to the fed-cattle model was implemented for daily monitoring of hog market prices for the three AMS barrow and gilt price reporting areas. These AMS market areas include Iowa-Minnesota, the eastern Cornbelt, and the modified western Cornbelt. The AMS reporting market area is the western Cornbelt region, which includes Iowa and Minnesota. To ensure non-overlapping markets, P&SP modified the territory to remove the Iowa and Minnesota hog transactions and prices from this region. Live and carcass prices are monitored, except in the modified western Cornbelt market, which only reports carcass prices. The model reported no daily price outliers for these five market prices from September 9, 2008, through September 30, 2009. Whether P&SP is monitoring fed-cattle or hog prices, when the statistical model reports an outlier, an economist from either the Midwestern or Western regional office reviews the suspect price and makes a recommendation report, which is reviewed by an economist in each regional office, the originating Business Practice Unit's supervisor, and an economist in headquarters. Based on the report and reviewer comments, the supervisor either closes the review or opens an investigation and requests firm-level data from AMS.

Committed Procurement Review and Audit

P&SP monitors the use of “committed procurement” arrangements, which commit cattle and hogs to a packer more than 14 days prior to delivery. Each year, P&SP economists obtain fed-cattle and hog procurement data for the previous calendar year from the five largest beef packers and four largest hog packers. If the packers change their procurement arrangements with suppliers from previous years, P&SP also collects any new or modified written marketing agreements or contracts. P&SP economists review the contracts and, if necessary, discuss them with the packers to determine how the terms of the agreements relate to committed procurement categories of interest. Economists then classify, review, and tabulate the individual transactions data, and calculate the reliance of the top packers on committed procurement methods. Finally, P&SP economists reconcile the calculations based on the detailed transaction data on committed procurement as reported by the packers in their Packer Annual Reports.

If there are significant differences between the transaction data and the Packer Annual Report submissions on committed procurement, the economists contact the packers to identify the cause of the discrepancy. If necessary, P&SP meets with the packers in person to discuss the packers’ procurement methods and explain how they should be reported on the Packer Annual Report. These meetings foster a mutual understanding of the reporting of requirements for committed procurement and more reliable reporting and calculation of the packers’ reliance on committed procurement methods.

Relying on written contracts and other information collected during the committed procurement reviews, P&SP agents analyze the various procurement and pricing methods used by hog and fed-cattle packers. Agents obtain and review all available contracts and agreements to determine if there have been any competition violations of the Act. The contracts are also used in procurement reviews of the packers to help determine if proper payment practices are being followed.

In 2009, P&SP conducted regulatory reviews of the procurement practices of the four largest hog packers. The reviews included analyses of contractual arrangements that packers had with pork producers, and price relationships among various procurement arrangements. P&SP also assessed whether the procurement methods reported to the Agency in the packers yearly reports accurately reflect packer procurement transactions, and whether packers made pricing decisions based on the size of the producer.

P&SP's review revealed hog prices differed based on pricing and procurement methods and seller sizes. For example, hogs purchased on the negotiated market, hogs priced on a live-weight basis, and hogs sold by smaller sellers tended to receive lower prices. Purchases from smaller sellers were primarily on the negotiated market, with most of these hogs priced on a live-weight basis, while purchases from larger sellers were primarily through marketing agreements using carcass-merit pricing. Hogs procured in the negotiated live market tended to be priced higher compared to hogs of equivalent quality procured using the carcass-merit negotiated market, based on a 75-percent yield. P&SP will be pursuing investigations in 2010 to determine if these differences constitute price discrimination in violation of the P&S Act.

The hogs procured in the reviews were mostly purchased on a formula basis using both written and verbal arrangements. P&SP regulatory reviews revealed that hogs procured through verbal agreements but reported to AMS on a formula basis were being reported to P&SP as spot market transactions because the agreements were made within 14 days before slaughter.

Poultry Contract Compliance Review Process

In 2009 P&SP added a formal poultry contract compliance review as a component of P&SPs performance measure (see Performance and Efficiency Measurement section below). Contract reviews in addition to the reviews conducted based on a random sample may be initiated based on industry intelligence or complaints.

A documented, automated process has been implemented for P&SP agents to follow in conducting such reviews. In general, the agent will collect relevant background information on the firm that is under review prior to conducting a site visit. Once on-site, the agent will conduct an interview and obtain copies of the grower contract being used at the plant location and 3 months of weekly ranking sheets for the contract. These documents are reviewed for consistency and adherence to P&S Act regulations. One week of payment data from the settlement sheet is selected as a random sample for a detailed review for accuracy and completeness. The results are compared to the firm's ranking sheets, settlement sheets, and payments to the growers to ensure consistency with the contract. If discrepancies are found, an investigation is opened. If the firm's practices are determined to be free of violation, the agent provides an exit interview indicating this to the firm's management.

Other Competition Activities in 2009

The P&SP Competition program also continuously analyzes significant industry events and industry mergers and acquisitions. Although P&SP does not have statutory authority to block mergers or acquisitions, the Program provides merger and acquisition analyses to the DOJ and the Federal Trade Commission (FTC) for their evaluations of mergers and acquisitions. The merger analyses also are used within P&SP to assess the mergers' estimated impacts.

In 2009, P&SP conducted an analysis of the proposed JBS Swift and Company acquisition of Pilgrim's Pride Corporation, which was approved by the FTC on October 15, 2009.

P&SP and OGC collaborated in 2009 with the Commodity Futures Trading Commission (CFTC) by providing information and analysis of livestock and meat marketing issues that are jointly relevant to P&SP and the CFTC's regulatory and enforcement activities.

Currently, P&SP is working with USDA's Economic Research Service to develop a generally applicable form of competition monitoring based on cost-price ratios. The approach is being tested to monitor the average price of a poultry contract reported by a particular firm compared to a statistical average that represents its estimated payment. Large variances between the observed and predicted costs would trigger a field audit to examine the variance, recognizing that many factors could legitimately explain the variance.

Trade Practices

Firms that furnish stockyard services in commerce are required to post a notice that informs the public that the stockyard meets the definition of a stockyard under the P&S Act. Once posted, the stockyard remains posted until it is de-posted through public notice. P&SP meets with new auction market owners and managers as soon as possible after the market begins operations to ensure that market operators understand their fiduciary responsibilities under the P&S Act, and that they are operating in compliance with the P&S Act and regulations. These visits in the early stages of a market's operation also provide important protection to livestock producers, who rely on the market to provide a nondiscriminatory and competitive marketplace. Similarly, P&SP conducts orientations for feed mill operators to ensure they understand the regulatory requirements for feed weights used to calculate producer/grower payments, thereby helping ensure that the feed weights and payments to producers are accurate.

P&SP reviews procurement practices to determine if unfair or deceptive trade activities are occurring in the procurement of livestock, meat, and poultry. The reviews assess pricing methods; payment practices; weighing of livestock, carcasses, and poultry; carcass grades used for payment; and accounting issued to sellers.

The P&S Act and regulations require markets, dealers, and packers to test scales at least semi-annually and file scale-test reports as evidence of scale maintenance. State and private companies test scales, and P&SP conducts weighing verifications and other investigations to ensure scale operators and firms subject to the P&S Act are properly using their scales and properly recording weights in the purchase and sale of livestock and poultry (Table 5).

Table 5. **Weighing Inspections and Violations, 2006-2009**

Type of Checkweigh	2006	2007	2008	2009
Inspections				
Market Scales	89	137	188	245
Dealer Scales	11	21	14	41
Packer Scales	6	14	13	18
Carcass Checkweigh	4	106	82	148
Poultry Checkweigh	100	87	58	74
Feed Checkweigh	51	76	43	63
Total Inspections	261	441	398	589
Violations				
Markets	4	8	14	15
Dealers	0	0	1	3
Packers	0	0	0	1
Carcass Checkweigh	0	10	4	25
Poultry Checkweigh	5	4	4	11
Feed Checkweigh	6	5	5	14
Total Violations	15	27	28	69

A purchase made on false or inaccurate weights, or with unauthorized modification to actual weights, such as modifying the actual weight of the livestock or failing to pass on a shrink allowance, is an unfair and deceptive practice. Anyone who believes that an action of a stockyard, market agency, or dealer caused personal loss or damage in violation of the P&S Act may file a complaint seeking reparation (damages) with P&SP within 90 days of learning of the action that caused damages. The Act does not provide for reparation complaints to be filed against packers, live poultry dealers, or swine contractors.

Enforcing Financial Provisions

P&SP's financial units enforce the financial provisions of the P&S Act and regulations. These enforcement actions support the financial integrity and stability of the livestock, poultry, and meatpacking industries. Enforcement is carried out through reviews of annual and special reports, and onsite financial compliance reviews and investigations. Financial compliance reviews and investigations address solvency issues, payment to livestock sellers and poultry growers, bond claims, trust claims, and maintenance of custodial accounts. When P&SP identifies a potentially serious financial situation that may cause imminent and irreparable harm to livestock producers, rapid response teams are deployed immediately to conduct an investigation.

Under the P&S Act, most regulated entities must be solvent (current assets must exceed current liabilities). P&SP monitors the solvency of regulated entities by reviewing financial data in annual and special reports, and by onsite financial compliance reviews and investigations. P&SP notifies entities of their insolvencies and the immediate need to correct them. P&SP requires special reports from firms whose annual reports disclose insolvencies. In addition, P&SP conducts onsite financial investigations to ensure correction of reported insolvencies or other financial issues. Formal disciplinary action is initiated against firms when appropriate.

Market agencies selling livestock on commission (auction markets) must establish and maintain a bank account designated as a "custodial account for shipper's proceeds" to hold proceeds from the sale of consigned livestock. P&SP monitors custodial accounts by reviewing annual reports from market agencies, analyzing special custodial account reports, and conducting onsite custodial account audits. When the monitoring reveals shortages, P&SP acts to have the account balance corrected (Table 6).

Table 6. **Number of Market Audits and Shortages Corrected Through On Site Investigations, 1998-2009**

Fiscal Year	Custodial Account Audits	Markets With Shortages	Corrected by On Site Investigation
1998	393	187	$3,690,355
1999	233	103	$2,701,091
2000	374	154	$5,916,746
2001	322	156	$6,313,383
2002	206	97	$2,814,439
2003	262	92	$2,055,203
2004	272	94	$2,144,986
2005	252	102	$5,269,525
2006	347	140	$7,256,052
2007	296	99	$2,037,080
2008	176	62	$5,022,966
2009	383	181	$2,581,725
Average	284	116	$4,010,291
Standard Deviation	67	36	$1,961,252

The P&S Act also establishes a statutory trust on certain assets of packers and live poultry dealers for the benefit of unpaid cash sellers of livestock and unpaid cash sellers or contract growers of live poultry grown for slaughter. Packer trust assets include all livestock purchased in cash sales, inventories, receivables, and proceeds from meat, meat food products, and livestock products derived from the purchase of livestock in cash sales. Poultry trust assets include all poultry obtained by live poultry dealers in cash poultry purchases or by poultry growing arrangements, inventories, receivables, or proceeds from such poultry or poultry products therefrom. Valid trust claims come before secured creditor claims in bankruptcy.

To be eligible for payment under the trust, a seller must file a claim with the packer or live poultry dealer and the Secretary within 30 days of the unpaid transaction. When a trust claim is filed, P&SP and OGC analyze the claim to assess whether it is timely and supported by adequate documentation. P&SP then makes the analysis available to the packer or live poultry dealer (the statutory trustee) and to trust claimants so that they can take any necessary action.

Additionally, all market agencies, dealers, and slaughtering packers purchasing over $500,000 of livestock annually are required to file and maintain bonds or bond equivalents for the protection of livestock sellers. To be eligible to receive payment under the bond, a seller (cash or credit) who does not receive payment for a transaction must file a bond claim within 60 days of the transaction. P&SP analyzes the claim to ensure it was filed within the timeline and supported by adequate documentation, and provides its analysis to the principal, and to the bond surety or trustee on a bond equivalent. In some instances the analysis is made available to all claimants to facilitate joint legal action. In some cases, claims may be made against and paid by both bond and trust assets.

Bonding requirements usually do not cover the entire loss sustained when a firm fails financially. Further, livestock sellers do not always determine the current bond status of smaller packers, dealers, and market agencies before selling livestock to them, making those sellers vulnerable to insufficient bond protection if the smaller firms fail. A large packer's failure may impact auction markets and dealers from whom it purchased livestock and failed to pay.

Since 1999, an average of 13 dealers failed each year, with actual ranging from 4 to 22 failures per year. During that same time period, producers received an average 18 percent payment on the dollar, with restitution ranging from 3 to 33 percent on the dollar (Table 7).

Table 7. **Total Dealer Financial Failures and Restitution, 1999-2009**

Fiscal Year	No. of Failures	Owed for Livestock ($)	Restitution From Bonds ($)	Restitution From Other Sources ($)	Percent
1999	10	1,684,128	291,261	38,024	20
2000	11	1,464,733	324,979	91,800	28
2001	11	2,841,305	317,444	24,786	12
2002	11	3,271,962	618,764	60,000	21
2003	5	1,805,600	112,281	28,923	8
2004	3	770,860	95,000	0	12
2005	1	2,993,990	0	0	0
2006	13	3,018,131	134,936	26,856	5
2007	31	6,941,930	257,634	549,303	12
2008	20	2,054,647	843,682	301,916	56
2009	25	3,134,145	348,018	411,133	24
Average	13	2,725,585	304,000	139,340	18
Standard Deviation	9	1,618,823	244,262	190,785	15

Auction markets may be especially vulnerable to a domino effect from dealer failures since many dealers purchase livestock from auction markets. The failure of a large dealer may impact every auction market that it failed to pay. A large dealer failed in 2005, owing more than $1 million in unprotected livestock debt. Since 1999, an average of 6 auction markets failed per year. Consignors received average restitution of 53 percent payment on the dollar, with a range of 29 to 77 percent on the dollar (Table 8).

Table 8. **Total Auction Market Financial Failures and Restitution, 1999-2009**

Fiscal Year	No. of Failures	Owed Consignors ($)	Restitution From Bonds ($)	Restitution From Other Sources ($)	Percent
1999	3	862,666	60,000	424,589	56
2000	4	399,023	100,193	186,113	71
2001	4	1,104,985	133,745	519,265	59
2002	6	1,082,034	378,610	0	35
2003	6	1,187,979	211,464	138,848	30
2004	2	145,772	60,000	16,649	53
2005	3	336,006	85,000	201,840	78
2006	9	979,543	267,174	19,380	29
2007	11	511,704	37,252	155,890	38
2008	6	602,100	237,734	352,111	98
2009	7	981,189	261,498	1,365	27
Average	6	744,818	166,606	183,277	53
Standard Deviation	3	358,462	110,792	180,003	24

To maximize recovery, bond claims filed against packers are normally paid after claims made against the packer trust are dispensed. On average, in any one year, 4 packers will suffer financial failures owing livestock sellers an average of $4,730,333 (Table 9). The bond payout for packers was, on average, $654,061, or 14 percent of the valid bond claims. Additional restitution from packer trust assets and other sources bring the average recovery to 60 percent of total amounts owed, with a standard deviation range of 35 to 85 percent.

Table 9. **Total Packer Financial Failures, Bond Payout, and Payout From Other Sources, 1999-2009**

Fiscal Year	No.	Owed for Livestock ($)	Payout from Bonds ($)	Payout from Other Sources	Percent*
1999	4	611,067	30,000	109,184	23
2000	3	686,924	25,000	460,505	71
2001	1	81,735	50,000	0	61
2002	3	17,007,170	6,394,489	5,838,750	72
2003	3	2,508,633	225,952	1,238,772	58
2004	1	2,056,869	142,752	369,507	25
2005	2	5,032,018	55,000	1,977,761	40
2006	5	755,550	35,267	683,834	95
2007	6	4,118,456	40,000	4,083,946	100
2008	4	3,498,895	0	1,588,620	45
2009	12	15,676,349	196,208	9,999,228	65
Average	4	4,730,333	654,061	2,395,464	60
Standard Deviation	3	5,960,932	1,905,349	3,105,340	25

* Some annual payouts include sums for prior years' claims, so percentages shown by row may not represent actual percent recoveries for that same year's claims. Some entries reflect adjustments from previously reported totals.

As the livestock and meat industries evolve, P&SP continues to examine alternate ways to effectively regulate and monitor the industries and to effectively allocate its resources for planning and conducting regulatory compliance reviews. Most recently, P&SP adopted a statistical model to identify characteristics that place a livestock dealer, market, or packer at risk of financial failure. The characteristics identified are used, along with other firm information and market intelligence, to assess the need for financial audits.

PACKERS AND STOCKYARDS PROGRAM MANAGEMENT

The Packers and Stockyards Program executes its management function through strategic, broad, multi-year goals and shorter term tactical annual objectives and activities. The primary method for monitoring and communicating these goals, objectives, and activities to all employees is a yearly Strategic Business Plan. The 2010 Plan identifies four broad strategic business goals:

- Increase the level of compliance through preventative regulatory actions;
- Attain compliance through investigations and enforcement;
- Implement directives, policies, and regulations, and perform industry analyses that effectively and efficiently keep pace with the changing livestock, meat, and poultry industries; and
- Improve organizational efficiency and effectiveness.

These broad strategic goals have remained constant while the tactical objectives and activities change to meet the longer term Program goals. The next section addresses how P&SP improves its performance and efficiency, and the results P&SP is demonstrating in achieving these goals.

The subsequent section presents management initiatives that span multi-year horizons and support achieving higher performance and efficiency. The initiatives include further enhancements and refinements to the ongoing business process re-engineering (BPR), and the development and use of a single, comprehensive P&SP database integrated with the workflow processes that was constructed as part of the Program's BPR.

P&SP has two smaller, though extremely important, management initiatives. The first is a training initiative. During 2009, all 49 new personnel with investigative and regulatory responsibilities participated in formal week-long training presented by the Association of Certified Fraud Examiners. The course provides a baseline level of institutional and technical information for all P&SP agents. Two classes are scheduled in 2010 for additional new staff. P&SP also has revised its Employee Manual to be a Web-accessible guide that complements the new standardized operating procedures (see *Employee Library).* Finally, P&SP is also pursuing legislative initiatives and new regulations (see *Industry Concerns* section*).*

Performance and Efficiency Measurement

P&SP measures its overall performance by annually measuring the regulated entities' compliance with the P&S Act. The performance measure encompasses activities P&SP conducts that directly or indirectly influence industry compliance. P&SP calculates industry compliance based on random samples with sample size based on obtaining a 90-percent confidence level. In 2009, industry compliance was 80 percent, the same as 2008. The primary reason for the constant compliance rate was a change in the components used in the index, which are explained in more detail below.

P&SP measures its efficiency at achieving industry compliance by the number of days it takes to complete the investigative phase (the time from complaint until a decision is made whether to refer the case to OGC or DOJ for possible enforcement action) of investigations. Results show the time has declined from 165 days in 2006 to 107 days in 2009. The time to conduct the investigative phase is only one measurement in the complex process of conducting an investigation. Additional information about efficiency measures follows the performance section.

Performance

P&SP's overall performance rate is a composite index of five program-wide audit and inspection activities. In 2009 the index included: 1) poultry contract compliance reviews, 2) financial audits of a random sample of a firm's custodial accounts with the sample size set to yield 90-percent confidence when inferred to the population of regulated entities; 3) financial audits of the prompt pay records of a random sample of firms with sample size set to yield 90-percent confidence; 4) inspection of all scales and weighing practices in all packing plants purchasing more than 1,000 head per year; and 5) inspection of all carcass evaluation devices and carcass evaluation practices for a random sample of packing plants purchasing more than 1,000 head per year.

The aggregated industry compliance rate index reflects the statutory and regulatory compliance of the regulated industry with the P&S Act (Figure 7).

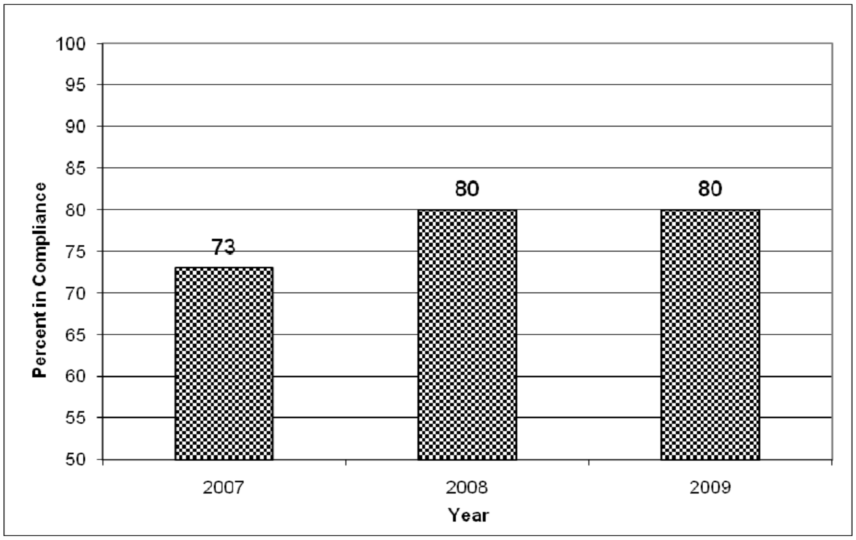

Figure 7. **Aggregated Industry Compliance From Random Samples, 2007-2009**

Financial audits are carried out in accordance with general accounting standards and supervised by staff with certified public accounting status. Business practice inspections are conducted based on standards established by the National Institute of Standards and Technology and supervised by staff trained in inspection procedures.

P&SP validates audits and inspections through internal compliance reviews, which were designed in conjunction with a private consultant, and adhere to the P&SP Standard Operating Procedures Manual published on the internal GIPSA Web page, "Employee Library."

The results of the individual component inspection and audits that comprise the aggregate index show a year-to-year increase in compliance rates in 2009 for four of the five areas reviewed. The poultry contract compliance review was new this year and scored a relatively low rate of 60 percent. Of the other four components, three were above 85 percent and the fourth was 77 percent (Figure 8). In previous years' aggregate index, insolvency audits were included as part of the measure. Insolvency audits were removed from the index this year because the firms selected for the review were being selected not in random samples, but based on targeted information aimed to prevent harm to livestock sellers. If insolvency audits had been included in the aggregate index as in the past, the aggregate index score would have been 85 percent.

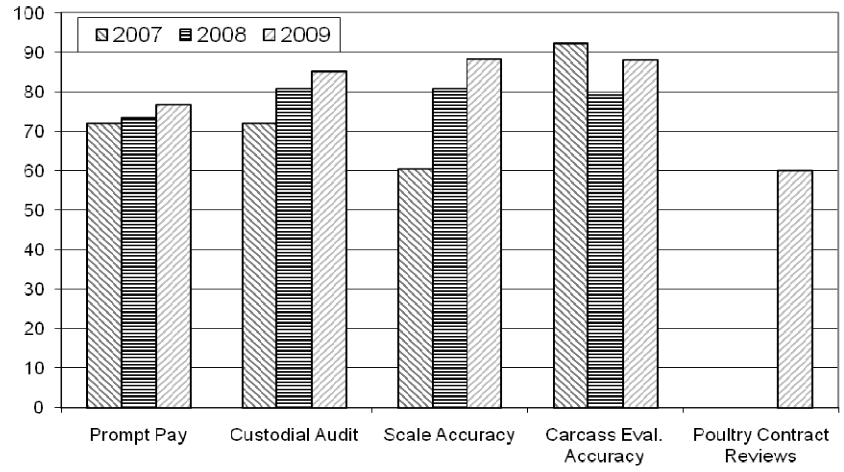

Figure 8. **Comparison of 2007, 2008, and 2009 Performance Measure Components**

Efficiency

P&SP measures its efficiency as the time from initiating an investigation to closing it in P&SP, or until the investigation is referred to the OGC. After referral, P&SP and OGC typically work together to develop adequacy and quality of evidence, determine witness availability, and complete final case preparation. P&SP has reduced the number of days in the investigative phase of investigations over the past 4 years. The average days to conduct an investigation in 2009 increased compared to 2008 as a result of economic conditions triggering a higher proportion of complex financial failure investigations in 2009 (Figure 9).

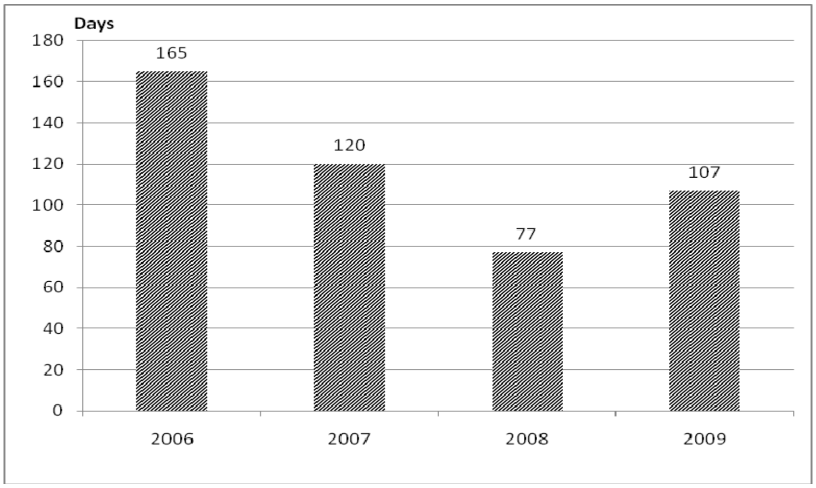

Figure 9. **Days in Investigation From Opening to Closing or to Referral to OGC, Investigations Closed in FY 2006 – FY 2009**

The data in Table 10 and 11, in contrast to Figure 9, are total days to closure, averaged across cases closed by P&SP without referral to OGC and those cases closed after referral to OGC.

Table 10. **Number of Field Investigations and Regulatory Activities Closed During Fiscal Year and Activities Open at End of the Fiscal Year, by Activity, Fiscal Years 2008 and 2009**

Type	Number 2008	Number 2009	Percent Change	Average Days 2008	Average Days 2009	Percent Change
Investigations Closed	370	381	3.0	209	202	-3.3
Investigations Open	228	243	6.6	362	394	8.8
Regulatory Activity Closed	1180	1214	2.9	35	35	0.0
Regulatory Activity Open	30	58	93.3	103	161	56.3

Field activities are conducted at regulated business entity locations.

Table 11. **Number of Office Investigations and Regulatory Activities Closed During Fiscal Year, and Activities Open at End of the Fiscal Year, by Activity, Fiscal Years 2008 and 2009**

Type	Number 2008	Number 2009	Percent Change	Average Days 2008	Average Days 2009	Percent Change
Investigations Closed	897	678	-24.4	101	126	24.8
Investigations Open	220	548	149.1	263	155	-40.7
Regulatory Activity Closed	84	808	861.9	91	34	-62.6
Regulatory Activity Open	18	423	2250.0	128	44	-65.6

Office activities are conducted in GIPSA offices and are typically filing violations, e.g., failure to submit required documentation.

Investigations address a broad range of potential violations under the P&S Act and are grouped into three categories: competition, trade practice, or financial violations.

Competition violations often involve preferential treatment or restriction of competition, such as through apportionment of territory. Trade practice violations include offenses such as unfair or deceptive practices, failure to register properly, and misuse of scales and improper weighing practices, including at any location where scales are used to weigh feed when feed is a factor affecting payment to livestock producers or poultry growers. Financial violations include misuse of custodial accounts, failure to pay or remit, slow pay, and tariff misrepresentation (Table 12).

Table 12. **Number of Closed Investigations in 2009 by Investigative Category**

Investigative Category	Number
Competition	
Restriction of Competition	12
Concentration/Industry Structure	4
Preferential Treatment	1
Financial	
Bond Activities	333
Failure to Pay/Pay When Due	127
Custodial Accounts	96
Annual Report	79
Other	59
Solvency	43
Packer/Poultry Trust	11
Trade Practice	
Registration/Jurisdiction	119
Weighing Practices and Scales	73
Unfair/Deceptive Practices	50
Contract Poultry Arrangements	14
Other	10
Inadequate or False Records	9
Reparations	7
Tariff	6
Grower Termination	3
Merchandising	3
Total	1,059

P&SP's regulatory and investigative actions often find that entities are in compliance with the P&S Act. When non-compliance is identified, P&SP either assesses fines, or stipulations, for admitted violations or pursues enforcement litigation with OGC. After referral but before filing, OGC works with P&SP to prepare the referred cases for filing and litigation before a USDA Administrative Law Judge or for referral to DOJ.

In fiscal year 2009, P&SP opened 1,439 cases, of which 1,408 were alleged violations for financial or trade practice behaviors. During the fiscal year, P&SP closed 986 cases without referring them to OGC (Table 13). An additional 73 cases were closed after referral to OGC.

Table 13. **Investigations by Category, and Average Days in Stages for Closed Investigations Indicating Enforcement Action**

	Average Days				
Status & Type	In PSP	Referral to Filing	Filing to Resolution	Start to Resolution	Number
A. Total Investigations Opened					
Livestock					
Competition					28
Financial					1,003
Trade Practice					304
Poultry					
Competition					3
Financial					15
Trade Practice					86
Total					**1,439**
B. Total Investigations Resolved and Closed by P&SP					
Livestock					
Competition	163			163	15
Financial	100			100	680
Trade Practices	124			124	239
Poultry					
Competition	7			7	1
Financial	97			97	11
Trade Practices	112			112	40
Weighted Averages & Sub Total	**107**			**107**	**986**
C. Total Referred to OGC and Closed					
Livestock					
Competition w/ Enforcement Action	71	36	537	644	1
Financial w/o Admin Action	209			497	15
Financial w/ Enforcement Action	189	346	370	905	30
Trade Practice w/o Admin Action	243			897	2
Trade Practice w/Enforcement Action	215	610	232	1056	5
Poultry					
Trade Practice w/Enforcement Action	242	537	204	983	1
Weighted Averages & Sub Total	**198**	**379**	**351**	**802**	**54**
D. Total Referred to DOJ Through OGC and Closed					
Livestock					
Financial w/ Civil Action	205	42	212	691	17
Financial w/o Civil Action	192			662	2
Weighted Averages and SubTotal	**203**	**42**	**212**	**688**	**19**
Averages & Total Closed	**114**			**153**	**1,059**

Table Notes: “w/o Admin Action” indicates that P&SP closed the case without filing a formal administrative enforcement action after referral to OGC. These cases include files referred to OGC for referral to DOJ that were returned to P&SP without referral. The “Referral to Filing” column in section C is the time that the case is in OGC prior to filing, whereas in section D this is the time that the case is in DOJ prior to filing, after being sent to DOJ by OGC. Cases that are referred may not be ready for administrative action without update, confirmation of witness testimony and availability, sufficiency of evidence, etc. Once the complaint is filed, indicated by the “Filing to Resolution” column, a case may go through a period before service is affected, may be resolved without hearing, or may go to hearing, subsequent decision by an Administrative Law Judge, appeal to the Department’s Judicial Officer, and/or appeal to the Court of Appeals.

Investigations resolved by P&SP are closed either through a finding of no violation, a Notice of Violation letter issued to the entity, or a stipulation settlement in which the respondent admits the violation and voluntarily agrees to a penalty. P&SP closed these cases within an average of 107 days. Another 73 cases were resolved that had been referred to OGC. Cases are referred to OGC when P&SP determines that the investigation requires cooperation with OGC. Frequently in competition and cases involving large financial failures, OGC and P&SP continue to develop evidence with the goal of filing a complaint. The average number of days for cases referred to OGC is calculated based on whether the cases were referred to DOJ for prosecution. Cases not referred to DOJ required an average of 198 days in P&SP; cases referred to DOJ required an average 203 days in P&SP. Table 13 represents only cases that were closed in 2009, and includes some cases that were referred to OGC in years prior to 2009. As a result of referrals from P&SP, 37 administrative actions that had been filed by OGC were closed in 2009, and DOJ closed 19 cases that OGC referred to DOJ. OGC closed an additional 17 cases after determining that evidence did not support formal administrative action.

Management Initiatives

In 2009, P&SP continued work on management initiatives that span multi-year horizons and support achieving higher performance and efficiency. The initiatives include further enhancements and refinements to the ongoing Business Process Re-engineering (BPR), and capitalizing on gains from the development and use of a single, comprehensive P&SP database integrated with the workflow processes. These initiatives represent a natural evolution of the initiatives to standardize the program's business processes—such as conducting custodial audits at livestock markets, and development of a new management information system. These initiatives, while not strictly a response to the 2006 USDA Office of the Inspector General (OIG) report on P&SP, are consistent with strengthening areas of weakness identified in that audit. P&SP initiatives, however, go substantially beyond deficiencies identified in the 2006 OIG report.

Central to the management initiatives has been the core recognition that the people in P&SP are its primary resource and strength in achieving its mission. Organizational Assessment (climate) Surveys of the P&SP staff conducted in 2006 and again in 2008 by the U.S. Office of Personnel Management reflect the effect of this leadership philosophy. P&SP's average score across the 17 dimensions of the survey in 2008 improved significantly compared to 2006. The P&SP average score was 22 percent higher than the Government-wide benchmark average, and P&SP scored higher than the benchmark median in 15 of the 17 individual elements of survey. The participation of staff in major management initiatives has been a significant factor in improving employees' attitudes and morale. Our employees have received USDA's highest recognition for their contributions. For two consecutive years, P&SP teams received the USDA Secretary's Honor Award. In 2007, a team of agents was recognized for maintaining the accuracy of industry scales that weigh livestock. In 2008, a second P&SP team was recognized by the Secretary for leading P&SP's BPR initiative.

The team that led the BPR initiative, the Change Agents Team, developed standard work processes and operating procedures for P&SP's major activities. Their work paved the way to a modern computerized management information system. As an outgrowth of their work, P&SP established a Continuous Improvement Program, which solicits recommendations from all P&SP employees and, through a formalized process, acts on those that show promise for further improving program operations.

Two subsections following the OIG Audit sub-section below further discuss P&SP's management initiatives. The first describes P&SP's new, online employee library that provides all employees with ready access to information on the standardized business processes adopted and implemented during 2008 as well as agency policies in general. The second subsection describes P&SP's ongoing effort to further enhance the computerized management of information through additional refinements to the new automated Packers and Stockyards Automated System, or PSAS.

OIG Audits

In early 2008, P&SP requested that OIG conduct a followup of its 2006 audit to obtain an independent assessment of the Program's progress in improving its efficacy and efficiency. In June 2009, OIG issued its report, *Follow up Audit of the Management and Oversight of the Packers and Stockyards Program,* Report No. 30016-0002-Hy. The report assessed GIPSA's management and oversight of P&SP, the working relationship between P&SP and OGC, and whether effective corrective actions were implemented in response to OIG's 2006 audit recommendations. Overall, OIG found that GIPSA's oversight of P&SP has improved since the 2006 audit and the Agency has a good working relationship with OGC. OIG noted that opportunities remain for GIPSA to further improve program operations by strengthening management and oversight of investigations and fully implementing agreed upon corrective actions. GIPSA concurred with the recommendations and has completed the actions responsive to the report findings.

Employee Library

P&SP's initiative to institute Standard Operating Procedures (SOPs) and sub-processes continued, with the updating of many policy documents (e.g., directives, memoranda, Employee Manual, etc.) to reflect numerous changes and improvements. On July 6, 2009, P&SP launched a new online Employee Library, a complete resource for P&SP policy and employee guidance. The Library, which is the official documentation of all P&SP policy, contains general information about P&SP, standard operating procedures, work instructions, sub-process modules, training modules, and P&SP administrative instructions.

The Library also includes procedural documentation for the new Change Control Working Group (CCWG), which was established as a single P&SP clearinghouse for all improvement ideas and initiatives. The CCWG process ensures that all P&SP employees have a voice in the direction and decision-making of the Agency. The CCWG administers a structured procedure to evaluate Change Requests (CRs) and facilitates implementation of those changes that enhance operational efficiency and effectiveness. The CCWG process is carried out through an automated workflow in the Packers and Stockyards Automated System (PSAS).

The CCWG reviews CRs, consults with subject matter experts, provides recommended action to the P&SP Program Management Team (PMT) for its approval, facilitates implementation of approved changes when necessary, and ensures final dispositions are communicated to P&SP employees. All of these activities are carried out through an automated workflow in PSAS.

The CCWG link on the Employee Library leads to automated procedures for filing Change Requests and tracking subsequent evaluation of the requests. In 2009, the CCWG received 60 Change Requests. Of these, 5 were approved and are fully implemented, and an additional 19 have been approved and still undergoing implementation. An additional 19 were approved by management but not yet under implementation. Management disapproved 10, and 7 were disapproved by the CCWG.

The Employee Library and CCWG maximize the gains from P&SP's BPR. In 2006, P&SP initiated a program-wide BPR effort to develop workflow process descriptions for all of its major activities. All regional offices and headquarters divisions participated. Phase 1 of the BPR process in 2006 required each regional and headquarters office to analyze its existing procedures. Next, P&SP improved the efficiency and consistency of the identified core processes throughout the program. The third and final phase, which is ongoing, involves implementing the 12 updated core processes. Eight primary core processes are being implemented in the regional offices and four at headquarters.

In the regional offices, *Entity Registration and Bonding* improves the registration process and ensures compliance with financial security requirements for entities subject to the Act. *Regulatory Activities* strengthens monitoring activities that determine if a regulated entity is complying with the Act. *Investigations* clearly defines actions to be taken by P&SP agents if there is reason to believe a violation of the Act is occurring or has occurred. *Enforcement* prescribes regional office actions when a violation has been identified. *Bond Trust Claims* defines actions to settle transactions when entities encounter financial problems or when claims are filed as a result of a disputed transaction. *Financial Instrument Termination/Expiration* spells out procedures followed for expiring letters of credit attached to trust agreements. *Scale Test Report* and *Annual Report Filing* processes improve regional offices' management of filed industry reports.

At headquarters, the *Enforcement* process is an extension of the regional enforcement process, streamlining headquarters approval of steps taken during enforcement activities. The *Regulation Promulgation* process provides a system to guide and track development of rules used to enforce the P&S Act. The *PSAS Change Control* process manages and develops suggested additions or updates to the new automated system.

The Investigations and Regulatory Activity processes both have sub-processes, which are specific tasks within each general process type (Table 14). The Investigation process includes 11 sub-processes; the Regulatory Activity includes 7 sub-processes. Each sub-process has a mapped workflow that uses spreadsheet modules as automated checklists to help agents conduct investigations or regulatory (business compliance) reviews. These modules were adopted and implemented in June 2008 and are undergoing operational adequacy tests. The sub-processes are enhancing efficiency through documented business processes and ensuring the uniformity of enforcement across all regions.

Table 14. **Investigation and Regulatory Workflow Process Sub-Processes**

Investigation Process Sub-Processes
Annual and/or Special Report
Checkweigh
Custodial Shortage or Misuse
Failure To Have Scale Tested
Failure To Remit
Failure To Pay
Inadequate Financial Instrument
Livestock Checkweigh
Operating Without Registration
Operating Without Financial Instrument
Weight and Price
Regulatory Activity Process Sub-Processes
Checkweigh Review
Dealer Buying On Commission Review
Market Review
New Entity Orientation
Packer Review
Poultry Review
Sale Day Market Review

Electronic Case Files

Successful completion of the BPA effort and standardization of business practices across the agency allowed P&SP to then focus on automating our information management system by developing the Packers and Stockyards Automated System (PSAS).

PSAS is comprised of Enterprise Content Management (ECM) and Account Management System (AMS) components. The ECM is the heart of the system, managing the workflows developed from the core processes and documents generated as part of those processes. The AMS is used to store and manage regulated entity business data, support queries, generate batch letters, and for reporting. The initial phases of PSAS were implemented in January 2009, with the automation of all core processes achieved in mid-2009.

Once P&SP implemented the initial phases of PSAS, the agency began converting to paperless electronic case files for conducting and documenting investigations. Cases are electronically tracked through the agency's standardized Investigation workflow from beginning to end. The workflow consists of sequential tasks which begin with the agent initiating the work, through the supervisor's and regional director's review and approval, to submission of the case to headquarters. Automating this system has allowed the agency to operate more efficiently, strengthen P&SP's ability to track major case milestones, and significantly reduce costs involved with performing investigations.

Additional phases in FY 2010 will provide several enhancements to both the Account Management System (AMS) and Enterprise Content Management (ECM) components of PSAS. Among the enhancements will be designing and implementing remaining workflows to include Scales, Special Reports, and Tariffs.

Proposed Regulation Status

P&SP worked on several proposed new regulations during the past year. Some of these were in response to statutory mandates, while others arose from P&SP's own initiatives in response to perceived needs. The regulations are briefly summarized below according to their present stage of development.

Final Rules Published – Three rules were published in final form during FY 2009.

Swine Contractors: In 2002, Congress added swine contractors as entities regulated under the Packers and Stockyards (P&S) Act. Accordingly, P&SP added ‘‘swine contractors’’ to the list of regulated entities subject to specific regulations. The rule clarifies that swine contractors are prohibited from knowingly circulating misleading reports about market conditions or prices; that they are required to provide business information to authorized USDA personnel; and that they are required to permit authorized USDA personnel to inspect their business records and facilities. The rule also clarifies that agents and USDA employees are prohibited from unauthorized disclosure of business information obtained from swine contractors. The rule was effective on November 20, 2008.

Scales; Accurate Weights, Repairs, Adjustments or Replacements after Inspection: P&SP amended one section of the regulations to incorporate by reference the 2009 edition of the National Institute of Standards and Technology (NIST) Handbook 44, ‘‘Specifications, Tolerances, and Other Technical Requirements for Weighing and Measuring Devices,’’ and to require that scales used by stockyard owners, market agencies, dealers, packers, and live poultry dealers to weigh livestock, livestock carcasses, live poultry, or feed for the purposes of purchase, sale, acquisition, payment, or settlement, meet applicable requirements of the 2009 edition of NIST Handbook 44. P&SP also amended that section of the regulations to add ‘‘swine contractors’’ to the list of regulated entities to which the section applies. The rule was effective on November 19, 2009.

Poultry Contracts; Initiation, Performance, and Termination: P&SP amended the regulations regarding the records that live poultry dealers must furnish poultry growers, including requirements for the timing and contents of poultry growing arrangements. The amendments to the regulations will require that live poultry dealers timely deliver a copy of an offered poultry growing arrangement to growers; include information about any Performance Improvement Plans (PIP) in poultry growing arrangements; include provisions for written termination notices in poultry growing arrangements; and notwithstanding a confidentiality provision, allow growers to discuss the terms of poultry growing arrangements with designated individuals. The rule was effective January 4, 2010.

Proposed Rules Published - P&SP also published three proposed rules for public comment during FY 2009.

1) Registration: P&SP proposes to amend the regulations regarding the registration of market agencies and dealers. Under the current regulations, there is no expiration date or renewal process for the registration of a market agency or dealer under the Act. The proposed rule would establish automatic renewal procedures with the filing of the annual report the entity files. Failure to file an annual report when due and after a specified time period would cancel an entity’s registration. The comment period on this proposed rule closed on February 17, 2009.

2) Required Scale Tests: P&SP proposes to amend the regulations regarding the requirement that stockyard owners, market agencies, dealers, packers, or live poultry dealers that weigh livestock, live poultry, or feed have their scales tested at least twice each calendar year at intervals of approximately 6 months. This proposal would amend the current regulations to state that the 6-month interval in which scale owners must have their scales tested each calendar year is no longer approximate. Specifically, the proposal would require that scale owners complete the first of the two scale tests between January 1 and June 30 of the calendar year. The remaining scale test would be required to be completed between July 1 and December 31 of the calendar year. In addition, a minimum period of 120 days would be required between these two tests. More frequent testing would still be required in cases where a scale does not maintain accuracy between tests. Finally, ‘‘swine contractors’’ would be added to the list of regulated entities to which the section applies. The comment period closed on October 23, 2009. P&SP is preparing the work plan for developing the final rule.

3) Swine Contract Library: On August 11, 2003, P&SP established a Swine Contract Library (SCL) as mandated by the new Subtitle B of Title II of the Packers and Stockyards Act that was added by the Livestock Mandatory Reporting Act of 1999. The statutory authority for the library lapsed on September 30, 2005, but was reauthorized on October 5, 2006, by the Livestock Mandatory Reporting Reauthorization Act (Reauthorization Act). P&SP proposes to re-establish the regulatory authority for the library's continued operation and incorporate certain changes contained within the Reauthorization Act that impact the SCL, as well as making other changes to enhance the library's overall effectiveness and efficiency in response to input from regulated entities and the public. P&SP is also requesting a 3-year extension of and revision to the currently approved information collection in support of the reporting and recordkeeping requirements for the SCL program. This approval is required under the Paperwork Reduction Act. The comment period on the proposed rule closed on December 28, 2009.

Advanced Notice of Proposed Rule Published – P&SP has also published an Advance Notice of Proposed Rule (ANPR) related to bonds. An ANPR notifies interested parties that the Agency perceives a need for a rule but has not developed specific provisions for the rule, and solicits input from the public on the need for rulemaking and, if so, possible regulatory language.

Market Agency, Dealer, and Packer Bonds: P&SP is reviewing standards for calculating the amount of bond required to be posted by each market agency, dealer, and certain packers (bonded entities). The review will determine what alternatives, if any, exist for revising the regulations to better protect the financial interests of livestock sellers and consignors without exceeding a reasonable bond amount for bonded entities. P&SP sought public comment on alternative revisions to the regulations and on the issues to be considered in this review. The comment period closed on March 23, 2009.

Rulemaking Actions Still in Initial Development – Several rules were mandated by Title XI of the *Food Conservation and Energy Act of 2008* (Farm Bill). The first rule implements an amendment to section 1324(c)(2) of the Food Security Act of 1985 (7 U.S.C. 1631(c)(2)), commonly referred to as the "Clear Title Program." The change allows the master list of debtors that States maintain to contain encrypted social security or taxpayer identification numbers. OMB cleared the work plan for this rule on September 16, 2009. As preparation for the second set of rules that implement Farm Bill sections 11005 and 11006, P&SP held three town hall meetings to gather recommendations regarding the proposed rules. For section 11005, the rules would establish requirements for contract termination, capital investments, and dispute resolution. A provision is also included that would require that a livestock or poultry contract must provide an option for arbitration when a dispute arises, if both parties agree in writing. To comply with Farm Bill section 11006, the rules would establish factors to determine unreasonable preference, what is adequate notice to poultry growers of suspension of delivery of birds, when requiring an additional capital investment constitutes a violation, and whether a live poultry dealer or swine contractor has provided a reasonable period of time for growers to remedy a breach of contract.

This section contains three annual assessments of the entities that P&SP regulates. First is an assessment of the general economic state of the regulated industries, including trends in the number of firms, financial conditions, and the percentage of the market held by the four largest firms of a particular sector (market concentration).[1] Second is an examination of the changing business practices of firms in the regulated industries, including pricing methods, and particularly pricing on live weight versus carcass weight; procurement methods, with a focus on commitments to procure more than 14 days before slaughter versus transactions conducted on a cash-carry or spot basis; and trends related to the volume marketed through market agencies via commissions versus direct purchases. Finally, this section outlines specific concerns about the behavior or conduct of the entities regulated under the P&S Act and P&SP's actions to address those concerns.

The 2008 data from annual reports filed by subject firms show a decrease in the number of firms regulated by P&SP compared to 2007. The number of entities subject to the P&S Act likely will continue to trend downward. As firms exit without replacement, there is a tendency for the larger firms to increase their share of the market as overall volume increases.

The four largest slaughter firms' share of the total value of livestock purchases (i.e., aggregate industry concentration) has increased slightly from 67 percent in 2007 to about 68 percent in 2008. Patterns of concentration in the purchase of different types of livestock, however, have exhibited varying trends. Four-firm concentration ratios by volume of steer and heifer slaughter and beef production declined compared to being relatively stable in recent years.

Concentration in poultry slaughter has trended upward since 2000. Cow and bull slaughter concentration increased from 1999 to 2007 and remained steady for 2008. Concentration in hog slaughter increased sharply in 2003, declined in 2006, and then returned to the previous level in 2007, where it remained in 2008.

[1] Data in this section is generally from regulated industry annual reports to P&SP, and those reports for the 2009 reporting year are not due until April 15, 2010. However, market share (concentration) statistics are based on calendar year federally-inspected slaughter except for 1980 and for beef production, which are based on firms' fiscal years as reported to P&SP.

Concentration in sheep slaughter declined from 1998 through 2004, but has increased sharply since. In general, increases in industry concentration from declining firm numbers reflect efforts by firms to increase net incomes. Agriculture firms in particular have tended to focus on cost minimization to increase net incomes. To achieve this objective, firms have adopted cost-saving technologies (frequently replacing labor with machines) that fostered larger capacities. Low interest rates throughout 2009 have provided additional incentives for firms to replace labor with capital assets. At the processor level increased worker productivity appears to be responsible in part for better income margins.

Firms regulated under the P&S Act began exiting business at rates above longer term trends during the first two quarters of fiscal year 2009. The faster rates of economic contraction were due to high feed and energy costs in the late summer of 2008 and restricted access to credit in the fall, both of which contributed to weakening domestic and international demand for livestock and meat products.

As the business conditions at the end of 2008 worsened and continued into 2009, industry contractions led to greater overall consolidation, not just at the top, but across all sectors in the market channel.

The greater consolidation due to the overall economic contraction has impacted the balance of power among competing businesses, market access for livestock sellers, and prices paid by consumers, producers, and processors. For example, the bankruptcy of Pilgrim's Pride Corp and its subsequent acquisition by JBS USA, LLC in 2009 placed Tyson Food Inc. and JBS USA in direct rivalry in the animal proteins (beef, pork, and poultry) industry at production, processing, distribution, and retail marketing levels. This level of comprehensive rivalry will be a first in the United States.

Some business practice trends are stabilizing. For example, carcass-basis purchases of cattle and hogs increased early in the decade, reaching around 20 million head in 2008 compared to 19 million head for cattle in 2007 and 90 to 95 million head of hogs compared to 80-85 million head in 2007. Carcass-based purchases reflect a trend by packers to pay livestock sellers through methods tied to product values.

As the volume of carcass-based procurement has increased, packers have increased the development and testing of carcass evaluation devices in the beef industry. Recent changes to carcass merit programs for hogs have been smaller than previous years, perhaps reflecting the fact that carcass-basis pricing of hogs stabilized at high levels in recent years as packers have become satisfied with the current degree of leanness in hogs.

Carcass-basis pricing tends to correlate with trends in increased contracting for procurement and reductions in the volume of transactions through market agencies. These trends started over 10 years ago in the livestock/meat sector and will be resistant to change, even in the face of economically stressful conditions since they are related to cost-saving motives for increased coordination of livestock, poultry, and meat production and marketing.

The use of committed procurement methods by the largest beef packers increased in 2008 at approximately the same rate as 2006 and 2007, with the gain coming from an increased use of forward contracts; packer feeding and use of marketing agreements only increased slightly. Packer feeding continues to represent only 7 percent of total cattle procurement.

Unlike the livestock industry, which relies on contract procurement to coordinate the market supply channel, the poultry industry has been almost completely vertically integrated for several decades. As a result, the use of spot markets for poultry is virtually nonexistent.

General Economic State of the Industry

At the end of 2009, 284 bonded livestock slaughter firms, 125 live poultry dealers, 4,529 registered dealers, and 1,225 market agencies were subject to the P&S Act (Table 15). Entities subject to the Act are:

- Bonded slaughter firms, including federally inspected and non-federally inspected plants. Some firms with smaller volume purchases voluntarily bond but do not file annual reports. All packers operating in interstate commerce are subject to the P&S Act, which requires firms that purchase livestock for slaughter of $500,000 or more to be bonded and to file annual reports.
- Livestock dealers purchase livestock for resale on their own accounts and take title to the animals. They may also purchase or sell as the agent or vendor of another entity.
- Market agencies are entities engaged in the business of buying or selling livestock in commerce on a commission basis,

furnishing stockyard services, or, in rare cases, a non-business entity providing State brand inspection services.

- Live poultry dealers, commonly called poultry integrators, contract with producers for grower services to raise chicks to slaughter size and weight. The integrator slaughters and further processes the poultry.

- Posted stockyards are physical facilities and are not necessarily separate businesses. For example, a county fairground may be registered as a stockyard. Terminal markets and auction markets are located at stockyards.

Table 15. **Number of Slaughterers, Live Poultry Dealers, Bonded Dealers, Bonded Market Agencies, and Posted Stockyards Subject to the P&S Act**

Year	Bonded slaughter firms	Live poultry dealers	Bonded dealers	Bonded market agencies	Posted stockyards
2000	359	N/A	4,772	1,608	1,519
2001	338	N/A	4,675	1,575	1,525
2002	335	N/A	4,480	1,544	1,510
2003	338	N/A	4,675	1,575	1,429
2004	314	N/A	4,152	1,457	1,443
2005	312	N/A	4,100	1,447	1,426
2006	304	N/A	3,984	1,433	1,400
2007	296	N/A	3,883	1,410	1,413
2008	281	126	4,685	1,326	1,392
2009	284	125	4,529	1,225	1,170

In 2008, P&SP began transitioning from multiple older databases to a new single database. In the process, data was manually re-entered into the new system after field verification, except for information about posted stockyards, which do not report annually. In 2008, P&SP re-posted 864 known stockyards and in 2009 began de-posting any stockyards that do not respond to a request seeking applicants for re-posting. P&SP did not maintain statistics on live poultry dealers prior to 2008.

The value of bonds held by packers has trended upward with the increase in dollar volume of business, while the value of bonds held by other types of entities has remained relatively constant (Figure 10 and 11). The total value of bonds held by subject firms should continue to increase with the total dollar business volume of these firms.

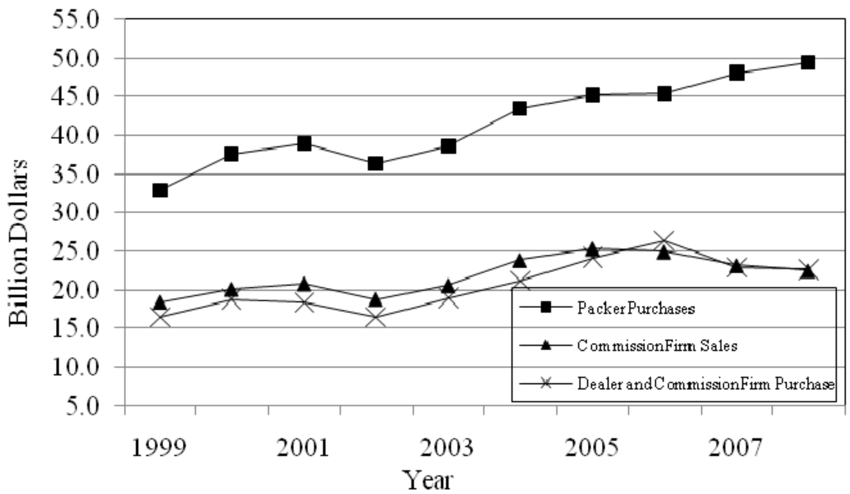

Figure 10. **Dollar Volume of Slaughter Firms, Dealers, and Market Agencies Selling and Buying on Commission Subject to P&S Act, 1999-2008**

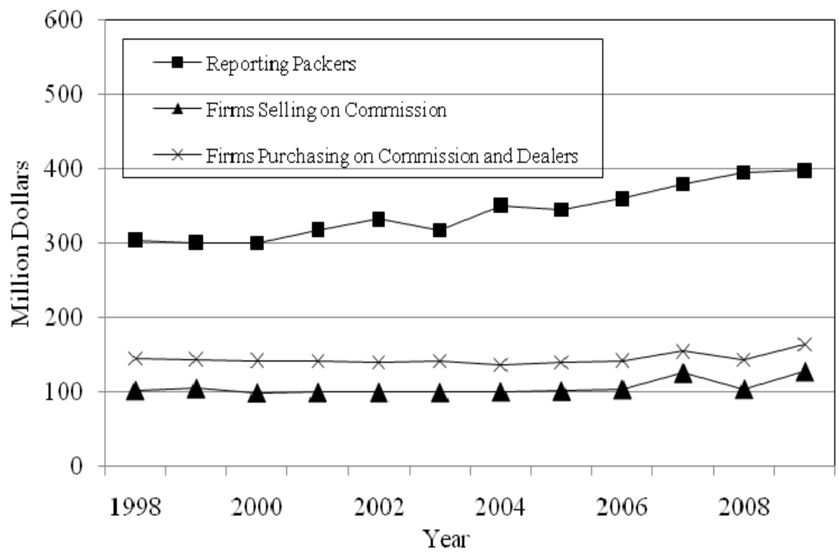

Figure 11. **Value of Bonds Held in Accordance With P&S Act by Slaughter Firms, Market Agencies Selling on Commission, and Dealers and Market Agencies Purchasing on Commission, 1998-2009**

The four largest slaughter firms' share of total industry expenditures on livestock for slaughter increased between 1997 and 2003 with downturns in 2001 and 2002, and currently is at the second highest level since 1985 (Figure 12).

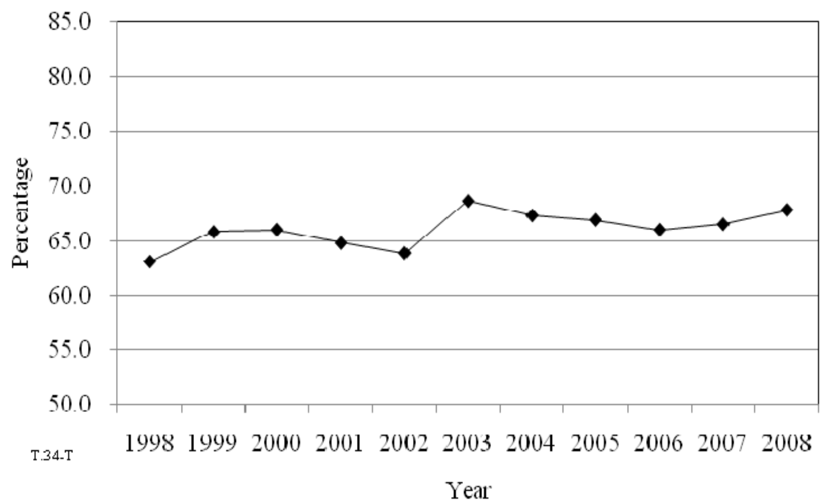

Figure 12. **Share of Total Industry Livestock Procurement Expenditures for the Four Largest Slaughter Firms, Ranked by Total Livestock Procurement Expenditure, 1998-2008**

While slaughtering and beef processing concentration has generally remained steady since 1995, firms slaughtering hogs have increased their market share (Table16).

Table 16. **Four-Firm Concentration in Livestock Slaughter by Type of Livestock and in Fed Beef Production, Selected Years, 1980-2008**

Year	Steers & Heifers	Fed Beef Production	Sheep & Lambs	Hogs
		Percent		
1980	36	53	56	34
1995	81	84	72	46
2000	81	85	67	56
2001	80	84	66	57
2002	79	83	65	55
2003	80	84	65	64
2004	79	82	65	64
2005	80	83	70	64
2006	81	84	68	61
2007	80	80	70	65
2008	79	76	70	65

Concentration of the four largest steer and heifer slaughterers rose from 36 percent in 1980 to a high of 82 percent in 1994 and has remained relatively stable since then. Four-firm concentration in hog slaughter rose from about 34 percent in 1980 to 64 percent in

2003 through 2005, declined to 61 percent in 2006, and then increased to 65 percent in 2007 and remained constant for 2008. Four-firm concentration in sheep and lamb slaughter rose from 56 percent in 1980 to 73 percent in 1996, but has declined over the last 10 years to 70 percent in 2008.

Four-firm concentration has stabilized in recent years, both overall and by type of livestock. Current economic conditions may influence future changes in the livestock and meat industry.

Two financial ratios are used to summarize financial conditions in the meat-packing industry (Table 17). The *Operating Profit Margin*, computed as operating income (gross profit minus operating expenses) divided by total revenue, measures the proportion of revenue from sales that remains after production costs have been paid. It reflects the financial performance or operating efficiency of a company over time or compared to other companies in the same industry. The *Current Ratio* is the ratio of current assets to current liabilities and is a measure of a firm's liquidity or financial health. It indicates the extent to which a company is able to cover its short-term liabilities. For example, a current ratio of 2 indicates that a company's current assets (cash, inventory, and receivables) are twice the value of its current liabilities (debt and payables).

Table 17. **Average Profit Margin and Current Ratios for the Top 4 and the Top 20 Firms**

	Profit Margin		Current Ratio	
Year	Top 4	Top 20	Top 4	Top 20
2006	-0.2	0.8	1.9	1.3
2007	0.5	1.7	1.9	1.6
2008	0.01	0.02	2.9	1.9

Profit margins both for the 4-largest and 20-largest firms moved from slightly positive in 2007 to breakeven in 2008. The Current Ratios for the largest 4 firms increased in 2008, but only improved slightly for the entire group of 20 largest firms. Current economic constraints will likely negatively affect both of these ratios.

These financial data are averaged across a wide variety of types of firms. The size rankings are based on total livestock procurement expenditures. There are differences both across and within size groups in combinations of species slaughtered (beef, pork, sheep, and poultry) by the included firms. Within beef slaughter firms, the larger packers all slaughter a large proportion of steers and heifers in their total slaughter mix. Many smaller packers specialize in cow and bull slaughter and almost no steers and heifers.

Financial data reported to P&SP by some firms may include information on operations other than meat packing and processing. Variation in other types of non-meat activities included in the data from some firms occasionally leads to large swings in some of the ratios, especially for the group of smaller firms.

Cattle – General Economic State of the Industry

The volume of cattle slaughtered by firms reporting to P&SP (firms with livestock purchases equal to or exceeding $500,000 per year) fluctuates with the cattle cycle. Total cattle slaughter by firms reporting to P&SP trended downward from 2000 through 2005 and resumed that trend in 2008 after increasing in 2006 and 2007 (Figure 13). Total cattle includes steers and heifers (often collectively called "fed cattle"), cows, and bulls. In most but not all cases, individual plants operated by firms that report to P&SP tend to slaughter either fed cattle or cows and bulls.

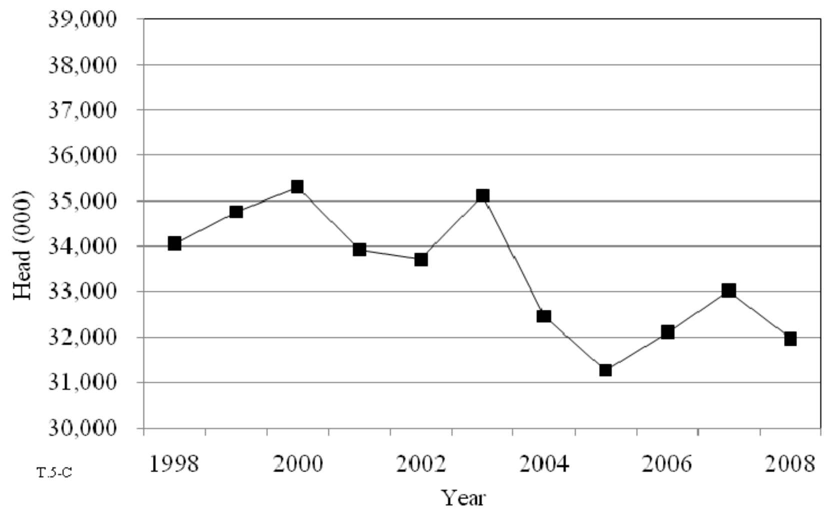

Figure 13. **Total Slaughter Cattle Purchases for Firms Reporting to P&SP, 1998-2008**

The number of cattle slaughter plants reporting to P&SP declined by approximately 60, or 27 percent, from 1998 through 2003, as plant sizes increased and smaller plants closed (Figure 14). The number declined by an additional 20 in 2008 compared to 2007, after a small increase in 2004. This gradual reduction in total numbers is expected to continue as financial conditions make larger firms less costly to operate.

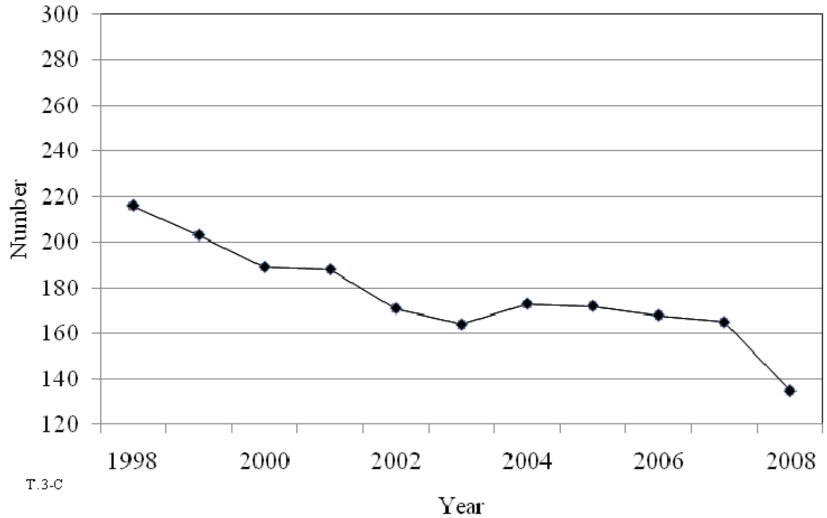

Figure 14. **Number of Cattle Slaughter Plants for Firms Reporting to P&SP, 1998-2008**

The percentage of the total volume of steer and heifer purchases accounted for by the four largest firms that slaughter steers and heifers has remained between 78 and 82 percent since 1998. The share of fed beef production has moved with steer and heifer slaughter concentration, although slightly higher until 2007 (Figure 15).

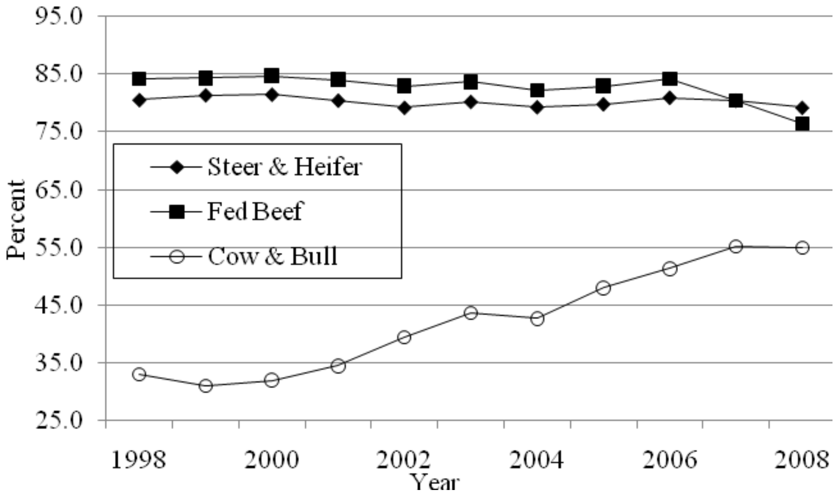

Figure 15. **Combined Market Share for the Four Largest Steer and Heifer Slaughter Firms, Four Largest Cow and Bull Slaughter Firms, and Four Largest Fed Beef Producers**

Concentration in cow and bull slaughter has always been less than fed-cattle slaughter concentration, but has trended upward since

1999. In 2006, several smaller packers ceased operating and some smaller plants were acquired by larger firms. These factors resulted in an increase in the combined market share of the four largest firms slaughtering cows and bulls.

Future changes in concentration are expected to follow the patterns of the last 5 years, subject to possible changes due to uncertainties about developments in the overall economy that began in 2008.

Hogs – General Economic State of the Industry

The volume of hogs slaughtered by firms reporting to P&SP has trended upward in the last 10 years, partly on the strength of export markets (Figure 16). Total purchases for slaughter are expected to remain steady.

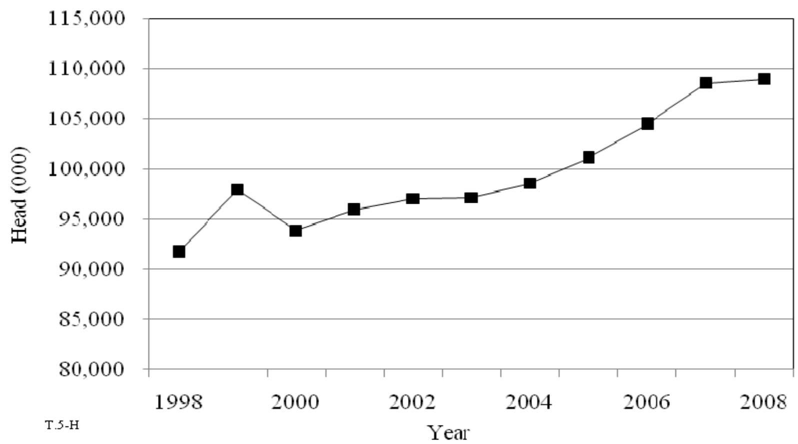

Figure 16. **Total Hog Purchases for Slaughter for Firms Reporting to P&SP**

The number of hog slaughter plants had been stable since 2004. In 2008, economic conditions, mergers and acquisitions, and efforts to approve efficiencies resulted in a large decline in the number of plants (Figure 17).

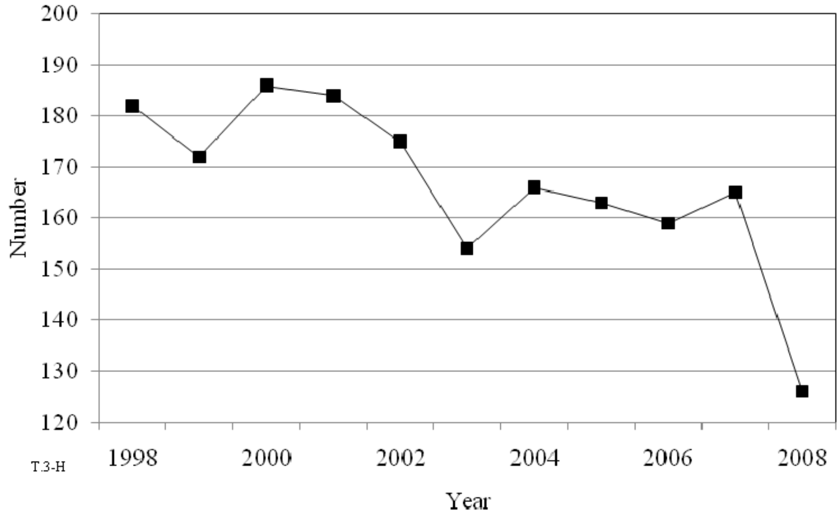

Figure 17. **Number of Hog Slaughter Plants for Firms Reporting to P&SP, 1998-2008**

The four-firm concentration ratio for hog slaughterers was roughly 56 percent in the late 1990s and then increased to near 65 percent in 2003, where it remained in 2008 (Figure 18).

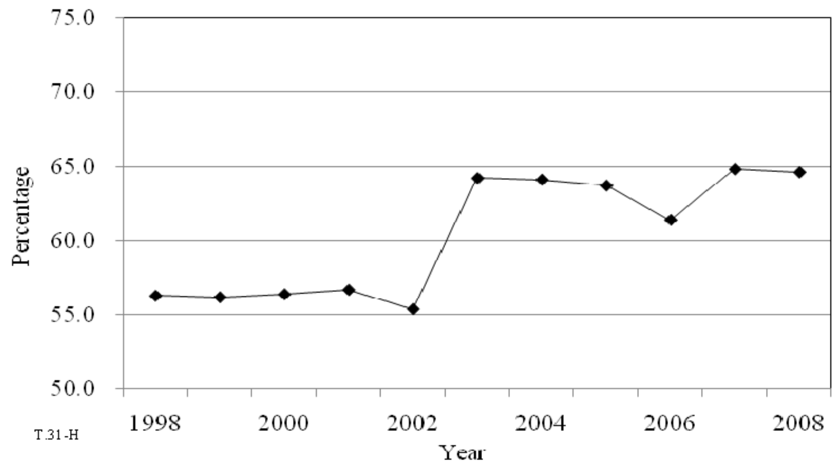

Figure 18. **Combined Market Share for the Four Largest Hog Slaughter Firms, 1998-2008**

Sheep – General Economic State of the Industry

The volume of sheep and lambs slaughtered by packers reporting to P&SP declined in every year but three between 1998 and 2007, with the sharpest single year decline between 2007 and 2008 (Figure 19). Annual slaughter of sheep and lambs declined from 2.5 million head in 2007 to 1.9 million in 2008.

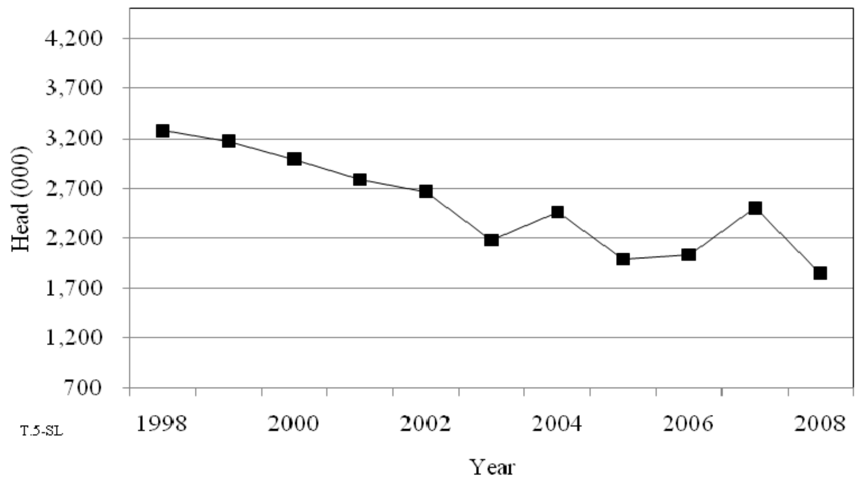

Figure 19. **Total Slaughter Sheep and Lamb Purchases for Firms Reporting to P&SP, 1998-2008**

The number of plants slaughtering sheep and lambs declined steadily from 1997 through 2002, remained relatively constant through 2007, and declined in 2008. Slaughter plant numbers are expected to continue at present levels in the short term (Figure 20).

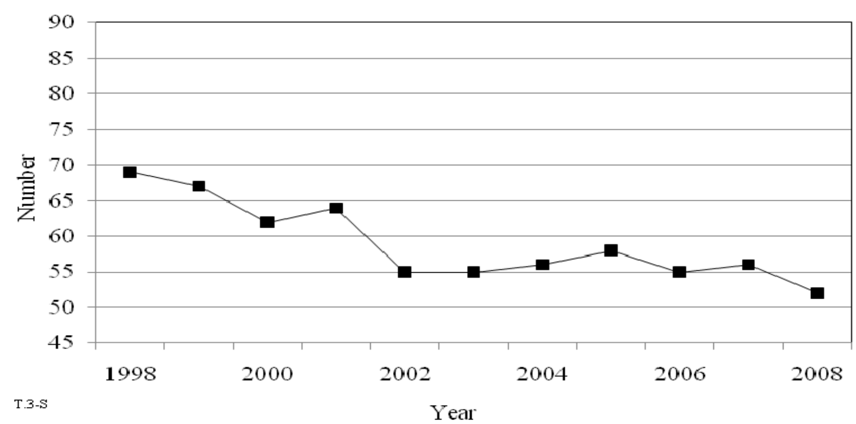

Figure 20. **Number of Sheep and Lamb Slaughter Plants for Firms Reporting to P&SP, 1998-2008**

The combined market share of the four largest sheep and lamb slaughter firms trended steadily downward from 1998 through 2004, as the largest plants in the industry decreased slaughter faster than total industry slaughter declined (Figure 21).

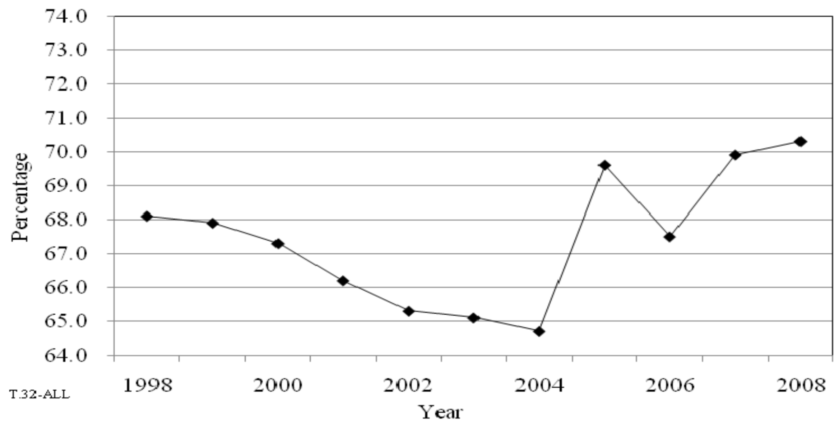

Figure 21. **Combined Market Share for the Four Largest Sheep and Lamb Slaughter Firms, 1998-2008**

Due to the small total slaughter volume of the industry, relatively moderate volume adjustments by any of the largest four firms result in relatively large changes in the percent of total industry slaughter accounted for by those firms. For example, in 1998, a new large firm entered the industry as a new member of the group of four largest and increased the share of the top four. The long-term decline in share reversed in 2005, when one of the four largest firms exited and the remaining three large firms increased their combined volume by an amount equal to the output of the exiting firm. An additional firm then entered the group of four largest, causing a net increase in total slaughter of the four largest firms and in their share of total industry slaughter.

The share of the four largest declined in 2006, returned to 2005 levels in 2007, and increased slightly in 2008. But, as in previous years, these changes in shares represented only a few thousand head of slaughter. Future changes in sheep slaughter concentration will continue to be variable due to adjustments among the four largest firms, but will likely remain in the 65-70 percent range.

Poultry— General Economic State of the Industry

This section addresses slaughter volume, industry concentration, and two measures of live poultry dealer financial health (the net profit margin and current ratio) obtained from annual reports filed by the industry with P&SP.

In 2008, 46.2 billion pounds of poultry were reported as slaughtered to P&SP. By comparison, in 2007 the federally inspected (FI) volume was 45.6 billion pounds. This reflects an upward trend in poultry slaughter since 1996, when FI volume was approximately 26 billion pounds. Turkey slaughter, in contrast, increased only slightly during the last 10 years, but continued to show an upward trend in 2008, with firms reporting 7.4 billion pounds to P&SP compared to the FI volume of 6.4 billion pounds for 2007. Poultry slaughter volume remained relatively high in early 2008, but slowed considerably in late summer and beyond, triggered by the negative effect of the strong U.S. dollar on exports.

Concentration in broiler and turkey slaughter has trended upwards since 2000. In 2008, the four largest broiler slaughterers controlled about 57 percent of the market share and the four largest turkey slaughterers controlled 51 percent. In contrast, in 2000, the four largest broiler slaughterers controlled roughly 50 percent of the market and the four largest turkey processors about 41 percent. Concentration is expected to remain relatively stable at 2008 levels into 2010.

In 2008, the operating profit margin (the proportion of revenue from sales that remains after production costs have been paid) of the 20 largest broiler companies averaged a negative 1.2 percent, foretelling the coming bankruptcy of Pilgrim's Pride, Inc. in 2009, but was 2.4 percent for the 20 largest turkey processing companies (Table 18).

Table 18. **Poultry Industry Market Share, Profit Margin, and Current Ratio**

		Profit Margin		Current Ratio	
Type	Market Share %	Top 4	Top 20	Top 4	Top 20
Broiler	57	-5.4	-1.2	1.9	2.1
Turkey	51	1.8	2.4	1.8	2.4

The average profit margins of the four largest turkey firms were lower than that of the entire group of 20 largest, and for broiler firms profits averaged considerably lower for the four largest than for the entire group of 20. The largest four turkey and largest four broiler firms exhibited less liquidity than the group of 20 largest of each type firm.

Profit margins and liquidity in the poultry industry have been subject to considerable negative pressure in late 2008 from weakening export markets and tight credit markets. Because of the lower cost of poultry production relative to pork and beef, poultry firms may be less vulnerable if current economic conditions persist for any length of time and domestic consumers select lower cost proteins.

Changing Business Practices

The long-term decline in the number of livestock slaughter firms reporting to P&SP reported in the previous section has been accompanied by a trend toward increased specialization in slaughter. This has been illustrated by a greater decline from 1997 through 2006 in the number of firms slaughtering two or more classes of livestock than in the number of firms slaughtering a single class (Figure 22).

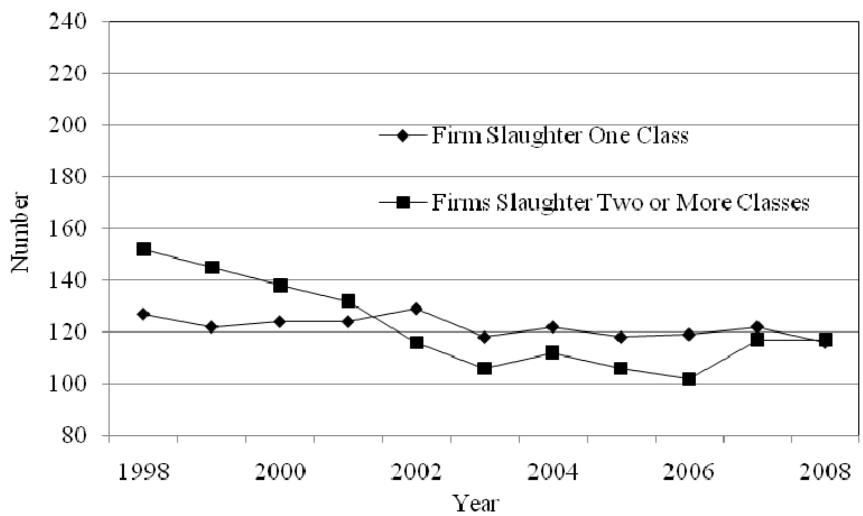

Figure 22. **Number of Firms Slaughtering One Class and Number of Firms Slaughtering Two or More Classes of Livestock**

For purposes of this comparison, the separate classes of livestock are steers and heifers; cows and bulls; calves; sheep and lambs; and hogs. While the number slaughtering two or more classes increased in 2007, the changes have followed similar patterns for all types for the last few years with some stability since 2003. Recent patterns are expected to continue.

Cattle—Changing Business Practices

The pricing method that sellers and purchasers agree to use for a transaction is a fundamental characteristic of any market transaction. For livestock, and for cattle transactions in particular, pricing methods are most often divided into two categories: live-weight and carcass pricing methods.

In live-weight purchasing of livestock, the price is quoted and the final payment is determined based on the weight of the live animal. Transactions that use some variation of live-weight purchasing are usually on an "as-is" basis with a single price per pound for all animals in the entire transaction.

The price may be fixed by negotiation in advance, or established from prices reported by a market price reporting service after the animals are delivered or slaughtered. In some instances, provisions may be made for paying different prices for animals that differ significantly from other animals in the transaction (e.g., animals that are much smaller than the average for the transaction may receive a lower price).

In a "carcass-based" purchase, the price is quoted and the final payment is determined based on each animal's hot weight, which is the weight of the carcass after it has been slaughtered and eviscerated.

Carcass-based purchase methods often involve schedules of premiums or discounts based on animal quality and other features, such as time of delivery and number of animals in the transaction. The price before premiums or discounts is referred to as the "target" or "base" price. Carcass-based pricing typically rewards sellers with livestock that meet or exceed the target standard. Livestock carcasses graded below the target result in the seller receiving significant discounts.

After declining annually through the 1990s, the proportion of cattle purchased on a live-weight basis by packers reporting to P&SP had been uneven but trended downward in 2008 (Table 19).

Table 19. **Number and Percentage of Cattle Purchased Live-Weight and Carcass-Weight by Packers Reporting to P&SP, 1997-2008**

	Live-weight		Carcass-weight	
Year	Head (000)	Percent	Head (000)	Percent
1997	18,413	52.5	16,628	47.5
1998	19,049	55.9	15,016	44.1
1999	17,546	50.5	17,217	49.5
2000	17,102	48.4	18,207	51.6
2001	15,044	44.3	18,877	55.7
2002	12,555	37.2	21,158	62.8
2003	14,116	40.2	21,008	59.8
2004	15,112	46.6	17,348	53.4
2005	13,663	43.7	17,591	56.3
2006	15,004	46.7	17,012	53.3
2007	14,135	42.8	18,887	57.2
2008	12,043	37.7	19,916	62.3

The total volume of cattle purchased on a carcass basis, as opposed to purchases on a live-weight basis, trended upward from 1998 through 2002 (Figure 23). Following a sharp decline in 2004, the volume stabilized in 2005 and 2006, then increased through 2008. The proportion of cattle purchased on a carcass basis is expected to remain in the 60-percent range with modest increases.

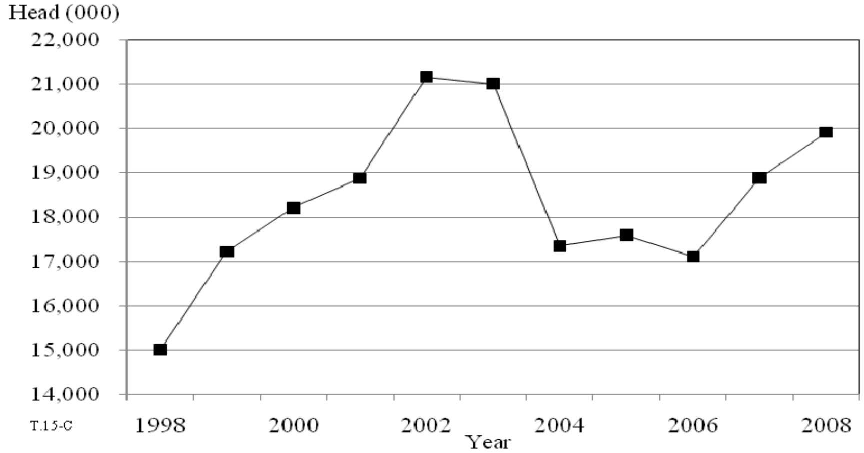

Figure 23. **Cattle Purchases on a Carcass Basis**

The proportion of calves purchased on a carcass-weight basis was greater in 2008, but has exhibited a mixed pattern in recent years. Having declined from 2000 through 2003, the proportion of calves purchased on a carcass basis increased almost 10 percentage points in 2004, decreased sharply in 2005, and has since trended up, reaching 46 percent in 2008 (Table 20).

Table 20. **Number and Percentage of Calves Purchased Live-Weight and Carcass-Weight by Packers Reporting to P&SP, 1997-2008**

	Live-weight		Carcass-weight	
Year	Head (000)	Percent	Head (000)	Percent
1997	734	59.5	500	40.5
1998	656	56.6	504	43.4
1999	504	47.6	556	52.4
2000	495	51.3	470	48.7
2001	479	54.7	397	45.3
2002	492	57.3	367	42.7
2003	553	59.4	377	40.6
2004	351	49.6	357	50.4
2005	415	63.7	236	36.3
2006	397	66.3	201	33.7
2007	387	61.1	247	38.9
2008	338	53.9	289	46.1

Packers have increased the development and testing of carcass evaluation devices in the beef industry. P&SP participates in carcass tests conducted jointly by the USDA Agricultural Marketing Service (AMS) and evaluation-device manufacturers to test device performance under real-time conditions in packing plants. While these devices are not yet being used as a basis for payment to producers, the industry is poised to augment traditional AMS meat-grading services with complex images that provide a "score" of carcasses for both yield grade and marbling.

Another business practice affecting transactions involves the location in the market channel of the transaction. P&SP monitors two major transaction location points in livestock marketing. One major transaction point is exchange between the livestock producer and an assembly point, usually a market that accepts the livestock on a commission basis. The buyer procures the livestock through the market, generally with no direct contact between seller and buyer.

Although the volume of cattle handled by commission firms has declined over the last 10 years, these firms continue to play an important role in the cattle industry, particularly for cull cows (Figure 24).

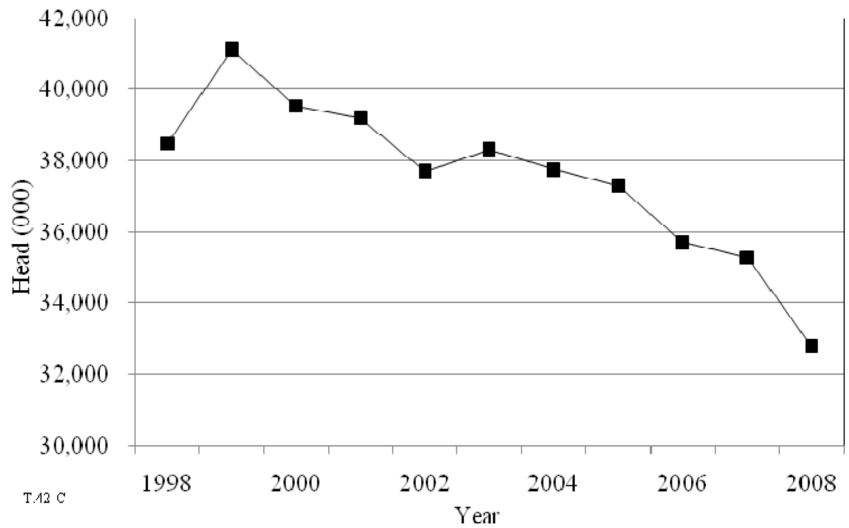

Figure 24. **Volume of Cattle (Slaughter and Non-Slaughter) Marketed Through Firms Selling on Commission**

The second transaction location point monitored by P&SP is direct exchange between the livestock seller and the packer. Packers use multiple direct exchange procurement methods to obtain live cattle for slaughter. The methods commonly fall into two categories: (1)

cash or “spot” sales for immediate delivery or normally delivery within at most 14 days, and (2) “committed procurement” arrangements that create an assured exchange and commit the cattle to a particular packer more than 14 days prior to delivery.

GIPSA’s reported measure of committed procurement includes cattle sold under an advanced volume commitment regardless of pricing method or the timing of price determination. USDA’s Agricultural Marketing Service (AMS) publishes daily prices and volumes of livestock purchased under alternative definitions based on pricing method. For example, AMS’s definition of formula cattle is based in part on the price being determined at a future date. Thus, there are some arrangements that GIPSA considers non-committed that fall into the AMS formula purchase type.

One example is “market price” or “top-of-the-market pricing” (TOMP) arrangements. These arrangements are often on-the-spot bids by packers to buy cattle at the current week’s average market price or top market price. The sellers decide on a week-to-week basis or even on a lot-by-lot basis whether to sell under those terms, thus there is no long-standing agreement or advance commitment by the seller to deliver cattle to the packer making the bid. However, the price is not determined until the week’s trades are completed and the average or top market price has been established. Thus, these arrangements fit the AMS definition for the formula category.

Another example of a difference in the measures relates to how negotiated grids are negotiated. GIPSA considers negotiated grids in general as non-committed purchases as long as the commitment to deliver is made 14 days or less before slaughter. The AMS definitions of negotiated grid and formula purchases depend on what is being negotiated. If the base price level is negotiated as a fixed dollar amount, the arrangement would fit the AMS definition of negotiated grid. If the base price is negotiated relative to a market price (for example “market price” plus or minus an adjustment, where the adjustment is the subject of the negotiations), the transaction would fit the AMS definition of a formula purchase, where the base price is determined at a future date.

There are other measurement differences between GIPSA and AMS defined measures of procurement methods in terms of coverage, data sources and timeliness.[2]

[2] GIPSA’s statistics only cover the top five (previously four) beef packers (80 percent of fed cattle), while AMS reports for all federally inspected packers that slaughter 125,000 head of cattle per year. GIPSA uses data

Why the definitions matter: The procurement practices covered under GIPSA's definition of committed procurement or AMS non-negotiated categories are not prohibited by the P&S Act. Nonetheless, it is thought by some that those methods, if widely used, may have the effect of reducing competition in markets for fed cattle.

Many industry observers have long believed that committed procurement methods, sometimes collectively labeled Alternative Marketing Arrangements (AMAs), are used by packers to reduce demand for cattle in the cash market and thereby reduce cash market prices. Some express a belief that AMAs can be used to depress not only cash market prices but cattle prices under all procurement methods. The belief is that potential anticompetitive effects of alternative marketing arrangements are present not because of the volume commitment associated with AMAs, but due to the pricing method or pricing commitment. If a procurement method, such as TOMP reduces the size of the market used to establish the market price (in this case, the negotiated cash market), then the effect is to reduce competition in the market that sets the price regardless of whether the cattle are committed in advance or not.

Stated another way, purchases under any method, where the price is determined by the market price or a plant average procurement price (most formula and TOMP purchases are priced this way), reduce the volume in the cash spot market that establishes those prices. At some point that market could become so thin or dominated by a single buyer that the price is not a competitive price, but a monopsony or oligopsony price, yet that (presumably lower) price is being used to establish the base price of the formula purchases, futures prices, as well as cash prices. The burden of price discovery is placed on others in the case of formula or TOMP pricing. Those buying and selling under formula or TOMP agreements and not participating in the cash market become "free riders" letting other firms that participate in the cash market establish the price. As that cash market thins, and especially if it comes to be dominated by a single buyer, the probability increases that that cash spot price is not being established in a competitive market and will more likely be lower.

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provided by packers generated directly by the packers' own information reporting systems while AMS uses specific standardized reporting forms mandated by the Livestock Mandatory Reporting Act, section 911(2) of title IX of the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2000 (Public Law 106-78). Also, GIPSA reports yearly on a calendar-year basis, by slaughter date (not procurement date) and as a percentage of total slaughter.

To those that believe this free rider problem is depressing fed cattle prices, the relevant measures to monitor are the volume of the negotiated cash transactions and the number of packers bidding in the negotiated cash market each week.

On the other hand, some believe captive supplies and AMAs lead to improved cattle quality; to improved seller certainty and packer efficiency; that they lead to greater economic welfare for consumers, packers and producers; and that those benefits offset any minor downward price effect they may have.

From 1999 to 2005, P&SP collected and audited data on the three major committed procurement methods used by the four largest firms that slaughter fed cattle. In 2006, P&SP expanded its collection to include data from the five largest fed-cattle slaughter firms. The firms use packer feeding, forward contracts, and marketing agreements to procure cattle more than 14 days prior to slaughter, for delayed delivery (Figure 25). Data for years prior to 2006 refer to the four largest firms; from 2006 through present, data include the five largest firms.

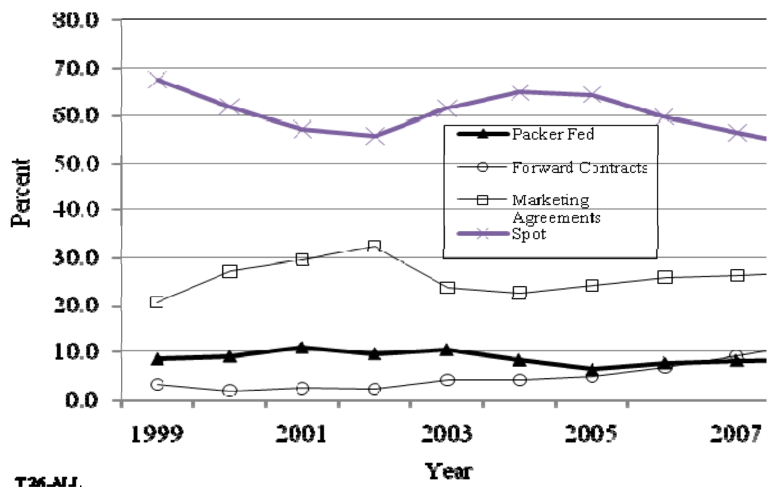

Figure 25. **Percentage of Steers and Heifers Procured Through Alternative Types of Committed Procurement Arrangements by the Four (and Five) Largest Steer and Heifer Slaughter Firms**

P&SP defines "packer fed" livestock as all livestock obtained for slaughter that a packer, a subsidiary of the packer, the packer's parent firm, or a subsidiary of the packer's parent firm owns, in whole or part, for more than 14 days before the packer slaughters the livestock. The percentage of total purchases of fed cattle that are obtained through packer feeding arrangements by the largest steer and heifer slaughter firms declined in 2004 and 2005, but increased slightly in 2006, 2007, and 2008.

Marketing arrangements termed "forward contracts" are agreements between packers and sellers for deliveries more than 14 days in the future of specific lots or quantities of livestock. The price of the cattle in a forward contract can be set at the time of the contract or determined upon delivery based upon an agreed pricing arrangement, e.g., using prices from the Chicago Mercantile Exchange futures market for live cattle with an adjustment for the basis at the time of delivery. The percentage of fed cattle procured through the use of forward contracts by the group of largest steer and heifer slaughter firms has trended upward since 2004. It has increased to more than 11 percent of total procurement.

The term "marketing agreements" includes a variety of arrangements that establish an ongoing relationship for trading multiple lots of cattle rather than negotiating single lots of cattle. In these arrangements, the seller agrees to deliver cattle to the packer at a future date, with the price generally being determined by some type of formula pricing mechanism. The price is often based on the current cash market at the time of delivery, with premiums or discounts determined by evaluation of carcass characteristics. Many producers join together in alliances or cooperatives to commit livestock through one of these agreements.

Of the three categories of committed procurement, marketing agreements account for the largest proportion of total committed procurement. The percentage of fed cattle procured through the use of marketing agreements by the largest steer and heifer slaughter firms fell in 2003 and 2004, and then increased from 2005 through 2008.

Information about business practices at the plant level, namely level of operations (e.g., one or two shifts per day), number of plants in business at any given time, and ownership of them, is also significant in describing industry trends.

Plant closures or re-openings can have direct competitive effects by shifting supply and demand patterns. The P&S Act does not provide authority to the Secretary for pre-merger review. Rather, that is the responsibility of either the U.S. Department of Justice or Federal Trade Commission under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (Public Law 94-435, known commonly as the HSR Act). Mergers and acquisitions, however, cause changes in business practices that may impact competition. P&SP monitors these industry events for any competitive effects.

The beef packing industry saw considerable activity on the international front in 2009. On February 20, 2009, the Brazilian packing firm JBS SA (JBS) announced it was dropping its attempt to purchase National Beef Packing Company, LLC (National). JBS had originally announced the intent to purchase National in March 2008, at the same time it announced intent to purchase the Smithfield Beef Group, Inc. (SBG); and Five Rivers Ranch Cattle Feeding, LLC (Five Rivers). The latter two purchases were finalized in 2008, but the U.S. Department of Justice had filed suit to block the acquisition of National.

On September 16, 2009, JBS announced it will also enlarge its South American and global beef business by becoming majority owner of Bertin SA, Brazil’s third largest beef company. It will then have the capacity to process 90,000 cattle per day. This will make JBS nearly twice as big globally as the next three companies combined. JBS also announced on August 11, 2009 that it approved foundation of the unit JBS Couros Ltda (JBS Couros) for purposes of entry into the industrialization, purchase, sale, and import and export of bovine hides and leather.

Another Brazilian company, Brasil Foods, is exploring expansion in the U.S. following JBS SA's bid to acquire Pilgrim's Pride Corp. Brasil Foods wants to become a familiar brand in the U.S., in addition to its main markets in Russia and the Middle East, and is willing to enter either through partnerships or acquisitions.

FK Corp-USA, a subsidiary of FK Corp in South Korea, is looking for a site in the Bismarck-Mandan area for a meatpacking plant that could slaughter up to 800 cattle a day and export 60 percent of the beef to South Korea. FK Corp has an exclusive contract with meat auctioneers and wholesalers in South Korea and direct access with 5,400 retail shops.

Domestically, in January 2009 Niman Ranch announced its merger with an affiliate of its largest shareholder, Natural Food Holdings LLC. Following the merger, Natural Food Holdings now owns 100 percent of both Niman Ranch and affiliated specialty pork processor, Sioux-Preme Packing.

On January 5, 2009, Cargill Meat Solutions Corporation (“CMS”) announced it had purchased certain assets of Carneco Foods LLC, including a ground beef processing plant in Columbus, Neb., and 80 acres of land. CMS purchased the Columbus facility to replace a plant in Booneville, Arkansas, that was destroyed by fire on March 23, 2008.

On February 26, 2009, National Beef Packing Company, LLC (National) announced that its wholly-owned subsidiary National Beef Leathers, LLC had entered into an Asset Purchase Agreement whereby it would acquire certain assets and assume certain liabilities of Prime Tanning Corp. located in St. Joseph, Missouri, thereby expanding National Beef's value-based marketing strategy into the quality wet blue hide category, in order to add value to the hides produced in National's beef processing facilities.

On March 13, 2009, Tyson Foods, Inc. (Tyson) reported it had completed the sale of its Lakeside operations in Canada, to XL Foods Inc. The beef operation has the capacity to slaughter and process 4,700 cattle per day. The commodity boxed beef produced by the plant is primarily sold to customers in Canada and the U.S. XL Foods Inc. is the largest Canadian owned and operated beef processor in Canada. It is part of the Nilsson Bros. Group of companies, which is a diverse agri-business that is involved in all facets of beef and cattle production, marketing and processing. XL Foods Inc. operates facilities in Alberta, Saskatchewan, Nebraska and Idaho.

On April 19, 2009, the North Star Foods processing plant in Saint Charles, Minnesota, was destroyed in a fire. The plant processed turkey, chicken, pork, and beef.

Premium Protein Products, a processor of beef, pork, and chicken products which had furloughed employees for several months at its plants in Lincoln and Hastings, filed for Chapter 11 bankruptcy in November.

Hogs—Changing Business Practices

The proportion of hog purchased on a live-weight basis steadily declined over the past several years; carcass-based purchases have become the predominant method used for hogs purchased for slaughter (Table 21; Figure 26). The proportion of hogs purchased on a carcass basis will likely continue to decline as a total of hog slaughter.

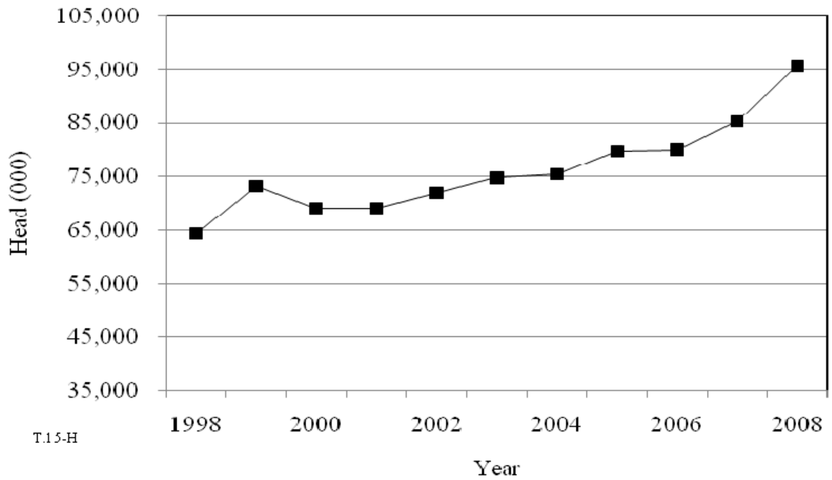

Figure 26. **Hog Purchases on a Carcass Basis, 1998-2008**

Some carcass-based purchases, often known as "carcass-merit" purchases, include a base price that applies to all carcasses in the transaction, with premiums or discounts for individual carcasses based on quality or other attributes of each carcass, such as quality grade, yield grade, yield, or percentage of lean meat in the carcass. Some carcass merit transactions use USDA grades to determine carcass quality. A growing number of transactions include price adjustments for quality characteristics that are not covered by USDA grades, such as percent of lean meat in the carcass and depth of the loin.

Table 21. **Number and Percentage of Hogs Purchased by Live-Weight and Carcass-Weight for Packers Reporting to P&SP, 1997-2007**

	Live-weight		Carcass-weight	
Year	Head (000)	Percent	Head (000)	Percent
1997	32,821	37.4	54,978	62.6
1998	27,448	29.9	64,383	70.1
1999	24,823	25.3	73,153	74.7
2000	24,711	26.3	69,145	73.7
2001	26,883	28.0	69,070	72.0
2002	25,077	25.8	72,003	74.2
2003	22,413	23.1	74,748	76.9
2004	23,092	23.4	75,496	76.6
2005	21,453	21.2	79,730	78.8
2006	24,474	33.4	80,075	76.6
2007	23,238	21.4	85,344	78.6
2008	13,295	12.2	95,708	87.8

The volume of hogs marketed by firms selling on commission declined between 1998 through 2002 (Figure 27). The volume of hogs marketed through commission firms has trended upward since 2002, but declined in 2008. Future changes will likely remain close to 7 million head.

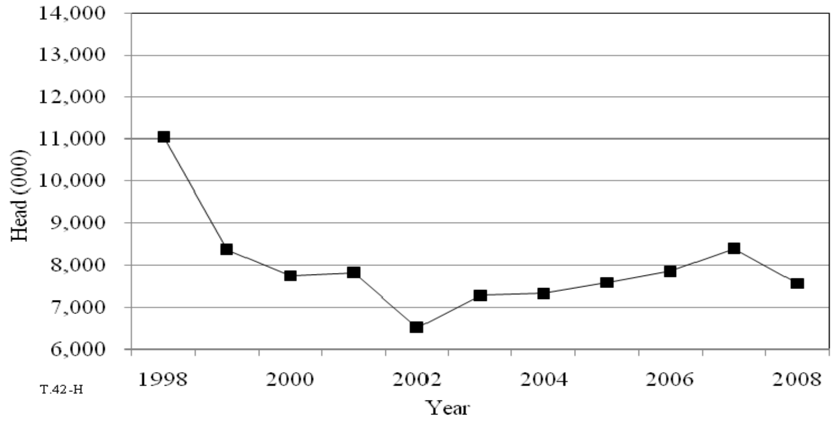

Figure 27. **Volume of Hogs Marketed Through Firms Selling on Commission**

Like cattle packers, hog packers use multiple procurement methods (Figure 28). About 12 percent of hogs are obtained on the negotiated spot market. Approximately 21 percent are packer-owned hogs that are supplied from a packer-owned farrowing operation, and are often fed under contract for the packer. The rest are purchased using various types of other marketing arrangements, usually either some variation of marketing agreement or forward contract. Marketing agreements for hogs generally are based on multi-year contracts under which the producer agrees to deliver a set number of pigs per year to a packer. Some of these arrangements are verbal agreements. “Forward contracts” for hogs are typically simple one-time contracts for a given number of hogs to be delivered within a certain time window, with price based on an expiring futures contract. Other modes of procurement for hogs are largely verbal contracts.

Procurement methods used by individual packers vary significantly among packers, ranging from the packers that are fully integrated to packers that rely primarily on the open market. Most hog packers use some combination of packer-fed hogs, marketing agreements, forward contracts, and negotiated spot market procurement. These combinations may vary by plant for multi-plant packers.

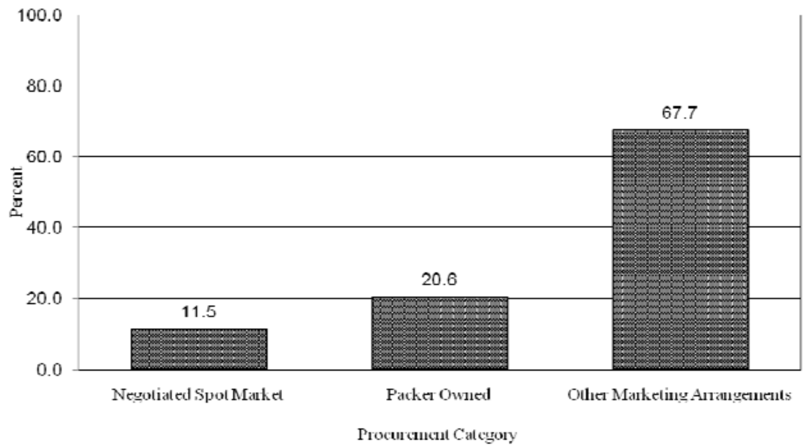

Figure 28. **Percentage of Hogs Procured Through Alternative Types of Procurement Arrangements by Four Largest Hog Slaughter Firms, 2009**

Meadowbrook Farms Cooperative, Rantoul, Illinois, ceased its hog slaughter operation in January 2009, owing approximately $5.5 million in payments to its members. Meadowbrook Farms Cooperative filed, in the Southern District of Illinois, a voluntary petition for protection under Chapter 7 (liquidation) of the Bankruptcy Code in March 2009. Meadowbrook opened in 2004 with the expectations to process 3,600 hogs a day and market 150 million pounds of pork per year.

In February 2009 Smithfield Foods Inc said it would close 6 processed meat plants and eliminate 1,800 jobs while retaining its current hog slaughter capacity as it restructures its pork group. Plants slated for closure include Smithfield Packing Co. plants in Smithfield, Va., Plant City, Fla., and Elon, N.C., as well as a John Morrell plant in Great Bend, Kan.; a Farmland Foods plant in New Riegel, Ohio; and an Armour-Eckrich Meats factory in Hastings, Neb. Four of its existing independent companies would be combined under The Smithfield Packing Co., Inc., John Morrell & Co., and Farmland Foods Inc. units.

On May 29, 2009, Sara Lee Corp. announced that it would open a new, state-of-the-art sliced meat manufacturing facility in Kansas City, Missouri, which will become fully operational by 2011. Sara Lee stated the facility will provide competitive advantage in value-added meats and brand development.

Sheep—Changing Business Practices

The volume of sheep and lambs purchased on a carcass basis peaked at over 1.9 million head in 2001, but declined to around 1 million head in recent years (Figure 29).

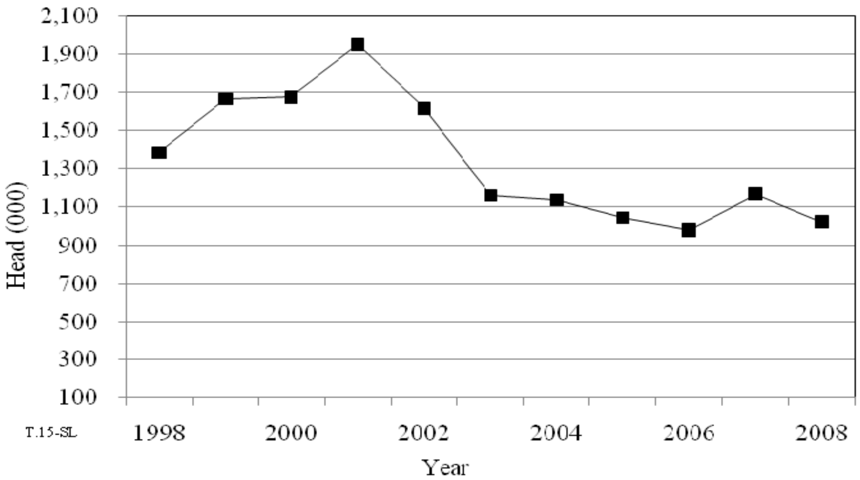

Figure 29. **Sheep and Lambs Purchased on a Carcass Basis**

The volume of carcass purchases has declined with total slaughter over time, and purchases of sheep and lambs on a carcass basis declined slightly in 2008. Live-weight purchases in 2008 declined to less than 50 percent of the sheep and lamb purchases for slaughter by packers reporting to P&SP (Table 22).

Table 22. **Number and Percentage of Sheep and Lambs Purchased by Live-Weight and Carcass-Weight for Packers Reporting to P&SP, 1997-2008**

	Live-weight		Carcass-weight	
Year*	Head (000)	Percent	Head (000)	Percent
1997	1,773	56.3	1,378	43.7
1998	1,899	57.9	1,380	42.1
1999	1,513	47.6	1,663	52.4
2000	1,323	44.1	1,674	55.9
2001	840	30.1	1,951	69.9
2002	1,062	39.6	1,615	60.4
2003	1,023	47.0	1,156	53.0
2004	1,329	53.9	1,135	46.1
2005	948	47.7	1,040	52.3
2006	1,056	51.9	977	48.1
2007	1,338	53.4	1,166	46.6
2008	828	44.8	1,019	55.2

Procurement methods used to purchase 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.

Some producers who feed their own lambs market their lambs through a lamb feeding operation or feedlot that has a supply contract agreement with a packer. There also are business arrangements in which individuals who have financial interests in large lamb packing companies also have lamb feeding operations and supply lambs to the packing company. Some producers participate in cooperatives, associations, or pools of lamb producers to collectively market their lambs and lamb products.

As with other species, the various procurement methods used for lambs continue to evolve, but P&SP has not observed major changes in the methods in recent years and expects this stability to continue.

Use of commission firms for the sale of sheep and lambs has declined similar to the trend in use of commission firms for cattle through 2007, but in 2008 increased slightly and will likely remain steady in the near term (Figure 30).

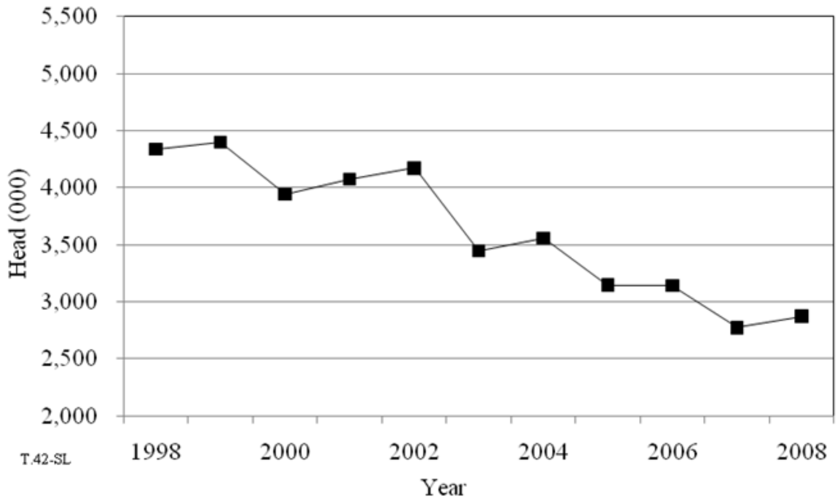

Figure 30. **Volume of Sheep Marketed Through Firms Selling on Commission**

Poultry—Changing Business Practices

Poultry firms have recently experienced considerable difficulties due to oversupply of meat, high prices for inputs, and weak domestic and international demand. Pilgrim's Pride filed for bankruptcy under Chapter 11 in December 2008. In September 2009, JBS SA successfully completed acquisition of a 64-percent stake of Pilgrims Pride for $800 million.

Internationally, Marfrig Alimentos SA, the world's fourth largest beef packer, agreed to buy Cargill Inc.'s Brazilian poultry and pork business for $706 million in cash. It will also assume $194 million in debt from Cargill's Seara Alimentos SA, Brazil's second biggest poultry processor. Cargill paid about $130 million for Seara in 2004. Observers note that the deal is further evidence of the rapid geographic and protein diversification of Brazilian meat companies. One factor is continued government support through Brazil's National Development Bank (known as BNDES). Marfrig went public in 2007 and BNDES holds 14.7 percent of its common stock.

Industry Concerns

GIPSA receives complaints about behaviors that adversely affect one or many livestock sellers or poultry growers. An illuminating case was discussed by Professor Richard Sexton at a recent Farm Foundation forum held December 2009 in Washington D.C.[3]

In his example, Professor Sexton suggested that hog procurement, due to the high degree of contracting, is no longer an open market. In place of the open market a bargaining game has evolved where hog processors use production contracting to capture a supply in excess of processing capacity. The excess capacity effectively eliminates producer bargaining power and once producers have committed themselves to hog production, processors can compensate at a level that only allows the producer to pay costs of operation without paying producers' salary. In effect the producers' opportunity costs have been driven to zero. The producers because of their prior investment are locked into production and subject to the hold-up costs.[4]

The idealized model of perfect competition that economists use as a benchmark includes four structural characteristics: many buyers and sellers, a uniform product, costless entry into and exit from the market, and perfect information. Deviations from any one of these features provide a potential source of market or bargaining power to one or more of the bargaining parties. The neoclassical economic analysis of anti-competition focused on deviations in the model of perfect competition arising in markets with one buyer and many sellers (monopsony) or its converse, many buyers and one seller (monopoly). The analysis of those markets indicates a reduction in prices paid to sellers (monopsony) or an increase in the price received from buyers (monopoly) relative to perfect competition. The price effect occurs simultaneously with a reduction in the level of trade that would have been expected relative to the ideal perfectly competitive market.

In markets such as livestock and poultry where the level of processor output is related directly to input procurement, any reduction in procurement comes at the expense of potential loss of market share on the output side.[5] If rivalry is strong in the output

[3] http://www.farmfoundation.org/webcontent/The-Economics-of-Structural-Change-and-Competition-in-the-Food-System-1721.aspx?z=85&a=1721, accessed 12-14-09.

[4] The empirical evidence for hold-up costs in poultry production contracts is discussed by T. Vukina and P. Leegomonchai in "Oligopsony Power, Assett Specificity, and Hold-up: Evidence from the Broiler Industry", Amer. J. of Agri. Economics, pp. 589-605, Aug., 2006. A general discussion of the hold-up problem by Paul Milgrom and John Roberts is found in "Economics, Organization, and Management" pg. 136, 1992.

[5] Gravelle, Hugh and Ray Rees. (2004) Microeconomics. 3rd ed. Prentice Hall FT. Harlow England. Pp 218-219.

market, a processor would potentially face economic losses for reducing procurement in the upstream market. As a result, livestock and poultry processors have incentives to exert market power to effect prices or compensation through mechanisms that do not directly reduce trade from the expected levels under ideal perfect competition.

In the hog contracting example above, the processors gained market power from a combination of sources including perishable products, asymmetric information, and the large cost hog producers would bear if they leave production. The last source in particular allows for the decoupling of the lower compensation payment from an immediate reduction in hog procurement. It also is compatible with the processors economic incentive of not reducing market share in output markets.

To the extent that business practices can redistribute wealth from sellers to the processor without restricting trade immediately, they do not effect market efficiency or dead weight losses in the short-run. The distributional effect of the buyer expropriating seller economic value, however, may nonetheless have a corrosive effect on competition.

Related to these general concerns about the structure, performance, and conduct of the livestock, meat, and poultry industries, in November 2009, GIPSA announced that it will be participating with the U.S. Department of Justice in workshops throughout 2010 to further explore competition issues in these industries.[6] These will be the first joint U.S. Department of Justice and U.S. Department of Agriculture (USDA) workshops ever held to discuss competition and regulatory issues in the agriculture industry. GIPSA hopes to promote dialogue and listen to and learn from parties with experience in the agriculture sector, and inform participants about the appropriate legal and economic analyses of these issues.

The day-long workshops will be held in Alabama, Colorado, Iowa, Washington, DC, and Wisconsin beginning in March 2010, with the last workshop taking place in December 2010. The public will have an opportunity to ask questions and provide comments at each workshop, which may also feature keynote speakers, expert panels, and break-out sessions that will address more narrowly focused issues. GIPSA is encouraging public attendance and participation of farmers, ranchers, processors, consumer groups, agribusinesses, government officials, academics, and all other interested parties.

[6] Additional information is at: http://www.gipsa.usda.gov/GIPSA/webapp?area=home&subject=mp&topic=doj

REPORT PROVENANCE

Congress mandated specific content of this Packers and Stockyards Program Annual Report with amendments to the P&S Act. Specifically the information on the disposition of cases was mandated by the Food, Conservation, and Energy Act of 2008 (Farm Bill). The relevant amendment in the Farm Bill to the Act states:

SEC. 416. ANNUAL REPORT.

(a) In General- Not later than March 1 of each year, the Secretary shall submit to Congress and make publicly available a report that:

(1) States, for the preceding year, separately for livestock and poultry and separately by enforcement area category (financial, trade practice, or competitive acts and practices), with respect to Investigations into possible violations of this Act--

> *(A) the number of investigations opened;*
>
> *(B) the number of investigations that were closed or settled without a referral to the General Counsel of the Department Agriculture;*
>
> *(C) for investigations described in subparagraph (B), the length of time from initiation of the investigation to when the investigation was closed or settled without the filing of an enforcement complaint;*
>
> *(D) the number of investigations that resulted in referral to the General Counsel of the Department of Agriculture for further action, the number of such referrals resolved without administrative enforcement action, and the number of enforcement actions filed by the General Counsel;*
>
> *(E) for referrals to the General Counsel that resulted in an administrative enforcement action being filed, the length of time from the referral to the filing of the administrative action;*
>
> *(F) for referrals to the General Counsel that resulted in an administrative enforcement action being filed, the length of time from filing to resolution of the administrative enforcement action;*

(G) the number of investigations that resulted in referral to the Department of Justice for further action, and the number of civil enforcement actions filed by the Department of Justice on behalf of the Secretary pursuant to such a referral;

(H) for referrals that resulted in a civil enforcement action being filed by the Department of Justice, the length of time from the referral to the filing of the enforcement action;

(I) for referrals that resulted in a civil enforcement action being filed by the Department of Justice, the length of time from the filing of the enforcement action to resolution; and

(J) the average civil penalty imposed in administrative or civil enforcement actions for violations of this Act, and the total amount of civil penalties imposed in all such enforcement actions; and

(2) includes any other additional information the Secretary considers important to include in the annual report.

(b) Format of Information Provided- For subparagraphs (C), (E), (F), and (H) of subsection (a)(1), the Secretary may, if appropriate due to the number of complaints for a given category, provide summary statistics (including range, maximum, minimum, mean, and average times) and graphical representations.

Through an earlier amendment to the Grain Standards and Warehouse Improvement Act of 2000 (PL 106-472, Nov. 2000), the P&S Act was amended to include the following language:

Section 415. Annual Assessment of Cattle and Hog Industries.

Not later than March 1 of each year, the Secretary shall submit to Congress and make publicly available a report that—

(1) assesses the general economic state of the cattle and hog industries;

(2) describes changing business practices in those industries; and

(3) identifies market operations or activities in those industries that appear to raise concerns under this Act. (7 U.S.C. 228d)

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