

Restoring Economic Health to Contract Poultry Production¹

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Introduction—Market Power in the Food Industry

Concentration in major markets for agricultural products is dramatic, and the number of major food processing firms is concentrated in the hands of only a few. These anticompetitive markets deliver processed foods to consumers and retailers by using their market power to demand higher prices, causing an increase in the consumer cost of food. The highly concentrated structure of the American food processing markets drives producer prices down dangerously, while increasing consumer costs unnecessarily and unfairly.

Monopsony power exists where too few consumers of raw goods control the market and can engage in the practice of “under-demanding” their full need, thereby creating an artificial impression and causing sellers of perishable goods to accept unfair lowered prices. Major ag markets are controlled by companies with monopsony power.

Farmers and ranchers are unable to bargain effectively with purchasers of major ag commodity products in the United States. They are thwarted by monopsony (buyer) market power produced by disparate information, opaque markets, and concentration so intensive there are simply too few firms at the marketplace, in a competitive bidding setting, to sell their beef, pork, broilers, dairy products and many other agricultural commodities. This is acutely true in the poultry industry where producers cannot bargain for a supplier relationship due to market structure, cannot own their birds, and are dependent on the whims of a single processor for continuing business to meet significant capital debt service requirements on their poultry facilities.

Consumers are poorly served by existing market structures, too. The spread between the price paid to the farmer and the price paid by the consumer increases steadily as concentration increases in food processing and retailing. The winners are in the middle. The losers are producers and consumers.

The monopsony problem is not new to American agricultural, but it is extremely acute, now, in the early part of the 21st century. A hundred years ago a similar problem led to enforcement of the newly-enacted antitrust laws and the adoption of the *Packers and Stockyards Act* of 1921, all in an effort to rid the nation of monopsony’s gripping the same major agricultural markets then,

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as find themselves gripped by the monopsony problem now. Concern must focus on the basic purposes of antitrust laws. The authors believe the most significant evil, at which antitrust laws are aimed, is concentration. Antitrust laws serve the fundamental purpose of ensuring freedom of business opportunity. They are not designed to prevent growth, nationwide businesses, or success. But, they are designed to prevent monopolies, monopsonies, and abuse of market power.

Market concentration in too few corporate hands poses risks of price, biosecurity, and lack of redundancy to all American consumers. Corrective action is an urgent national priority.

The State of Contract Poultry Production, 2010

The domestic poultry meat industry is integrated vertically. This means ownership and control of essentially all aspects of production in the vertical chain from baby chick to processed broilers and wholesale poultry products is held by poultry companies. These companies are commonly known as “integrators.” The poultry industry, which includes broiler, turkey and egg production, is the most vertically integrated of all major agricultural industries.

Integrators generally own or control the breeding flock, hatcheries, chicks, assignment of baby chicks to growers, feedmills, feed ingredients, transportation of feed, and processing (slaughter) plants. These companies, integrating all decision making affecting poultry production, direct the course of action in all key areas of production: placement of baby chicks, the number of chicks placed with each grower, what birds are fed, and when birds ready for processing will be picked up from the grower. Integrators also dictate physical size and equipment specifications for grow out³ house and equipment. Locations or placements of grow out facilities are fully dictated by the integrators.

Under the dominant business arrangement, the integrator owns the chicks and feed, while farmers, commonly called contract growers, carry out actual production, or grow out, from chicks to birds ready for processing.⁴ If the bird dies, it becomes the grower’s property and responsibility. This is achieved by paying the grower or producer for only what is returned when the birds reach slaughter weight.

The integrator directs and oversees the production process and serves as overlord to the contract grower. Company representatives (called service technicians) typically visit each producer and grow out house weekly to supervise the grower’s work and check on litter, waste and dead birds. Integrator representatives also give directives governing maintenance and upgrades of facilities. They police the handcuffing provisions in nonnegotiable standardized contracts integrators

³ Each segment of agriculture has its own “lingo” What poultry producers call integrators are the same as what beef and pork producers call “packers” or “slaughterhouses”. A “grow out” house is where young birds gain weight to reach market readiness, or slaughter weight.

⁴ See, for example, Tomislav Vukina, “Vertical Integration and Contracting in the U.S. Poultry Sector,” Journal of Food Distribution Research, July 2001:29-38.

demand of growers. “This network of company specialists (i.e. service technicians) comprises the command-and-control structure that specifies the grower’s production process.”⁵

Integrators require growers to provide expensive specialized production facilities (houses, associated equipment, and utilities), grower services (labor and management), waste management and dead bird disposal. Costs for these facilities can reach \$1 million or more for a typical family operation.

Beginning in the 1950s broiler production contracting evolved from simple credit arrangements with feed companies, to profit-sharing arrangements, to flat fee contracts, and finally to a basic feed-conversion contracts.⁶ Almost all broiler and turkey contracts now establish a base fee the grower will receive, with adjustments based on relative performance compared to other growers for the same integrator in the same complex. Economists call this a “tournament pay system” but, due to variable feed and chick quality, more of a “lottery.”

Open, transparent cash markets for broilers or turkeys ready for processing disappeared decades ago.⁷ There is no open market for poultry ready for processing, so there is no economically viable alternative for commercial, non-specialty growers who wish to be independent from integrators. The integrator companies refuse to purchase birds from independent growers. They break them. In poultry the choice is stark: Sign the handcuffing contract offered, or get out of the business through bankruptcy. Once one enters the life of a grower, the trap is closed: high capital costs and large debt to enter the business, no input on product price, no market in which to sell goods and no way out except bankruptcy if the integrator “dumps” the grower.

Early in the course of complete vertical integration poultry companies and growers tended to look out for each other’s economic welfare like partners. Vukina and Leegomonchai, observed, “*Production contracts have played a decisive role in the broiler industry’s remarkable growth but the integrator-grower relations have gradually worsened. Starting in the mid 1990s the tensions have received increasing attention nationwide.*”⁸ The industry now, by 2010, places growers completely at the mercy of their integrators. In economics, this is referred to as monopsony, “buyer” or “contractor” power held by the integrator over their growers.

⁵ J. J. Molnar, T. Hoban and G. Brant, “Passing the Cluck, Dodging Pullets: Corporate Power, Environmental Responsibility, and the Contract Poultry Grower,” Southern Rural Sociology, Vol. 18 (2), 2002, pp88-110.

⁶ Vukina further discusses evolution of the poultry industry. See *supra* note 4. The lack of bargaining power is also discussed by Daryll E. Ray, “On Compensating Producers Who Contract Production,” Article Number 233, Agricultural Policy Analysis Center, University of Tennessee, 2005.

⁷ Although there is no open, transparent market for birds ready for processing, there have special “sweetheart” deals allowing executives and insiders of some integrators to sell birds ready for processing to the integrator.

⁸ Tomislav Vukina and Poramet Leegomonchai, “Political Economy of Regulation of Broiler Contracts,” American Journal of Agricultural Economics 88, December 2006, 1258-1265.

Broiler production is both capital and labor intensive.⁹ Growers bring roughly one-half of the capital and most of the labor required to produce a processed whole bird. Growers' capital and labor are "captive" to the integrator. It gets the broilers, sets the price, and imposes the growing conditions. The grower does the work and hopes to please the "boss" integrator.

Integrators typically mandate specifications for poultry houses and equipment, and often require growers to make investments in upgrading equipment or facilities. A 2001 USDA national survey reveals that 84% of contract poultry growers were "... *required to make investments in equipment or facilities.*"¹⁰ A USDA survey update revealed that 49% of broiler growers were required to make capital investments in 2004, and that this investment in the single year averaged \$49,037 per grower. Survey results imply that the average respondent had 3-4 standard size houses, so the average investment in the single year averaged \$10,000-15,000 per house for about one-half of the growers.

New growers borrow all funds for construction of houses and equipment, offering a small acreage of land as collateral. Integrator mandated house and equipment modifications send growers to creditors and rob them of any equity they manage to earn. It may take 20 – 30 years to pay off the amortized debt for a poultry facility, but the integrators contract is seldom more than five, and often only two or three, years long. Recent contracts, some covering several years, actually only guarantee the grower a single flock. Renewal time puts the integrator in control and leaves the producer with no power to bargain.

New growers are not permitted to negotiate contract terms; the only option offered by an integrator is to accept or reject the integrator's standard form contract. Accepting means the grower will have birds to grow; rejecting means she will not. Vukina and Leegomonchai, state, "*Modern broiler contracts are written by the integrator and offered to prospective growers on a take-it-or-leave-it basis.*"¹¹ The integrator alone decides when a new contract will be written. The integrator decides the take it, or leave it, terms. The long economic life of highly specialized poultry grow out facilities makes business options facing an existing grower narrow to (a) bankruptcy, or (b) acceptance of the integrator's dictates. Arms-length contract negotiations rarely if ever occur between grower and integrator; rather, contracts of adhesion characterize the industry. Indeed, with no cash market for broilers, there is no basic context above or within which price negotiations can occur.

MacDonald and Korb, economists with ERS/USDA, state, "*Once the investment is made, growers face the risk of opportunistic behavior by integrators, who may have considerable monopsony power at that point. ... With a short-term contract, integrators may adjust payment*

⁹ Vukina notes, "The poultry industry is predominately organized in a manner that limits capital requirements by the integrator." *Supra* note 4.

¹⁰ <http://www.ers.usda.gov/Briefing/FarmStructure/Questions/livestock.htm>

¹¹ Tomislav Vukina and Poramet Leegomonchai, "Political Economy of Regulation of Broiler Contracts," *American Journal of Agricultural Economics* 88, December 2006, 1258-1265.

schemes, or hold up growers for additional investments, as a condition of renewal.”¹² The 2008 Pew Commission report on Industrialized Farm Animal Production emphasizes the limited choices grower have, “Once the commitment is made to such capital investment, many farmers have no choice but to continue to produce until the loan is paid off. Such contracts make access to open and competitive markets nearly impossible for most ... poultry producers, who must contract with integrators if they are to sell their product.”¹³

These industry characteristics are manifestations of poultry integrator market power. Even though there may be several integrators in some areas, integrators maintain monopsony power over their contract growers in nearly all phases of their business lives. This includes bank credit, which requires a contract with an integrator the bank likes, birds to grow, which come from the integrator, feed and vet supplies which must conform to integrator specs, specifications for the physical plant including updates, and the protocol used for waste and dead bird disposal. The grower provides the sinew and muscle and performs the stoops and heaves, but makes none of the judgments.

Poultry Market Concentration

Concentration statistics are often improperly used to assess market power. At a given market level, the concentration ratio on the seller side of the market is not generally equal to the concentration ratio on the buyer side of the market. Using a seller’s CR4 or HHI to increase buyer power is inappropriate and misleading. For example, GAO reports CR4=57% in broiler production. The HHI=1,200. Broiler processing concentration measures may be appropriate for assessing seller power in the wholesale market for poultry and poultry products, but they are absolutely inappropriate for analyzing buyer power of the poultry companies. The integrators have nearly absolute control of their respective growers. From an antitrust perspective, the integrator “defines” the relevant market for grower services, typically no more than 40 miles from the integrator’s feed mill and processing facility.

Tacit collusion of integrators can suppress grower switching and “police” producers. Even without collusion, the Hobson’s choice facing a grower is between a bad arrangement with her current integrator and an equally bad arrangement with another one.

In the tournament system, each grower has detailed information on flock performance relative to all flocks processed that week by the integrator. By law—PSA regulations—the integrator is required to furnish this information to the grower on what is commonly called a “settlement sheet.” Such settlement sheets for many flocks establish whether a grower is a good or poor manager. In a truly competitive market for grower services, integrators would be trying to sign the good managers for other integrators. But such switching is extremely rare, even in areas with several integrators.

¹² James M. MacDonald and Penni Korb, “Duration in Production Contracts,” paper presented at the American Agricultural Economics Association Annual meeting, Long Beach, CA, July 23-26, 2006, pp 4-5.

¹³ Putting Meat on the Table: Industrial Farm Animal Production in America, a Report of the Pew Commission on Industrial Farm Animal Production, The Pew Charitable Trusts and Johns Hopkins Bloomberg School of Public Health, April 29, 2008, p. 49.

A recent study of detailed USDA poultry grower survey data by Key and MacDonald, ERS economists, concluded, *"There appears to be small but economically meaningful effects of concentration on grower compensation."*¹⁴

Sharing of Detailed Cost, Pay & Production Information by Integrators

A recent GAO Report states *"We did not identify reliable information on prices poultry farmers received (p. 15)."* USDA does not report prices contract poultry producers receive, although they report cattle and hog prices twice daily. To some extent, GAO's inability to find direct data to support the impact of concentration on poultry farmers is understandable¹⁵. Once a market is destroyed, useful data cannot be gleaned from it, just as a house cannot be inhabited once it has burned to the ground.

Most poultry integrators participate in a common private reporting service, known as AgriStats,¹⁶ and share information on contract grower pay by month. They do not share this information with growers or outsiders.

The sharing of price and other market information by so-called competitors is well known as a significant antitrust issue. Grower payout and cost information shared by most integrators is incredibly detailed and comprehensive. As such it could provide critical data for competition investigations and analyses of oligopoly and oligopsonistic behavior far more complex and advanced than available for any other agricultural industry. An intensive inquiry is needed.

Highly Limited Public Information for Growers

Integrators share highly detailed cost and pay information monthly. But growers typically have little or no information on the economics of contract production. During expansion phases of the industry, integrators typically increase grower pay to induce new entrants. Due to the lack of accurate public information on the true economics of contract production, potential growers must

¹⁴ Nigel Key and James M. MacDonald, "Local Monopsony Power in the Market for Broilers: Evidence from a Farm Survey," Selected Paper, Annual meeting of the AAEA, Orlando, FL, July 27-29, 2009.

¹⁵ Throughout this publication, General Accounting Office's Report, GAO 09746R, *Concentration in Agriculture*, issued June 30, 2009, is generally referred to as the GAO Report.

¹⁶ *"Agri Stats, Inc. is a statistical research and analysis firm serving agribusiness companies domestically and internationally. Clients include, but are not limited to: Tyson, Louis Rich, Perdue, Jennie-O/ The Turkey Store, Cargill, and Smithfield. Agri Stats was founded in 1985 by James H. Cox as a provider of management reports to improve the profitability of broiler companies in the United States and around the world. Twenty years later, Agri Stats has grown to be the premier management reporting and benchmarking company for numerous industries: broiler, egg, turkey, swine, beef and dairy. Agri Stats also provides consultation on data analysis, action plan development and management practices of participating companies... Our mission: To improve the bottom line profitability for our participants by providing accurate and timely comparative data while preserving the confidentiality of individual companies."* <http://www.agristats.com/>, downloaded on 2/12/2010. While AgriStats may have some semblance of trying to "preserve confidentiality of individual companies," we think that the reports are so detailed that an insider could identify other company's pay and cost information.

rely on representations made by integrators. Historically, integrators' keep their representations oral and then take the representations away in their nonnegotiable contract documents. The representations routinely misstate and omit expenses. The process of becoming a contract grower is so completely controlled and structured by integrators that it leads to integrator contracting only with pliant, malleable, silent, trusting growers. In academia this is called adverse selection.

Ten years ago Shofner¹⁷ noted the problems growers face in assessing the true economics of contract production, “... *recently there have been many complaints from the poultry growers. Part of the problem is a result of poultry growers' incorrect expectations about projected expenses and revenues. These erroneous expectations are a product of poor information that they received prior to signing their initial contract. There is no publicly available data to examine grower returns; therefore it is nearly impossible to determine the overall financial situation of poultry growers. For the most part potential growers are left to their own devices when evaluation of the feasibility of new poultry farms.... Many integrators give the grower only oral information about the profits that they will receive under the contract. ... One major problem is that many of the contracts do not generate the initial profits described by the integrator ... often (profits) decline after the second year making it necessary for the farmer to seek other income opportunities.*” Goodwin makes similar statements¹⁸.

Bankers contribute to the problem. The credit industry is concerned about “cash flow” which is not the same as generating a competitive or fair return for the grower’s labor, management, risk and equity over the 20-30 year life of the facility. Grower – integrator contracts become financing tools, like commercial leases. Poultry loans are structured to “cash flow,” making them acceptable to bankers. A short-term contract provides this cash flow, initially. Integrators often make a grower’s loan payment directly to the bank. This makes for good short-term credit viability, but very adverse medium and long term market repercussion and success prospects for the producer. The grower is “stuck” at contract renewal time between the demands of the banker, and the paltry terms of the integrator.

Integrators often misrepresent future cash flows to potential new growers. They tell young grower prospects to expect high loan payments initially and little cash flow for family expenses, but to take comfort that things will be much better after debt is retired. This “promise” that effort has its reward is illusory. In fact, after 10-15 years—about when loans are paid off—the integrator mandates expensive new equipment in the house, which puts the grower right back in the debt cycle.¹⁹ Growers remain trapped between the nonnegotiable terms of the integrator and the relentless interest meter of the bank.

¹⁷ Tara Shofner, “Development of the Interactive Broiler Income Spreadsheet, American Journal of Agricultural Economics, December, 2000, pp 1240-1246 (Award-Winning Paper).

¹⁸ H. L. Goodwin, “Spreadsheet for Broiler Farm Economic Analyses, Avian Advice, Univ. of Arkansas, Spring 2002, pp 1-4.

¹⁹ Mark Jenner, Understanding the Lender’s Share of Grower Contract Pay, American Farm Bureau Federation, January 3, 2002.

Dr. Daryl Ray²⁰ describes the contract poultry industry as follows. “... let us look at what happens with broiler (or turkey) production. To attract new producers the company has to offer a price that will allow the producer to pay all of the variable costs and some return for management and risk. In addition, a new operator will need enough income to pay principal and interest on the loan that has to be taken out to build the facilities. At that point [before incurring debt, building houses, or signing the initial contract²¹] the farmer has nothing at risk and can walk away from the first contract if the offer does not cover the variable costs, the fixed costs, and a reasonable return for management and risk. ... What happens when the contract is up for renewal? The producer usually still owes some money on the original loan, plus he has the equity from the investments in the original facilities. If the company decides to reduce the price offered for the birds, the grower is in a difficult position, given his investment in the barns and remaining debt. If the company offers a lower price for the birds or does not offer some increase to cover increased labor costs, the grower has no leverage. ... He is a captive of the company.”

Dr. Ray continues, “This is what many contract growers (and economists) call ‘hold-up’. ... In most cases the farmer cannot negotiate with another company because there is usually only one company in a give area. In this situation, the farmer is not negotiating in a free-market environment. Rather he is selling into a monopsony, where the company has all of the negotiating power. In this situation the producer is in a take it or go bankrupt situation. ... Because of the investment to begin production and because he is selling into a monopsony, the producer has no bargaining power at contract renewal time. The producer may be forced to choose between moderate and consistent losses, and the higher cost of foreclosure on the land and buildings and exiting the business. Either way the producer loses. Exit is far from costless; rather exit is likely to be a financial catastrophe. The investment in farms is useless if the grower does not get more birds from the company”

The 2008 Pew Commission report on Industrialized Farm Animal Production emphasizes the limited choices growers have, “Once the commitment is made to such capital investment, many farmers have no choice but to continue to produce until the loan is paid off. Such contracts make access to open and competitive markets nearly impossible for most ... poultry producers, who must contract with integrators if they are to sell their product.”²²

Entry and exit barriers are important antitrust economic considerations in a monopsonistic market. The poultry industry is rife with entry and exit barriers and contract negotiations barriers.

²⁰ Daryl Ray, “On Compensating Producers Who Contract Production,” Jan. 21, 2005, (<http://apacweb.ag.utk.edu/articles05.html>). Dr. Ray holds the Blasingame Chair of Excellence in Agricultural Policy at the University of Tennessee, and is the Director of their Agricultural Policy Analysis Center (APAC).” Parenthetical comments added.

²¹ Clarification in brackets added.

²² Putting Meat on the Table: Industrial Farm Animal Production in America, a Report of the Pew Commission on Industrial Farm Animal Production, The Pew Charitable Trusts and Johns Hopkins Bloomberg School of Public Health, April 29, 2008, p. 49.

Costly poultry houses are single use facilities that have extremely limited use in other agricultural operations. They are massive entry barriers. Poultry growers are wed to their buildings, their mortgages, and their integrator's through nonnegotiable contracts and absent cash markets for their products. Once they enter with the dream of entrepreneurship, they find themselves in the dogged trough of a life without exit... a life of true serfdom.

True Economics of Contract Poultry Production

A major problem with contract poultry production is sub-competitive pay for growers.

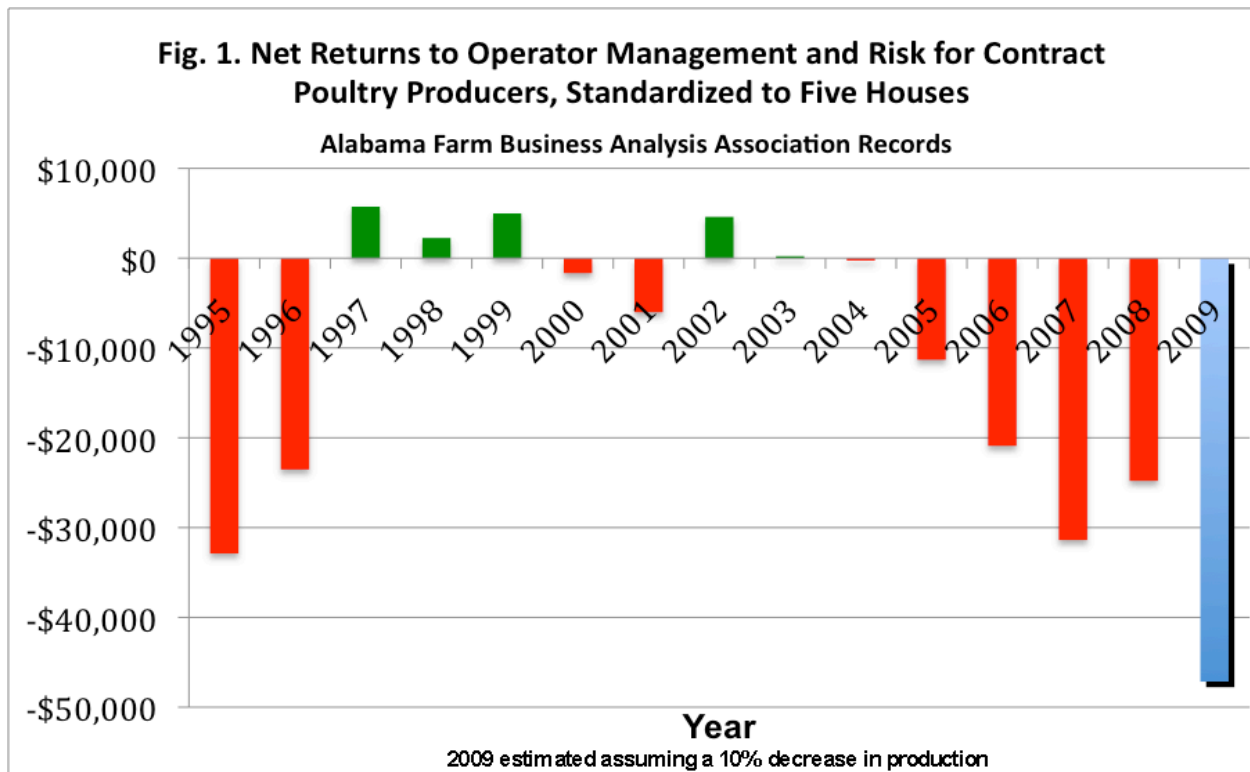
The Alabama Farm Business Analysis Association (AFAA) maintains the *only* set of consistent records on the *actual* economics of contract poultry production.²³ These records are based on trained farm management experts sitting down with participating producers and going over every single income and expense item and appropriately allocating each to different farm enterprises, such as poultry or cattle.

AFAA records are intended solely for management purposes and are not intended for tax purposes or for corporate financial reporting. They are the best information available on the true economics of contract production. Integrators have the same business model for all complexes, so the AFAA records are reasonably representative of poultry growing conditions outside Alabama, too.²⁴

Figure 1 shows the annual net returns to operator management and risk for a five-house operation, which is approximate size of an average operation, 1995-2009. A modest charge of \$7.00/hour for family labor was included as a cost. The records show a negative net return in 10 of the 15 years. Cumulative losses total \$182,000 for 1995-2009.

²³ See the Farm Business Analysis summary for poultry available at <http://www.aces.edu/menus/Financial.tmpl>. See also C. Robert Taylor, "Restoring Economic Health to Contract Poultry Production," Agricultural and Resource Policy Forum, Auburn University, College of Agriculture, May, 2002.

²⁴ Many other Land-Grant Universities have farm business record keeping programs similar to the Auburn University AFAA program. None at this time provide a summary of costs and returns for participating poultry producers.



AFAA records show gross contract payouts are somewhat above average for the area. Thus the economic plight of the average contract grower is worse than shown in Fig 1.

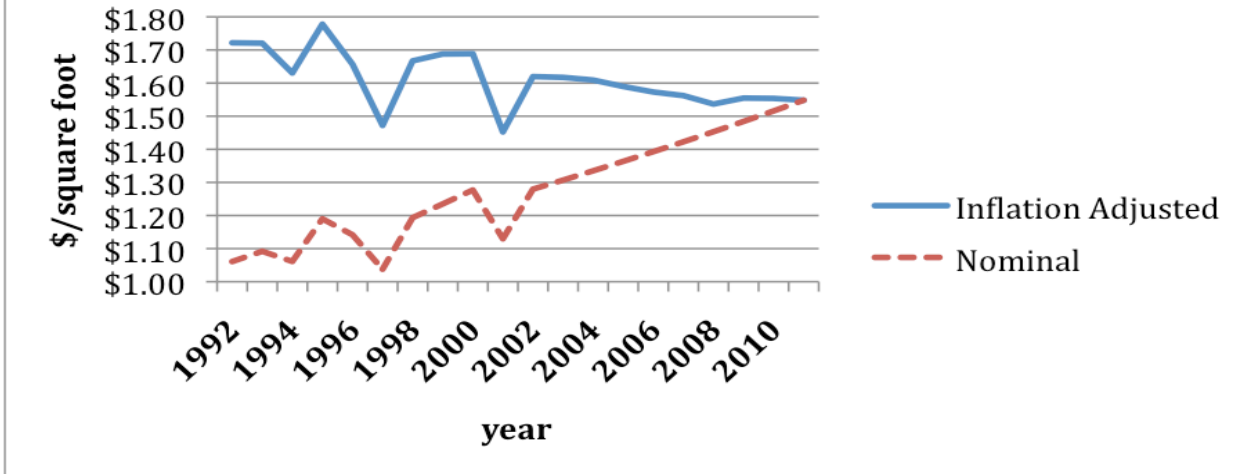
Industry representatives often assert that grower pay (per pound produced) has been increasing. For example, Michael Donohue, Vice President, Agri Stats, Inc., stated, “*Grower expense (i.e. gross pay per lb) has risen each year over the last fifteen years in absolute and in relative terms.*”²⁵ While this is true in nominal terms, grower pay per pound of bird adjusted for inflation actually shows a downward trend. Industry representatives also assert that growers have benefited from production per foot increasing. While this is true, gains have been very modest in recent years, not offsetting increases in expenses.

Cunningham’s budgeted estimates of average broiler grower returns over cash operating expenses per foot of house space, nominal and real, are shown in Figure 2. The Consumer Price Index (CPI) was used to adjust for inflation. Estimates shown in Figure 2 assume a normal production cycle, and do not reflect, in particular, reduced placements in 2009-2010. Furthermore, the budgeted estimates shown in Figure 2 do not include any depreciation or loan expenses.

While the trend in nominal returns over cash expenses has trended upward, real returns over cash expenses have trended downward (Fig. 2).

²⁵ Michael Donohue, “The Importance and Value of America’s Poultry Farms,” <http://www.nationalchickencouncil.com/aboutIndustry/detail.cfm?id=20> downloaded 4/26/2010.

Figure 2. Nominal and Real (inflation adjusted) Grower Returns Over Cash Expenses per Square Foot of House Space (based on Cunningham budgets)



Growers profitability is worse than depicted above. Costs of technologically advanced houses and equipment, often mandated by the integrator, have increased more than inflation. Based on house and equipment estimates presented in various reports by Cunningham, the nominal cost of houses has increased by 82% since 1992.²⁶ Inflation adjusted cost of houses and equipment has increased by 15% in about two decades, while inflation adjusted pay per foot has decreased (Figure 2). Thus the contract grower has been caught in a profit vise controlled by the integrators.

Tara Shofner reports a 1999 survey of Arkansas poultry growers conducted by the University of Arkansas on behalf of the Arkansas Farm Bureau Association (AFBA). She reports that the survey revealed “... 67% (of respondents) stated that they are not getting a fair return on their investment.” Shofner also states, “As it becomes apparent that income from the poultry operations is not sufficient, many producers are finding it necessary to have off-farm income just to make ends meet. Over 47% of respondents of the AFBA survey revealed that their spouse had either part-time or full-time off-farm employment. There simply may not be adequate net income

²⁶ Dan L. Cunningham and Brian D. Fairchild, Broiler Production Systems in Georgia Costs and Returns Analysis 2009-2010, University of Georgia Cooperative Extension Service, Bulletin 1240, Dec 2009. Dan L. Cunningham, Cash Flow Estimates for Contract Broiler Production in Georgia: A 20-Year Analysis, University of Georgia Cooperative Extension Service, Bulletin 1228, March 2003. Up until recently, Cunningham’s cash flow budgets extended only 16 years, even though the life of a house is 25-30 years. Thus, Cunningham’s analyses are generally incomplete.

*from the poultry operations only to support a household. This is particularly the case if substantial debt service on the operation exists.”*²⁷

H. L. Goodwin, Jr., Economist, Center of Excellence for Poultry Science at the University of Arkansas, reports results of a survey of Arkansas grower cost and returns. He states, “... *data was gathered from four growers with four different companies (16 total) over a four-year period. Participating companies approved of the project and provided the names of at least four contract growers. Growers names submitted were from the top one-third of each production complex based on their past performance and record-keeping practices. Actual data were collected through personal contact with growers.*”²⁸

Integrator control apparently exerted over a cost and return survey by university economists, as noted in the above quote, is another illustration of the lack of transparency and unbiased information prevalent in the industry.

Results from the survey reported by Goodwin show net farm income of \$9,206 annually for a four-house operation. What he calls net income is actually a return to unpaid labor, management, equity and risk.²⁹ Once a modest return is subtracted for operator labor, Goodwin’s analysis shows a negative return to management, equity and risk for growers that were in the “top one-third.”

Goodwin also alludes to the fact that market values may be distorted because of the lack of public information on actual costs and returns. He states, “... *many potential farm sellers are not usually willing to supply all of their past records to be evaluated before the sale of their farm. This situation leaves buyers with little actual data upon which to judge the profitability of their impending purchase, and potential growers are faced with the difficult task of approximating the farm’s past performance.*”³⁰ Because of a lack of information, biases can be institutionalized into the appraisal process.

“Budgeted” poultry cost and returns are highly sensitive to assumptions about the house equipment replacement cycle and cost. Sensitivity of budgets to assumptions is apparent from Cunningham’s 2009-2010 analyses. Cunningham assumes a single equipment upgrade in 30

²⁷ Tara Shofner, “Development of the Interactive Broiler Income Spreadsheet,” *American Journal of Agricultural Economics* 82 (Dec. 2000): 1240-1246.

²⁸ Goodwin, H. L. “Spreadsheet for Broiler Farm Economic Analyses,” *Avian Advice*, Spring 2002, University Arkansas Division of Agriculture, Center of Excellence for Poultry Science.

²⁹ The budget shows \$2,700 labor cost. Since four houses are typically full time for one person, this labor cost appears to be hired labor only and does not include a charge for unpaid family labor.

³⁰ Goodwin, H. L. “Spreadsheet for Broiler Farm Economic Analyses,” *Avian Advice*, Spring 2002, University Arkansas Division of Agriculture, Center of Excellence for Poultry Science.

years, equal to about 20% of initial construction cost. In contrast, Simpson, et al, state³¹: “A new modern broiler house may have a useful life of twenty-five or more years. However, the equipment must be replaced periodically, and regular repairs and refinements to the facilities will also be required. A good rule of thumb is that the house and site preparation will account for about 45%, and the equipment portion for about 55% of the total facilities (housing and equipment) cost. Thus, about 55% of the new facilities cost should be allocated for repair and replacement of equipment every 10 to 15 years. Production efficiencies, bird genetic improvements, and new technologies are likely to occur more frequently in the future than in previous years. These facts will result in a need for making improvements to your houses every few years. This contingency should certainly be factored into your projected cash flow as an anticipated and realistic expense.”

A 2001 USDA national survey reveals that 84% of contract poultry growers were “... required to make investments in equipment or facilities.”³² A USDA survey update revealed that 49% of broiler growers were required to make capital investments in 2004, and that this investment in the single year averaged \$49,037 per grower. Survey results imply that the average respondent had 3-4 standard size houses, so the average investment in the single year averaged \$10,000-15,000 per house for about one-half of the growers. These USDA survey results show that Simpson’s, et al, recommendations for budgeting equipment replacement are much more accurate than Cunningham’s assumptions.

Long-term profitability for growers is declining. A 1992 Oklahoma State University (OSU) study reports a negative budgeted return (loss) of \$953 annually (on a \$100,000 investment) to risk, management, land, and overhead after subtracting a modest charge for family labor.³³ A similar OSU budget published in 2006 reports a larger loss of \$4,260 annually (on a \$255,000 investment).³⁴ Translated from economic jargon, the OSU studies, like the detailed AFAA records, show that growers are getting a sub-competitive return for labor, and nothing for bearing substantial risks due to the integrators control of future pay, flock placements, and many other factors influencing profitability.

USDA conducts an annual survey of field-level production practices, farm business accounts, and farm households, called the Agricultural Resource Management Survey (ARMS).³⁵ ARMS

³¹ Simpson, E. H., H. B. Strawn, M. K. Eckman, J. P. Blake, and J. O. Donald, Entering the Contract Broiler Business, Alabama Cooperative Extension System, Department of Agricultural Economics and Rural Sociology, AEC-PS 0001, June, 2000.

³² <http://www.ers.usda.gov/Briefing/FarmStructure/Questions/livestock.htm>

³³ Damona G. Doye, Joe G. Berry, Parman R. Green, and Patricia E. Norris, Broiler Production: Considerations for Potential Growers, Oklahoma Cooperative Extension Fact Sheet, F-202, November 1992.

³⁴ Damona Doye, Brian Freking and Joshua Payne, Broiler Production: Considerations for Potential Growers, Oklahoma Cooperative Extension Fact Sheet, F-202, March 2006.

³⁵ For details on the ARMS data set, see <http://www.ers.usda.gov/Briefing/ARMS/>

survey results can be summarized by production specialty (poultry) and farm typology, but generally do not separate income and expenses specific to a poultry operation from other on-farm agricultural enterprises such as cattle and crops.

A summary of the rates of return on equity and return on assets for the poultry specialty for 1996-2008 ARMS surveys are given in Table 1. Financial ratios shown in Table 1 represent a return on the investment and risk, as a modest charge for unpaid family labor and management were deducted.

| Table 1. ARMS Survey Data for the Poultry Production Specialty, 1996-2008. | | | |
|---|-----------------------------|-----------------------------|--|
| Farm Typology | Return on Equity (%) | Return on Assets (%) | Gross Income from Contract Pay (%)³⁶ |
| Farming occupation/higher-sales | -3.6% | -0.7% | 68.0% |
| Farming occupation/lower-sales | -5.5% | -3.0% | 68.2% |
| Large | 0.9% | 2.3% | 79.1% |
| Residential/lifestyle | -5.5% | -3.4% | 77.0% |
| Retirement | -2.5% | -1.9% | 62.4% |
| Very large | 5.3% | 6.0% | 47.6% |
| Nonfamily | 25.1% | 34.4% | 7.7% |
| TOTAL | 4.7% | 5.5% | 42.7% |
| TOTAL, Excluding Nonfamily | -0.2% | 1.4% | |

The 13-year average-return on equity for the poultry specialty in the ARMS survey is negative or a very small, except for the very large and the non-family farm typologies included in the surveys (Table 1). Survey respondents in the very large typology have a positive, but below competitive market return. Farms in the very large category obtained less than one-half of their gross income from poultry.

The non-family farm typology is not representative of contract poultry production, since contract pay represents only 7.7% of gross income averaging almost \$3 million annually (Table 2). Furthermore, this group represents only 2% of the poultry growers. This category may, in fact, include financials for some of the integrators themselves and thus account for the high rates of return.

³⁶ Contract poultry pay is included in the ARMS category, “other farm related income.” And thus may overestimate income from poultry contracts compared to gross income for the whole farm.

| Farm Typology | Gross Income | Contract Income | Farms Represented | Assets | Equity |
|-----------------------------------|---------------------|------------------------|--------------------------|------------------|------------------|
| Farming occupation/higher-sales | \$87,704 | \$59,640 | 3,980 | \$615,451 | \$467,768 |
| Farming occupation/lower-sales | \$31,037 | \$21,173 | 3,810 | \$407,005 | \$313,430 |
| Large | \$98,358 | \$77,835 | 5,931 | \$664,606 | \$532,195 |
| Residential/lifestyle | \$20,334 | \$15,655 | 6,405 | \$364,832 | \$288,507 |
| Retirement | \$14,896 | \$9,289 | 1,740 | \$290,514 | \$275,025 |
| Very large | \$326,185 | \$155,150 | 12,213 | \$1,225,221 | \$929,213 |
| Nonfamily | \$2,758,814 | \$211,163 | 683 | \$2,276,107 | \$1,677,194 |
| TOTAL | \$198,029 | \$84,636 | 34,824 | \$775,459 | \$601,906 |
| TOTAL, Excluding Nonfamily | \$152,030 | \$81,747 | 34,141 | \$754,155 | \$582,499 |

The 13-year average-return on equity for the poultry specialty in the ARMS survey, excluding the unrepresentative non-family typology (but including the very large typology) is negative 0.2%; the average return on assets is a paltry 1.4%.

Inflation over the 13 years covered by the ARMS survey averaged 2.6%, so the average return of 1.4% represented a *real* loss of 1.2%.

The American Agricultural Economics Association (AAEA) Commodity Costs and Returns Estimation Handbook, after reviewing risks and returns for non-agricultural investments, suggests that a reasonable additive risk adjustment for agricultural investments would be from 3% to 6% *plus* inflation.³⁷ With inflation averaging 2.6%, a reasonable or fair or competitive long-term return would range from 5.6% to 8.6%, well above the 1.4% actual shown in Table 1.

ARMS data covering 13 years, and AFAA detailed managerial data covering 14 years all show that contract poultry growers, on average, are not earning a fair or competitive return for labor, management, equity and risk. This is true for AFAA records for the whole farm as well as AFAA records for the poultry enterprise isolated from other farming and ranching activities. While poultry contracts may cash flow (i.e. pay bank loans and put some money in the growers pockets), contract pay has not generally been sufficient for growers to earn a competitive return.

Contract poultry growers are now living off depreciation.

³⁷ "Commodity Costs and Returns Estimation Handbook," published by the American Agricultural Economics Association Task Force on Commodity Costs and Returns, Feb. 1, 2000, p. 2-39. This Handbook is used by USDA in cost and return budgeting, <http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm>. The Handbook is available on the USDA/NRCS site, <http://www.economics.nrcs.usda.gov/care/Aaea/index.html>

Aggregate Industry Statistics

USDA's monthly periodical, *Livestock, Dairy and Poultry Outlook*,³⁸ discusses poultry market conditions and reports numerous statistics for livestock and poultry, but does not give average or base pay received by contract broiler growers.

Included in the USDA's *Livestock, Dairy and Poultry Outlook* are estimates of monthly returns to producers of feeding cattle and feeding hogs. Also included is the USDA's estimate of monthly "estimated returns for broiler, turkey and egg production." These three series, however, reflect the return the integrator received, not what the contract grower received. In other words, these USDA series reflected integrator profits, not poultry grower profits.

After reporting integrator profits for over 25 years in *Livestock, Dairy and Poultry Outlook*, USDA changed its policy in 2004 and converted the estimated returns from cents/lb to indices.³⁹ The USDA's published explanation was "...the use of indexes shifts the focus of the data to the relative changes and away from absolute net returns values that have been the primary source of concern to a number of segments of the poultry industry."⁴⁰

The only "industry participants" who have concern about USDA statistics on estimated integrator profits would be the integrators themselves. In contrast, USDA did not change similar series for Great Plains cattle feeding or North Central hog farrow-to-finish operations. No policy justification for the estimates of integrator profits has surfaced to the authors' knowledge.

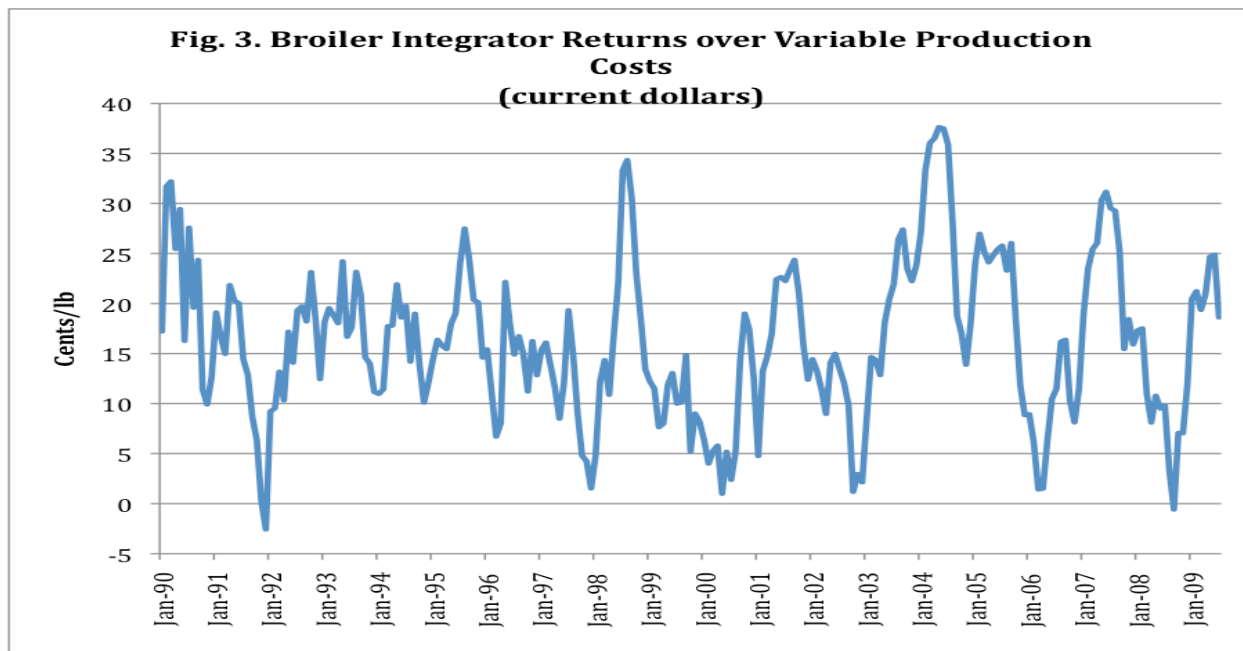
Figure 3 shows estimated integrator net returns in current dollars.⁴¹

³⁸ <http://www.ers.usda.gov/Publications/LDP/>

³⁹ It is illogical to index profit, as profit be negative, zero, or positive, while indices are typically positive only.

⁴⁰ USDA/ERS, *Livestock, Dairy & Poultry Outlook*, LDP-M-117, March 16, 2004.

⁴¹ Nominal net returns for 1990-2003 are those reported by USDA, and net returns for 2004 on were computed based on the USDA net returns index keyed to the ratio of the index and net returns per pound in an overlapping period in 2003.



One necessity for competitive markets is symmetric information. Both sides to a transaction must have similar information. Poultry growers do not have public access to either grower pay or integrator profits, yet integrators have both. Information asymmetry strengthens the integrator’s monopsony or oligopsony position.

Risks and Risk Shifting

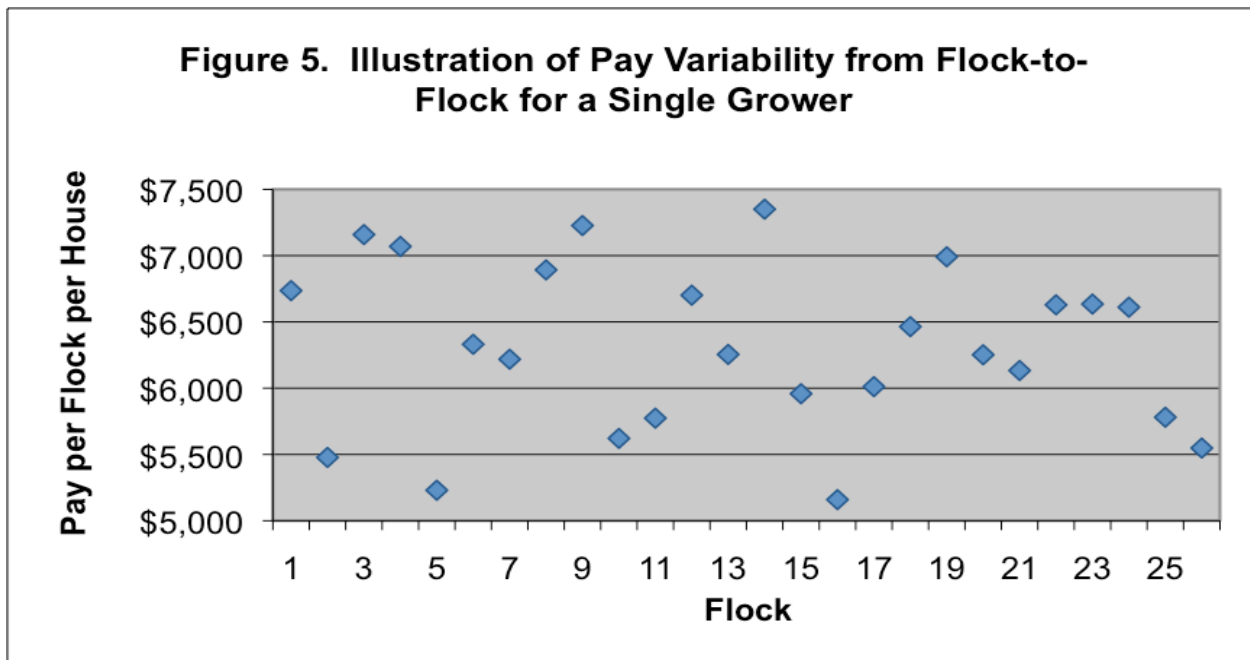
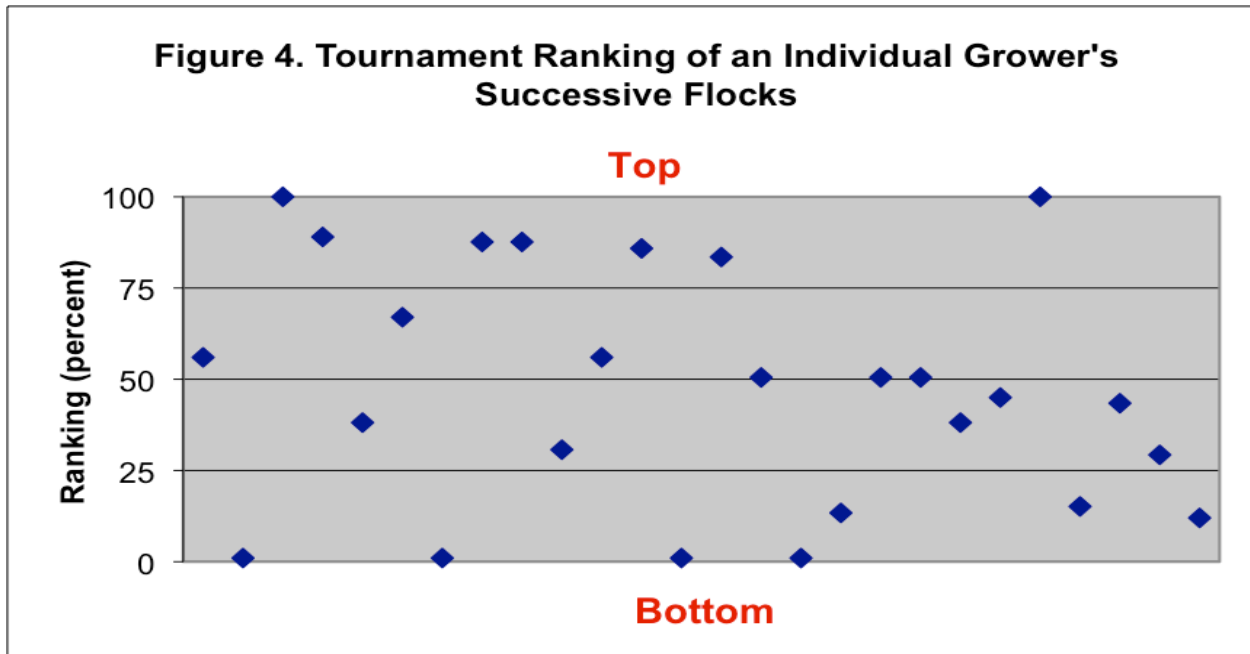
Many assert that contracting reduces risks for growers. The National Chicken Council claims “grower contracts ...securely lock-in a stable income flow (for growers).”⁴² Academics have claimed that significant gains from contract farming come through the reallocation of risk from farmers to integrators (Knoeber and Thurman; Hedge and Vukina), and USDA economists have stated that tournament contracts shift “almost all” traditional output and input price risk, and common yield risk, from the grower to the integrator (USDA, MacDonald). The academic statements refer to risks very narrowly defined and are often taken out of context and given much broader, but inappropriate, interpretation.

Contracting does not eliminate risk. Contracting does not allow growers to “lock-in stable income” as contracts are presently written. Contracting changes risk but it does not give growers any real advantage because the grower lacks power to take advantage of a viable bargaining position during contracting. Indeed, contracts are not “negotiated”; they are advanced by integrators on a “take or leave it – and if the latter, we leave you stuck with your investment” basis. The contract allows the grower to subsist, perhaps, but not to grow, profit, or prosper.

⁴² National Chicken Council, submission to the Legal Policy Section/Antitrust Division, U.S. Department of Justice, 12/21/2009.

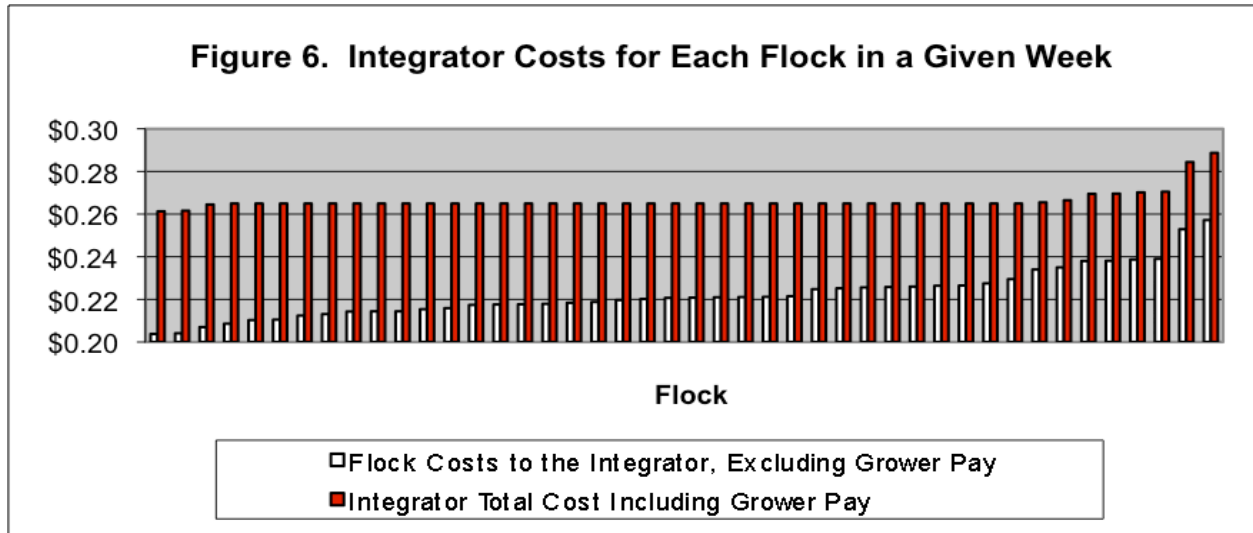
There is no “wealthy” subset of chicken growers, except perhaps for corporate insiders with sweetheart deals.

Although there is a set average pay amount in the integrator’s price tournament, actual grower pay fluctuates considerably from flock to flock because tournament rankings fluctuate as shown in Figure 4 (actual data). Often the growers ranking changes more because of factors controlled by the integrator than by the grower’s management. As a result, grower gross returns fluctuate considerably as shown in Figure 5.

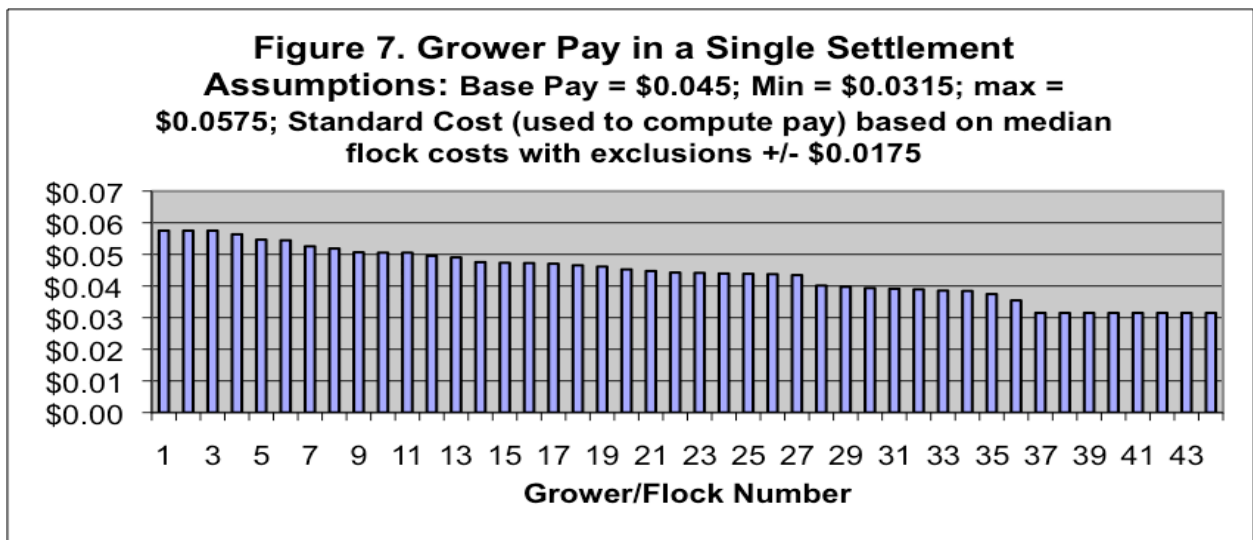


If growers were paid a fixed unit pay for all flocks, they would still have an incentive to properly manage flocks because poor management would result in less production. That is, grower pay would decrease with poor management, but growers would not be doubly penalized as they are in existing tournaments.

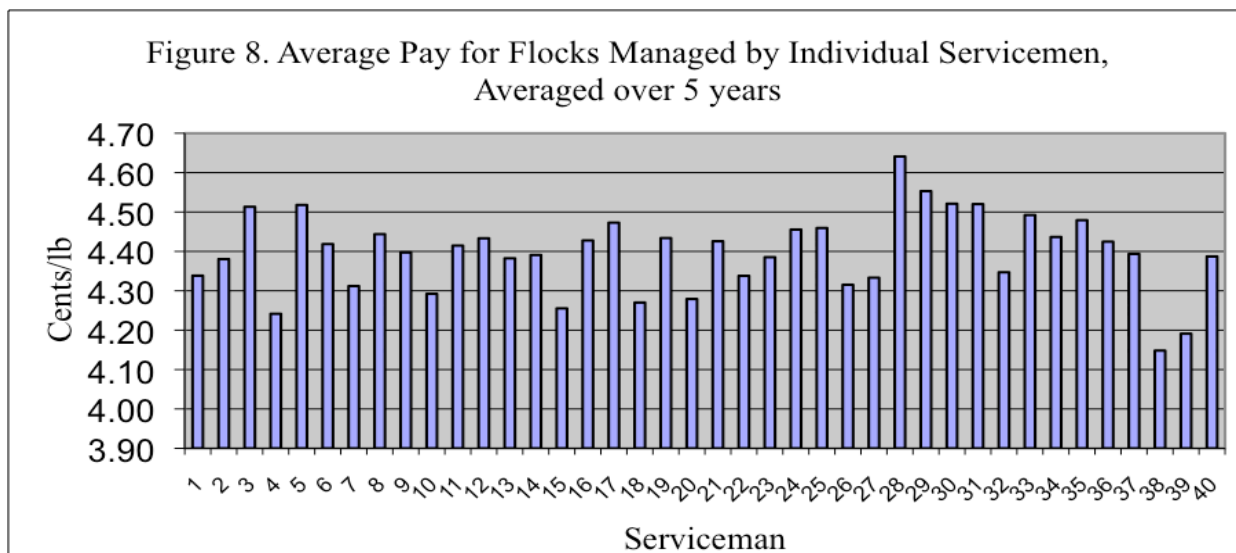
Because of the way in which the grower pay “tournament” is typically structured by the integrator, the cost of broilers to the integrator is the same for almost all flocks produced in a given week (see Figure 6). Week-to-week variability in actual flock costs to the integrator is only due to feed cost changes, and not due to changes in grower pay in the aggregate.



Yet, grower pay for individual flocks varies considerably from flock-to-flock as shown in figures 4, 5, and 7. In other words, the tournament system transfers risk to growers. Growers are doubly penalized for performance shortfalls with individual flocks because of the tendency for unit pay to fall along with reduced production, unlike what would happen for an individual producer in a competitive market.



The integrator's representative or agent assigned to the grower may have a significant effect on grower's performance. Figure 8 shows average pay for all flocks assigned to individual representatives in a single complex, averaged over five years. The grower thus faces the risk of having flock management dictated by a sub-par company representative.



The manner in which most integrators determine pay for individual flocks may result in declining pay as other producers in the same tournament (lottery) adopt new, more efficient technology. This deceptive practice has the effect of shuffling an average producer with a conventional house down the pay scale in a concealed way, making average pay to all growers with conventional houses less than stated in the contract. Stated average contract pay often differs by the style or type of chicken house. For example, stated base pay for a conventional house might be 5.0 cents/lb, while base pay for a more modern tunnel house might be 5.5 cents/lb. However, the pooling of flocks from different houses in the same tournament will tend to result in actual average pay less than stated contract pay for growers with conventional houses, and actual pay to growers with modern house being higher than stated base pay. This is a deceptive practice.

Some tournaments are based on weighted (by size) average flock cost, some based on an un-weighted average flock cost, and some on a median flock cost. Exclusion of certain flocks, as well as minimum and maximum pay also typically factor into calculation of grower pay by the integrator. Often these integrator-controlled factors result in a true average pay for growers that is below the average pay specified in the grower's contract. Growers do not have all information necessary to uncover and monitor such potentially deceptive practices.

Economic risk for growers is imbalanced. The growers bear the risks of production, but they are forced to shoulder many risks that appropriately should reside with the integrator. Integrators often adjust to a soft wholesale market for broilers by reducing placement of chicks or by delaying delivery of chicks to their contract growers. This practice transfers income risk from the integrator to the contract producer.

Often the biggest risk of all is that of bankruptcy. Integrator acts and demands, not grower's mismanagement, is the problem. Delayed delivery of chicks, reduced placement, or similar actions by the integrator can have a devastating effect on the profitability of the contract poultry operation. A decision by the integrator to slow delivery of chicks to a grower can mean quick bankruptcy for that grower⁴³. Several reported instances of this happening in the 1990s to growers who tried to organize other growers so they could bargain collectively for pay. These reprisals created tremendous fear in the industry; the fear lingers and now permeates the industry. The integrator controls the economic viability of each grower and can easily push select targets into bankruptcy, even on whim.

Termination of entire broiler production complexes has left rural areas in economic ruin and families destroyed. This was not brought about by bad management by growers, but because of bad decisions or even spiteful actions by integrators

Recent events surrounding Pilgrim's Pride Corporation (PPC) bankruptcy painfully illustrate the problem with control combined with bigness. PPC's road to bankruptcy came from paying too much for GoldKist Poultry, rapidly rising feed prices, the wrong position in the futures market for corn, a softening market for poultry, dependence on the commodity markets, and loss of a substantial contract to supply a large grocery chain.

PPC used Bankruptcy Court to close down entire complexes, terminating 200-300 growers in the process. PPC stated publicly and in court that they were terminating complexes to reduce production to increase price. We fail to see how this is not a clear violation of Section 202 (e) of the PSA, which "*(prohibits a live poultry dealer from) engag(ing) in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly in the acquisition of, buying, selling, or dealing in, any article, or of restraining commerce.*"

PPC compounded the anguish when it refused to sell processing plants (complexes) because the buyer would put them back into production and in their words, thereby "compete" with PPC and prevent poultry product prices from increasing. PPC working through the Bankruptcy Court blocked entry of a competitor who would have put the terminated growers back in business. The end result of the PPC bankruptcy is that a few hundred growers were terminated, losing their livelihood and in some cases the family farm, local banks lost millions, but PPC emerged from bankruptcy court with stock plus \$800 million from JBS. Fair? Hardly.

A competitive market with many small or mid-sized poultry processors stressed by low poultry prices and high feed prices would have had much different economic adjustments. Production would have decreased, but production changes would have occurred at the margin. Inefficient growers would have exited the industry. Efficient growers with houses and equipment that had

⁴³ The spreadsheet model developed by Moore shows that a five-day increase in out time (days between flocks) decreases net returns by \$2,350 per house annually. Casey Moore, "Economic Returns to Contract Broiler Production," M.S. Thesis, Auburn University, May 10, 2003, p. 46.

reached the end of their useful economic life would have exited. Remaining growers would have struggled until the markets readjusted. But there would not have likely been the bloodbath--a bloodbath triggered by bad decisions by a “too big to fail” corporation.

Comparison to Competitive Cash Markets

An individual producer in a true competitive market who has “bad” or below average production would still receive the same unit price as growers who had a good crop. Under the tournament, however, growers who have bad flocks not only have lower production on which pay is based, but get dinged on price as well—a double whammy for a grower with a below average flock and a double bonus for a grower with a above average flock.

In a typical tournament system, if all growers are equally good managers they receive the same pay as they would if they were all equally bad managers. With the tournament ranking system, if 100% of the growers do an excellent job of raising their flocks, 50% or more of these highly efficient growers will fall below average for that group and receive below average pay. In a competitive cash market, contract growers in one complex would benefit if they were all equally good managers relative to other complexes with growers who were not good managers. The integrator would benefit if growers were all equally good managers relative to other groups of growers who were not good managers. The integrator benefits if all of their growers are good managers, as opposed to if they were all bad managers, but the growers do not benefit.

The tournament pay system, as structured by integrators, does not mimic a competitive market.

Industry Efficiency

Industry apologists often brag about the wonderful “efficiency” of the vertically integrated poultry industry especially compared to beef and pork. This is generally true, but only for “feed” efficiency. Feed efficiency should not be equated with aggregate economic efficiency, which is imbedded in antitrust law and economics. Perfect feed efficiency does not necessarily result in aggregate economic efficiency.

Textbook economic theory shows that a monopsonist (or oligopsonist) tends to acquire a sub-competitive quantity at a sub-competitive price. Because the processor acquires less than a competitive buyers market, less is processed and less is sold on the retail market. Sub-competitive quantities provided by a firm with buyer power can thus result in higher retail prices to final consumers. Thus, consumers may be hurt by an integrator’s buyer power. Exertion of buyer and seller power reduces aggregate economic efficiency, even with perfect feed efficiency.

Fair Return in a Competitive Market

In a mature competitive market, the equilibrium return for an input supplier, such as a poultry grower, would be a market rate of return on the labor, capital and management provided by the input supplier, and a return on risk commensurate with asset returns in competitive industries. In equilibrium, no windfall profits would be earned.

Although economists tend to discuss competition in the context of price discovery in “cash” markets, the same principles and economic outcomes apply to price discovery in a vertically integrated market involving “contracts” between a processor and an input supplier. For a competitive market to function efficiently and fairly, there must be a balance of market power between buyers (processor) and sellers (cash market or contract producer).

The imbalance of power in contracting is evident in the poultry industry, as contract terms are not negotiated; the grower must accept the contract offered by the integrator. Thus, there is no balanced “price discovery” in contracting. As shown in a theoretical paper⁴⁴, when the buyer has the power to dictate both price and quantity to the competitive supplier, as is the case with the vertically integrated poultry industry, the integrator ends up appropriating income that would normally be earned by the supplier (grower).

What is “fair” or unfair in a PSA or antitrust context can be defined relative to what an average supplier (contract grower) would earn in a true competitive market, averaging out short-term fluctuations in prices and production over the economic life of houses and equipment that are captive to the integrator. By this definition, AFAA records (figure 1) and other information presented previously show that growers have not earned a fair return over the past decade or two.

Retail Developments & Emerging Business Practices

Retail consolidation and emerging business practices also raise concern about competition.

Highly regarded University of Missouri Agricultural Economist Harold Breimyer’s warning from almost a half-century ago has gone unheeded, *“Not the least among the consequence of the integration of broiler production in the United States is the change in the status of the grower. Formerly an independent entrepreneur in the traditional sense, he bought his supplies on the open market; he directed his enterprise as he saw fit; he was at once manager, investor of capital, and worker; and he sold his produce also on the open market for the best price it would bring. If he is still in the business, in all probability he is a contract grower. In some areas he not only would find it hard to survive as an independent producer but might not be able to operate at all because no processing outlet would be available to him. Fully integrated production brings to an end one of the old and established characteristics of a freely competitive market system, namely, freedom of entry.”*⁴⁵

A potential entrant into poultry processing faces two hurdles.⁴⁶ First, a small processor cannot

⁴⁴ C. Robert Taylor, "[Monopsony and All-or-Nothing Supply: Putting the Squeeze on Suppliers](#)". College of Agriculture, Auburn University, Working Paper. June, 2003.

⁴⁵ Harold F. Breimyer, [Individual Freedom and the Organization of Agriculture](#), University of Illinois Press, 1965, p. 214.

⁴⁶ Specialty products and niche markets are an exception. However, as niche markets have been developed by small producers and processors and begin to grow, they are often taken over by existing large integrators.

deliver the volume demanded by consolidated food retailers. Second, even if a small processor accessed the retail market they may face stiff predatory pricing by existing processors. Thus, entry into poultry processing now requires large size as well as financial staying power, which can be substantial hurdles to potential entrants into poultry processing.

Breimymer anticipated the power shift to retailers: *“During the last 30 years (published in 1965) the power center in farm markets has shifted forward from processors to retailers. Quoted in Chapter 7 was Earl Crouse’s observation that ‘the real big force in the integration movement is the change in the retail outlet.’ George Mehren has sketched the possibility that all production and marketing might be integrated up to the retailing level: ‘Carried to a distant and perhaps never-to-be-realized but still logical extreme, present trends could well mean that competitive independence may one day be restricted basically to the retailing segment—and such competitive independence may be greatly different from that which prevails today’.*”⁴⁷

In the half Century since Briemyer’s warning, we have witnessed the emergence of four potentially beneficial but also potentially anti-competitive business practices: category management, category captains, slotting fees, and long-term fixed-price contracts with retailers.

“Category management” refers to a retailer having an employee manage an entire product category such as the meat and poultry section of stores as a category rather than allocating shelf space on a brand-by-brand basis. This practice can vest considerable market power in the hands of a few individuals who manage the category for all stores owned by a large retailer. Some retailers have started to outsource retail category management to a chosen supplier on whom they rely for strategic recommendations, a practice referred to as “category captainship.”⁴⁸ Of antitrust concern is the possibility that category managers and category captains may be able to exclude non-captain processors, or only deal with very large firms.⁴⁹

A related business practice is known as “slotting fees” to have a supplier’s products placed on retail shelves, or placed in prominent locations in the retail outlet. Small suppliers may not be able to pay such fees, thus relegating their products to less prominent locations in the store or not even being able to access the retail market.

An increasingly dominant business practice in the U.S. is “long-term fixed price contracts” between integrators and food retailers. Such contracts pose two competition concerns. First, the economic outcome could be akin to classic price-fixing and favor either the category manager

⁴⁷ Breimymer, pp. 287-288.

⁴⁸ Mumin Kurtulus and L. Beril Toktay, “Category Captainship: Who Wins, Who Loses?” 2005, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=934970

⁴⁹ A report based on roundtable discussion of concerns about retail category captains is available from the American Antitrust Institute, <http://www.antitrustinstitute.org/Archives/270.ashx>

(retailer) or category captain (supplier), depending on relative market power. Second, the long-term (12-18 month) nature of these contracts may result in magnified production changes imposed on poultry growers compared to a competitive market. With shifting demand, as has occurred recently, these contracts may prevent price and quantity adjustments that would be experienced in a competitive vertical market chain. With price fixed, reduced demand will result in a decrease in quantity consumed larger than if retail price adjusts along with quantity. In essence, long-term fixed-price contracts between retailers and integrators may make the grower the shock absorber for the industry, an unfair practice.

Considerable investigation and research is needed to better understand the economic and competition aspects of category managers, category captains, slotting fees, and long-term fixed-price contracts in the meat and poultry industry.

Bigness of integrators and retail food corporations create barriers to entry for new processors. Such barriers may be higher due to emerging business practices discussed above. The barriers may be so high, in fact, that a John Tyson or Bo Pilgrim, or Arthur and Frank Purdue, or Lloyd Peterson, all of who are pioneers of the vertically integrated industry and who began with backyard sized operations, would not likely be successful if they were to begin today.

Sweetheart Deals for Corporate Insiders

Integrators often assert that the *Packers & Stockyards Act* (PSA) requires them to have the “same contract” for all growers. The plain language of the PSA does not require growers to have the same contracts; the PSA prohibits “... *use of unfair, unjustly discriminatory, or deceptive practice or device.*” To an economist, a contract that offered higher pay with higher risk would not necessarily be unfair. Integrators’ use of the PSA to stifle growers’ efforts to negotiate fair contracts can be construed as a violation of the intent and the plain language of the Act.

Integrators’ PSA assertions are belied by the fact that many integrators have different contracts for different complexes, even adjacent complexes, bounds of which integrators define without any reference to the PSA. A grower in one complex may have production facilities in close proximity to another grower for the same integrator but have a different contract, only because the two growers’ production facilities are in different complexes.

Integrators’ claim that the PSA requires them to have the same contract for all growers is belied by “sweetheart deals” for insiders and executives. The extent of sweetheart deals is so prevalent in the industry that the Internal Revenue Service (IRS) published a lengthy training manual on the subject in 2002.⁵⁰

The IRS Training Manual describes these deals in detail,

⁵⁰ IRS, Market Segment Specialization Program: Poultry Industry, Training 3123-013 (03/2002), TPDS No. 87537E. Parenthetical statements added.

“Most (poultry) contracts are with unrelated third party growers ... However, corporate officers, majority stockholders, their family members, and close business associates, may be given access to special arrangements involving these contracts. The industry name for these special contracts with “insiders” is “Sweetheart Deals.”... Following the downfall of the publicly sold tax shelters (in 1986), some of the companies set up a new plan under the title “Sweetheart Deals”. The corporate “insiders” needed a vehicle through which they could obtain large losses to offset their corporate salaries and other sources of income. The “Sweetheart Deals” provided just such benefits by shifting various costs from the companies records to the insider’s tax return. By devising an internal system of accounting for the “Sweetheart Deals”, the stockholders and corporate employees are kept unaware of the transactions.

A company employee prepares documents that assign numerous grower contracts to selected “insiders”. Amounts are designated as the separate prices covering the chicks, feed, medication, technical services, etc., which are purchased from the corporation. ... The invoices provided to the insider supporting these transactions are not usually run through the regular corporate accounting system. The main corporate employee privy to this information maintains complete control of all the paper work, including checks written at year-end, as well as the subsequent sales proceeds. The payments for chicks, feed, and medication, etc., are normally based on historical or estimated costs and not on the actual costs. In most situations, the actual costs to the corporation for feed, technical and medical services, etc. are more than the contracted amounts paid by the insider. The insider is not liable for any amounts in excess of the contracted costs...The corporate explanation for these favorable transactions may be the shifting of their risk of loss due to the large number of flocks in various stages of completion. By “selling” the flocks to the investors the company would not be liable for any loss if the flock is destroyed by fire, tornado, etc. In reality, the company normally absorbs the loss in these situations. A new flock may be substituted for the lost flock or the lost flock will be shown as “sold” back to the company based on estimated weights.”

Other “SWEETHEART DEALS” can include the use of corporate entertainment facilities, excess rents being paid to the “insiders” for farm structures, such as hog farrowing and finishing houses (or egg layer facilities), and waste water treatment facilities located near their corporate owned processing plants. Normally the amounts paid to the insiders are not comparable to a true arms length transaction.”

Yet, integrator representatives tell growers that the PSA “requires” them to have the “same contract” for all growers. Simply, the integrators misrepresent the law to the unknowing. Growers are not told that the birds they may be raising are in fact a sweetheart deal for an insider. Growers have not been offered the chance to buy birds and feed from the integrator, raise birds and sell them back for processing, nor are the given the opportunity to grow their own birds to an integrator’s specifications then sell birds ready for processing.

Environmental Responsibility is Absent

Health and environmental degradation associated with confined animal feeding operations (CAFOs) are of increasing concern. It is widely known that concentrated poultry production in several areas of the U.S. generates more waste products than can be effectively and safely

applied to nearby land. These problems have led to a host of state and federal regulations, as well as taxpayer subsidies to haul excess litter out of sensitive areas. The poultry industry has a long record of deflecting responsibility: They did not know that there were problems, or that they think that there are no problems, or that it is the growers fault.

An April 2008 report by the Union of Concerned Scientists states, *“The problems that arise from excessive size and density (e.g. air and water pollution from manure, overuse of antibiotics) are exacerbated by the parallel trend of geographic concentration, whereby CAFOs [confined animal feeding operations] for particular types of livestock have become concentrated in certain parts of the country. For example ... broiler chicken CAFOs in Arkansas and Georgia.”*⁵¹ They also state, *“Manure from CAFOs is a major source of water pollution because these operations produce too much manure in too small an area, and this manure is rarely treated to eliminate potentially harmful components before being applied to crop fields or stored in facilities such as lagoons or pits (EPA 2003)”*⁵²

An integrator’s decisions about where to locate a complex and the size of the area in which growout facilities (and thus waste production) is typically based on its out-of-pocket expenses for hauling feed to growout facilities and birds to processing plants. The business model adopted by integrators ignores external (pollution and health) costs associated with poultry waste and thus results in waste generation and land application of waste being concentrated in relatively small geographical areas. Watershed pollution problems in the aggregate are therefore determined not by an individual farmer’s growout operations, but by integrators individual and collective decisions to concentrate poultry production and thus waste generation in relatively small geographic areas. As stated in a University of Arkansas Extension Bulletin, *“The real issue is not the P concentration in runoff from the edge of any one field, but the total P load that is transported to the stream or lake from an entire watershed.”*⁵³

Integrators have used their economic control over growers to attempt to shift environmental costs and health risk costs from themselves to growers. Molnar, et al, summarize this attempted risk shifting, *“Broiler production is concentrated in a few southern states where farmers are highly dependent on contract arrangements for income and livelihood. ... Asymmetrical power relationships shift waste management responsibilities to growers in a number of ways. This paper details maneuvers poultry integrators use to avoid environmental risk and transfer it to their contract growers. Corporations ‘pass the cluck’ when they shift responsibility for achieving regulatory compliance to the farmer who then must seek technical and financial assistance from*

⁵¹ Doug Gurian-Sherman, CAFOs Uncovered: The Untold Costs of Confined Animal Feeding Operations, Union of Concerned Scientists, April 2008, p. 2.

⁵² *Ibid.*, p. 42.

⁵³ Mike Daniels, Tommy Daniel and Karl VanDevender, Soil Phosphorus Levels: Concerns and Recommendations, University of Arkansas Division of Agriculture, Cooperative Extension Service, Bulletin FSA1029-500-3-04R, 1999 and 2004

*public agencies. Poultry integrators ‘dodge pullets’ when they retain ownership of live animals, but dead birds become the farmer’s property and disposal problem.”*⁵⁴

A Pew Commission report, published in 2008, notes the integrators shifting of risks and external costs to growers, *“Under the modern-day contracts between integrators and growers, the latter are usually responsible for disposition of the animal waste and the carcasses of animals that die before shipment to the processor. The costs of pollution and waste management are also the grower’s responsibility. ... Because the integrators are few in number and control much if not all of the market, the grower often has little market power and may not be able to demand a price high enough to cover the costs of waste disposal and environmental degradation. These environmental costs are thereby ‘externalized’ to the general society and are not captured in the costs of production nor reflected in the retail price of the product.”*⁵⁵ The 2008 report on CAFOs by the Union of Concerned Scientists discusses at length the external costs of excess manure being borne by society rather than integrators.⁵⁶ Integrators’ shifting of environmental risks to growers and society at large is evident.

Integrators fully control who will be a grower, who will be responsible for disposal of waste and dead birds, and all contract terms. Integrators therefore determine the location of poultry waste generation. Due to high transportation costs for waste products, integrators determine where the waste products will be disposed.

Early grower contracts made no mention of used litter and waste disposal responsibilities. However, since the early 1990s, integrators’ contracts typically state that the grower is “responsible” for meeting all applicable state, federal, and local environmental laws and regulations. The integrator owns the bird, the feed, determines who will be a grower, where than grower will be located, generally adds phosphorus to the feed which worsens phosphorus pollution, indirectly determines where the waste will be land applied, but claims the litter and all environmental responsibility belong to the serf. But the contracts do not state in practical or legal language that the grower “owns” the used litter, excrement, and dead birds.⁵⁷ This is classical risk shifting.

⁵⁴ J. J. Molnar, T. Hoban and G. Brant, “Passing the Cluck, Dodging Pullets: Corporate Power, Environmental Responsibility, and the Contract Poultry Grower,” Southern Rural Sociology, Vol. 18 (2), 2002, pp88-110.

⁵⁵ Putting Meat on the Table: Industrial Farm Animal Production in America, a Report of the Pew Commission on Industrial Farm Animal Production, The Pew Charitable Trusts and Johns Hopkins Bloomberg School of Public Health, April 29, 2008, p. 6.

⁵⁶ Doug Gurian-Sherman, CAFOs Uncovered: The Untold Costs of Confined Animal Feeding Operations, Union of Concerned Scientists, April 2008. Chapter 3, in particular, discusses the externalized costs of CAFOs.

⁵⁷ We are aware of only a single contract that states that the grower actually owns the litter, and that contract is recent and by a small integrator.

Environmental risks are shifted to growers, pollution and adverse health consequences are shifted to citizens, and costs of cleanup are shifted to state and federal taxpayers. None of these occur in an operative market. But the broiler market is broken. Indeed, it is an utter failure.

SOLUTIONS

Restoring Economic Fairness to Contract Production

Only a functional viable market characterized by relatively equitable pricing power, equal access to information, transparent sales transactions, and contracts that either have a duration that matches producer debt structure for duration, or are so brief as to make the cash market vibrant again. Sweetheart deals must end. The market must reward product quality, producer efficiency, and other factors that go with value, availability, cost efficiencies, and innovation. The market is not a place to reward only the abusively shrewd.

Growing chickens was a family business but now it happens only “by invitation.” One who wants to produce chickens must have a contract with an integrator. Deliveries of sickly or underweight chicks, late deliveries, bad feed deliveries, and bad advice from the integrator’s field representative, or simple pricing power can all ruin the producer’s business. It is well known in the chicken industry that producers dare not speak out against integrators.⁵⁸

After contracting to be a grower, the integrator has near total economic control over profitability in the grow-out operation. The grower’s capital, labor, management and risk bearing are all captive to the integrator. In economics the relationship between the grower and integrator is an extreme power imbalance; in law this is a contract of adhesion; in colloquial terms this is serfdom—with a mortgage.

Supreme Court Justice Peckham, in one of the first substantive decisions interpreting the Sherman Antitrust Act, said

*“[I]t is not for the real prosperity of any country that such changes should occur which result in transferring an independent business man . . . into a mere servant or agent of a corporation . . . having no voice in shaping the business policy . . . and bound to obey orders issued by others.”*⁵⁹

Yet poultry producers have become precisely what Justice Peckham opined antitrust laws were intended to prevent. Based on the AFAA records summarized in Figure 1, a paltry increase in grower pay of 0.34 cents—not 34 cents but about a third of a penny per pound—would offset the cumulative loss of \$182,000. More is needed to provide the grower a return for management, equity and bearing substantial risk. Economic health—modest returns on management and risk for contract growers—could be established with a pay increase of only about one penny per

⁵⁸ Taylor, C. Robert, *Restoring Economic Health to Contract Poultry Production*, [Agriculture and Resource Policy Forum](#), Auburn University College of Agriculture (May 2002).

⁵⁹ Source: Peter Carstensen

pound (\$0.005/lb). If transferred to consumers, such an increase would amount to slightly over of a penny per pound, or \$0.012/lb on a dressed weight basis at the retail counter.

Restoring economic health, viability and fairness to contract poultry production would cost the average consumer about a dollar a year, at most, and perhaps nothing.⁶⁰ The key to restoring economic fairness⁶¹ is establishing a balance of power in economic relationships between integrator and grower. The key to restoring environmental harm caused by CAFOs is internalizing externalities. While internalizing externalities would eventually result in very small increases in the cost of poultry products to consumers, eliminating the current taxpayer subsidies now going to clean up problems could offset higher costs at the grocery store. Solving these two fundamental problems in the poultry industry—fairness in contract production and internalizing externalities—will not collapse the U.S. economy, or lead to the demise of the poultry industry, or lead to the poultry industry leaving the country, or have make poultry too expensive for consumers.

The current monopsonistic system appears to be too far gone to “repair”; it may require whole scale redefinition by expansion and enforcement of the *Packers & Stockyards Act*, and redefining property rights to the environment to internalize external costs associated with poultry waste disposal.

Vertical integration of the poultry industry has achieved much efficiency, and brought a consistent product to consumers.⁶² The PSA and antitrust challenge is to design a policy that will maintain efficiencies, but restore fairness. We believe that the following changes would go far to restore competition and fairness in the poultry industry. The changes might make it possible to avoid the necessity to split integrators into smaller units. Information is power. Information asymmetry is a power imbalance. Eliminating the huge power imbalance in the poultry industry is imperative. Steps that need to be taken are

1. USDA must collect and publicly report average contract pay by region, at least annually.
2. Grower settlement must be required to include basic information, such as breed, strain and sex of chicks, health and feeding histories.

⁶⁰ Per capita consumption of poultry in the U.S. averages about 100 lbs/year.

⁶¹ In the context of this article, fairness for contract poultry growers would be achieved if they earned a “competitive” return on labor, management, risk and equity over a long time period.

⁶² Poultry industry representative often make definitive public statements about all of the wonderful efficiency gains achieved by their business model. What they don’t tell you is that their claims are based purely on feed efficiency. Feed efficiency and aggregate economic efficiency are related, but they do not equate. In an antitrust context, aggregate economic efficiency is an important criterion, not feed efficiency. Textbook monopoly and monopsony models both show that there is aggregate economic inefficiency and consumer harm from the power imbalance, even with maximum feed efficiency as defined by the poultry industry.

3. Growers must have means to validate essential payment computation parameters. Transparency and validation must be required.
4. Detailed information—AgriStats – now available to integrators to share with each other must be made public promptly. This must become USDA NASS⁶³ data.
5. More information like the Alabama Farm Business Analysis Association managerial records need to be publicly provided along with educational programs on the true economics (not just cash-flow) of poultry production.
6. Growers should be less trusting of representations made by integrators, or get such representations in writing.
7. Contract reform must occur. Grower contracts must have legally controlling criteria; a balance of power in contracting is needed.
8. Pre-dispute mandatory arbitration provisions and waivers to the right to trial by jury at the time of contracting must not be allowed to continue. The use of the courts and the right to trial by jury are basic to the American system.
9. Contract must clearly state who owns used litter and waste, and not just who is responsible for disposal of waste and dead birds.
10. Contracts must be publicly available. Legislation similar to the swine contract library must be enacted.
11. Bankers must “wake-up.” Routinely making 10-15 year loans on the basis of a contract that only guarantees a single flock of birds is not a sound banking practice. Multi-year contracts that guarantee only a single flock of birds do not solve the bankers or growers problems. Contracts need to guarantee a minimum number of flocks over a long enough time period to at least insure loan repayment.
12. Banking credit standards must be adjusted to analyze long-term risks and rewards for the banker and the grower over the term of the loan, and the capital asset’s, useful life. This can be done with banking credit regulations that will not be an onerous burden.
13. Contracts must be for longer time periods, and must include grower renewal options and prohibitions against assignment by the integrator to a shell entity or financially weak successor. Contracts should permit the integrator to “buy out” of the contract at a declining rate over the life of a house.

⁶³ U S Department of Agriculture, National Ag Statistics Service. (USDA NASS).

Conclusion

Change must come to the poultry industry in America. The industry, as structured today, simply does not have hallmarks of sustainability essential to the nation's food supply's stability. It is debilitated by market concentration and monopsony power wielded against producers by integrators.

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